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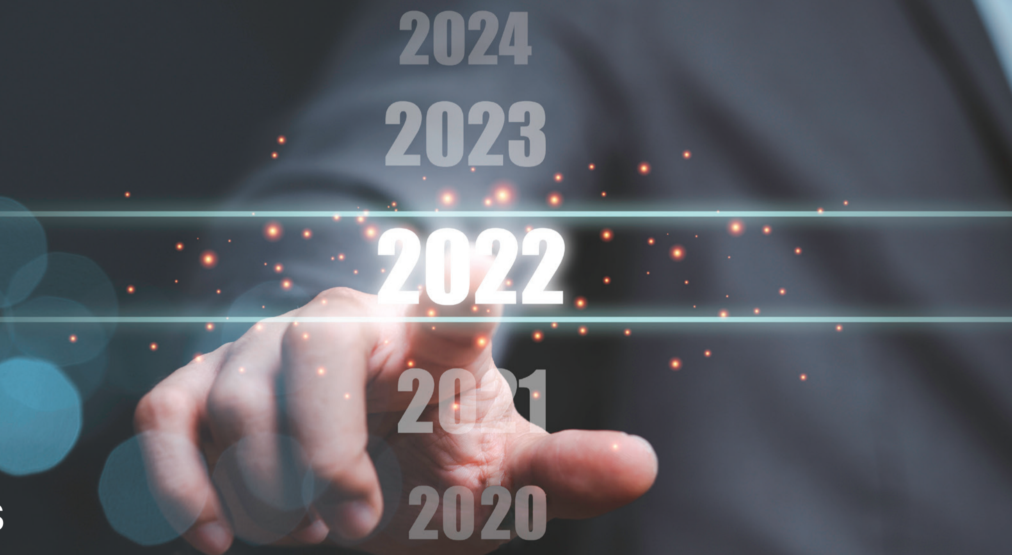


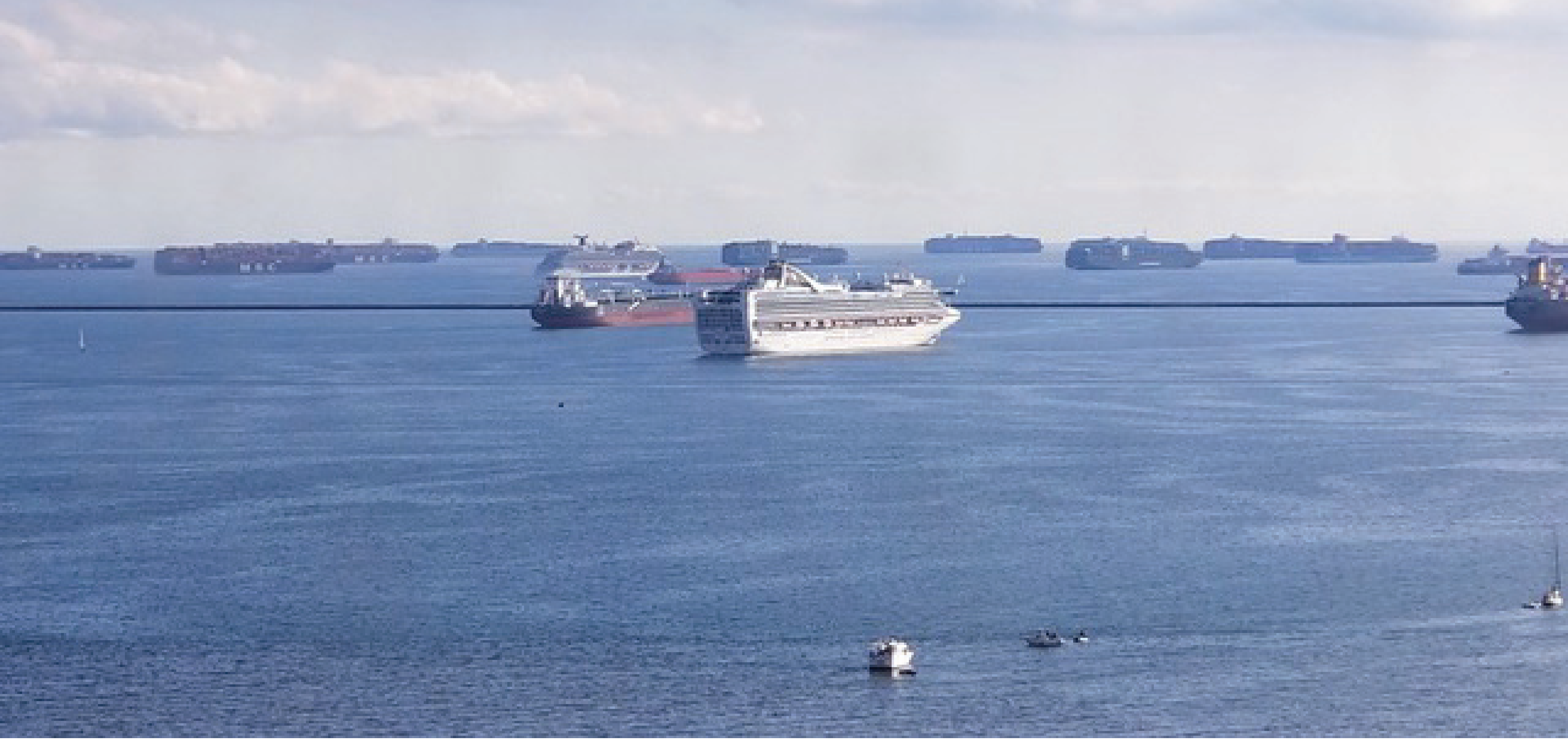
The Alta Group Insights

Headwinds and Tailwinds for 2022

The way we have "always" done business is gone. So, how do we move forward as an industry, having been spurred into action by the digital demands of remote work and other competitive and economic pressures? ***Embracing challenge as opportunity*** should be the theme for 2022. Everything we do, from client interactions to employee experience, to how we assess equipment and what we invest in needs to be reimagined this year. Successive economic challenges and the hybrid work becoming commonplace show us that the new normal is already here in some ways. Those who don't adapt will get left behind.

2021 was a year of surprises and we'll be dealing with the fallout from that for a while yet. While customer demand for new equipment was strong, equipment availability was a challenge due to supply chain lags and manufacturing issues. To meet demand, used equipment prices skyrocketed in transportation sectors especially. This issue is certainly not going to simply dissipate with the dawning of a new year, but it's not the only one to look out for. In fact, there is no one key trend driving the industry in 2022, but many conflating into an inflationary environment that will make managing equipment challenging but potentially lucrative. We saw immense change in the last year.

By most accounts, 2021 was a great year for the equipment finance industry. Many bank-owned finance companies, captives, and independents reported record origination levels and posted strong profits due in part to strong portfolio performance and access to low-cost capital. The depth and breadth of that change has affected equipment finance in new, and we think permanent, ways. Read on to find out the headwinds and tailwinds The Alta Group predicts for our industry in the coming year, and how our predictions last year panned out.



Inflation

Headwinds: The big one—inflation is here to stay. Setting aside some important but explainable price fluctuations, we believe the current economic inflationary environment is not transitory as some believe, but rather it is likely to be here through 2023. The price of goods has increased due to a few factors. Incredible liquidity, continuing supply chain troubles and the emergence of new coronavirus variants fueled inflation at the fastest pace in 40 years. Wholesale PPI inflation was up 9.7 percent year-over-year in December. We saw this particularly in the used vehicle market, with the average retail price of used trucks up over 120 percent year-over-year. **Expect sharp rises in equipment prices generally through April at least and for the inflationary market to continue throughout 2022 and into 2023.** Wage inflation is also here to stay. The ongoing war for talent shows no sign of easing in the short term. The outlook for long-term economic and currency inflation is continued increases, but as the economy deals with this seemingly permanent trend it will mean increasing cost of funds and at the same time long-term growth in margins. Successful companies will be those who skillfully navigate these tensions.

Tailwinds: The good news? Periods of inflation and rising interest rates like we're seeing now, combined with a difficult hiring environment and issues finding goods, are uncommon, but we have seen a small amount of inflation positively impact the industry in the last 40 years. **Stick rates will be high and equipment values will continue to rise in the next year, spelling opportunity for asset managers at end of lease.** But smart asset managers need to keep an eye on residuals and revert to the mean when forecasting out three-plus years. Keeping the price consistently high during a lease period could spell disaster for assets down the road. These sky-high prices won't remain elevated forever, so taking advantage of such opportunities in the first half of 2022 is a must.

Supply chain delays

Headwinds: Pipeline lags will continue, and there's no avoiding it. We've all seen the images of container ships lined up outside of the Port of Long Beach, Calif. But what you haven't seen are the ships still at sea, stuck out there because of the port's backlog. With 30 vessels waiting in the port there are 70 more moored in the ocean, and carriers are intentionally slowing transit times to account for delays in port. This isn't news to the industry, but we should expect more delays at ports since it will take time to work through the massive amount of container ships stuck at sea. And getting ships into port is just half the problem; the truck driver shortage will continue to snarl the supply chain as goods head out to delivery.

What's behind these delays? Spreading coronavirus variants have the world in various states of lockdown. That trickles into parts manufacturing, the ability to get hands on basic resources like hot rolled coil steel, and a need for equipment. **The price of shipping will remain high through 2022, contributing to our inflationary environment.**

Tailwinds: Supply chain issues will need to be addressed to ensure equipment can be delivered to borrowers in a timely manner. The cost of shipping will stay elevated, but reports show consumer demand has peaked and shipping capacity is set to increase as global orders for larger New Panamax and Post-Panamax container ships hit record highs, amounting to 6.4 percent of the existing fleet. They've been in high demand. Sales of new containers increased 10 percent in 2020 and sharply by 75 percent in 2021. Prices for new 20-ft and 40-ft ISO containers continued to rise throughout the year, reaching a 105-plus and 150 percent increase by midyear, respectively.

In addition, the $1.2 trillion infrastructure bill has about $17 billion slated for port infrastructure and waterways in the U.S. That and other infrastructure improvements will eventually alleviate delays and may even mean federal dollars for owners and lessors of equipment—as the government works on better roads, speedier broadband, reinforced bridges and reinforcing the power grid.

Technology

Headwinds: While technology always has an upside—innovation drives investment—the tech sector faces significant challenges in 2022 as chip shortages affect the rate at which new tech can reach consumers. Not only that, but we are experiencing a softening of demand for office technology like copiers and printers.

We also have not yet begun to see significant cybersecurity issues affecting people working from home. The weakest link in any organization is the human being and working in different places with different (often much lower) levels of security amplifies that risk. Phishing attacks appeared in the early days of the pandemic and have only continued. But remember, there's safety in numbers! Small to medium sized companies should look at creating a consortium to combine their buyer power for dedicated servers, risk protection, and insurance alternatives.

Tailwinds: In an industry that provides services primarily related to physical goods, it's hard to make the switch from a hardware mindset to one that considers software first. That's the challenge for us in 2022, but technology providers are adapting to our new remote lives. For example, in our sector leasing software providers worldwide are putting a greater emphasis on integrated systems, cloud-based solutions, and digital transformation programs. This was all in the works before the pandemic but has accelerated in the last couple of years.

As the nation looks forward to emerging from the pandemic, the most successful equipment finance companies are adapting their business models to meet changing customer demands. **Digital expectations are up and have only been accelerated by Covid. As we move forward in 2022 executives need to be intentionally digital and really pursue business agility.**

Everyone had to digitize during the pandemic when it turned out technology was a necessity. But many firms simply switched from signatures in ink to e-signatures and failed to change the way they approach the customer experience. It's time to learn and grow from the experiences of the pandemic into a "digitalization" mindset. That means reimagining your company's experience at every level.

The workforce has high digital expectations, too. And when taking the "Great Resignation" into consideration, making sure your employees have an experience that matches the ease of tech they use every day becomes paramount.

The healthcare industry has done a good job with this. There are multiple apps out there that allow people to access mental health resources with one click. They do something very important, though: In an emergency, they connect the end user with a professional who can deliver excellent results because of shared digital records. No matter who picks up the Zoom call, they are informed and can help. Equipment finance firms can learn from this.

Systems that allow your staff to forge meaningful relationships with clients allow you to retain that face-to-face feel, and in many cases can strengthen that relationship because meetings can happen more frequently. Major financial companies looking at this, including Vanguard and Fidelity, are currently going through the cultural shift to digital with apps that connect clients directly with customer care. Technology can ironically aid in the human need to connect with the humanity at the other end of the call.

This all starts with leadership. A leader must have a vision for the company culture moving forward and work strategically to take an inventory of available tools, capture what the experience should be, prioritize strategies and organize deployment. Keep in mind that you don't need to write all this code yourself. Strategic partnerships or plug and play solutions can help and are available.

It's all up to the creativity of the experience designer.

ESG

Tailwinds: **Why is 2022 the time to engage in ESG strategy? Three reasons: First, to retain talent. Second, because of the sheer amount of capital that has been unleashed into the sustainable market. And third, because the ongoing innovation in this sector creates major opportunity.**

The time to act is now. Equipment firms need to spend some time planning for their "ESG" strategies—Environmental, Social, and Governance. Investors are increasingly applying these non-financial factors into their analysis processes to identify material risks and growth opportunities. If that's not convincing enough, rating agencies including Fitch and Moody's take ESG into consideration for equipment lessors.

Sustainability is not just talk. As recently as November, banks, insurers, and investors with $130 trillion at their disposal pledged to finance green innovation at the COP26 U.N. climate conference in Edinburgh. They represent 19 countries and committed to ending public financing for fossil fuel projects abroad by the end of 2022.

There's a saying that generally pans out: Where the money goes, we all go. That's certainly true as more and more financiers are setting investment standards on the environmental and social impact of projects. Banks often lead the way in our industry because of their outlook on what to fund in the future. TD Bank, Wells Fargo and Bank of America all announced sustainable investment strategies in 2021. Goldman Sachs and JP Morgan Chase entered the sustainable bond market, as did Truist. In part, they are responding to international environmental and social standards that have been recently set.

There are many ways to do this. One easy way for equipment finance firms to do it is simply extending the useful life of equipment and accelerating a circular economy in our industry. There are a lot of other ways in which equipment finance firms can articulate their ESG strategies and they shouldn't be intimidated by ESG. Look first at how you're already applying ESG friendly policies. Do you already have a restricted industries list? Project financing is an area where lenders have long been sensitive to environmental impact.

But there is also a small window of opportunity in 2022 for unused non-environmentally friendly materials, such as mining equipment or anything burning fossil fuels as part of the combustion process. Those who are willing to finance them are likely to develop a lucrative market, as long as asset residuals hold up. As the market shift to "green" assets grows, buyers will find fewer lenders willing to finance those assets that don't fit within a "green" strategy. Looking internationally, Russia, for example, cannot afford to allow fossil fuels to become worthless commodities, meaning ESG efforts extending to their partners will not happen smoothly; and that means in terms of residuals that internal combustion engine equipment should preserve its value longer than expected in such an international market.

Those independent finance companies not bound to green assets by their boards or funding sources may find a near term opportunity to provide this kind of one-time opportunity funding, since banks and public entities cannot or will not do so. They also can partner with entities offering carbon offsets with their financing products, effectively making those financings fit within a green strategy.

War for talent

Tailwinds: ESG and tech matters also align with the current issues of finding and keeping talented workers. Millennials and Gen Z began flooding the workforce prior to 2020, and these generations both want to work for companies that share their values. ESG has become a talent issue in a hard-to-navigate hiring climate. It's a move from shareholder to stakeholder capitalism—and this change is accelerating, not slowing down.

Before the pandemic, forces were in motion to drive a change in our current model of shareholder capitalism where the shareholder reigns supreme and businesses make decisions to appease shareholders. Now, the winds of change are expanding that model to be stakeholder friendly not just for shareholders but for employees, vendors, customers, and the larger community. This isn't just a fad or a passing blip in the economic landscape. Not everyone realizes this but the "father" of capitalism, Adam Smith, actually advocated a stakeholder approach in the 18th century.

Headwinds: Inflation touches this issue, too. Young workers are demanding higher wages and competitive benefits. Those who know their worth are willing to change jobs for more attractive opportunities. **Companies should be prepared for wage increases and other incentives to keep employees happy in 2022.** As stated earlier, younger employees also expect a workplace that allows them a seamless tech experience, freeing them up to make human connections with coworkers and clients.

Managing equipment assets

Tailwinds: If there's opportunity in 2022, it's in the equipment finance field. Banks looking to rebalance Commercial Real Estate exposure can do so with equipment finance assets to mitigate their portfolio risks. The predictability of our field in the coming year can benefit any investor looking to diversify a portfolio.

Demand for equipment, particularly transportation-related equipment, soared in 2021 and prices will only increase in 2022. Demand for both trucks and trailers began rising in late 2020 and these assets are now backlogged into 2022. Truck and trailer sales increased about 20 percent in 2021. This would have been higher if not suppressed by chip and parts shortages.

Used heavy duty sleeper truck tractors showed very high retail prices in 2021 compared with 2020, bringing current prices to record levels, with greater increases seen at auction venues sometimes as much as 140 to 220 percent. Automotive saw new sales plunge more than 15 percent in 2020, and due to constraints increased only 3.5 percent in 2021. The price of the average used car increased by more than 60 percent to $29,000. These trends will all continue throughout the coming year.

Headwinds: This upswing in used equipment prices won't last forever. Smart asset managers will remember what we stressed earlier in this report: Keeping the price consistently high during a lease period could spell disaster for assets down the road. **These sky-high prices won't remain elevated indefinitely, so taking advantage of these opportunities in the first half of 2022 is a must.**

Compliance and currency

Headwinds: To combat the record inflation levels, the federal reserve will, at some point, need to increase interest rates to mitigate the problem. This increase in interest rates will create additional margin compression for those who have not properly hedged their cost of funds. Furthermore, several states either have already instituted or are in the process of instituting rate disclosure requirements for lenders and brokers for certain commercial transactions, creating

additional compliance costs for many in the industry. This year, too, a new global minimum corporate tax rate will start to take shape, impacting multinational corporations and their ability to utilize specific inter-jurisdictional tax treaties to their advantage.

And another development that will soon affect equipment finance firms is the increasing use of cryptocurrencies. This does not simply concern widely known currencies such as Bitcoin, Ethereum and Tether, but also the e-CNY or e-yuan. Increasing use of such currencies will create new concerns for equipment finance companies. Regulators have turned an eye toward cryptocurrencies and are concerned about this asset class because of the inherent risk and its speculative market. As this trend continues into 2022, regulators may intercede if the market becomes too volatile.

Tailwinds: But in a market with so much liquidity, mergers and acquisitions will continue into 2022. **It's a liquid market with ample opportunities to borrow, so those looking to unload and acquire assets both have opportunity.** We predict firms will want to take advantage of this sooner rather than later while rates are still at their low point.

Firms can acquire others to stay ahead in innovation or to boost their own market share, and integration of geographically dispersed operations and capabilities will continue to become more efficient and timely due to the technology applications discussed above. We saw many regional banks merge in 2021 to increase scale and drive cost efficiencies while gaining access to more deposits so they could effectively compete with their larger national rivals. This will continue with our current inflation. **Here's what we know for sure: It's an attractive marketplace for the equipment financing and leasing field for at least the first half of 2022.**

What we learned from last year

We were right in last year's prediction that in many cases "work from home" continues. While many workers went hybrid in 2021, the traditional office model has taken a real hit. And into the new year, many workers will continue to work from home or adopt a hybrid approach. Many of our clients are already embracing new work models, offering work from home or hybrid options to their employees.

While we predicted the adoption of new digital solutions would accelerate, the ongoing chip shortage and supply chain snarls have created equipment purchase delays which have subdued origination volumes.

Bank mergers have forged ahead and fintech has been a solid sector, as we said. Expect more of this into 2022 and keep an eye on fintechs as more people want to bank and work from home.

We were too conservative on equipment values for 2021 because we, like most, did not foresee the sustained supply chain issue. Many classes are much higher in value now due to supply chain disruptions, but we caution that those higher valuations may not be long-lived.

We predicted that geopolitical issues would inspire more domestic business, which held true. Many executives are still wary about the risks and costs of international expansion and will continue to focus on local growth in the coming year. Still, our global reach and perspective is valuable to lessors and lessees alike, due to our years of experience and consistent track record.

Jim Jackson, Valerie Gerard, Paul Bent, John Bober, Rafael Castillo-Triana, Carl Chrappa, Diane Croessmann, Gary Lomonaco, Rick Remiker, Patricia Voorhees and Dave Wiener of The Alta Group all contributed to this report. Special thanks to our partner Denis Stypulkoski of Reimagine Advisors for his contribution.

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