Upturn Reaches the German Leasing Sector – After Some Delay

Extracts of the BDL's annual report 2010/11

The Overall Economic Picture

In 2010, the German economy finally emerged from the severe recession that followed the international financial crisis of the autumn and winter of 2008/2009. Not only did the country's monetary, financial and economic policymakers manage to stabilize real economic activity at a low level, but renewed foreign demand for German products – in particular from the newly industrialized countries – also helped reinvigorate all sectors of the German economy. In the course of the year under review, the economic upturn was further buoyed by an increase in domestic demand. According to the calculations of the Federal Statistical Office (Statistisches Bundesamt), Germany's gross domestic product grew at a nominal rate of 4.2 percent (3.6 percent in inflation-adjusted terms).

The increase in aggregate demand and in the utilization of capacity resulted in renewed investment activity, which was further boosted by the moderate increases in unit labour costs that have typified recent years, by historically low interest rates, and by banks' growing willingness to lend to German enterprises. The phasing out of the declining-balance write-off method also provided companies with an incentive to invest. Year on year, investments in machinery and equipment (including investments in "other equipment") increased nominally by 8.6 percent. Building investment (not including homebuilding) rose in nominal terms by 1.9 percent. Overall investment activity in Germany (not counting investments in homebuilding programmes) was up 6.2 percent. In the years immediately prior to 2010, the German economy suffered under a decline in export-related investments. Last year, however, a renewed appetite for investment contributed significantly to the growth of the country's gross domestic product.

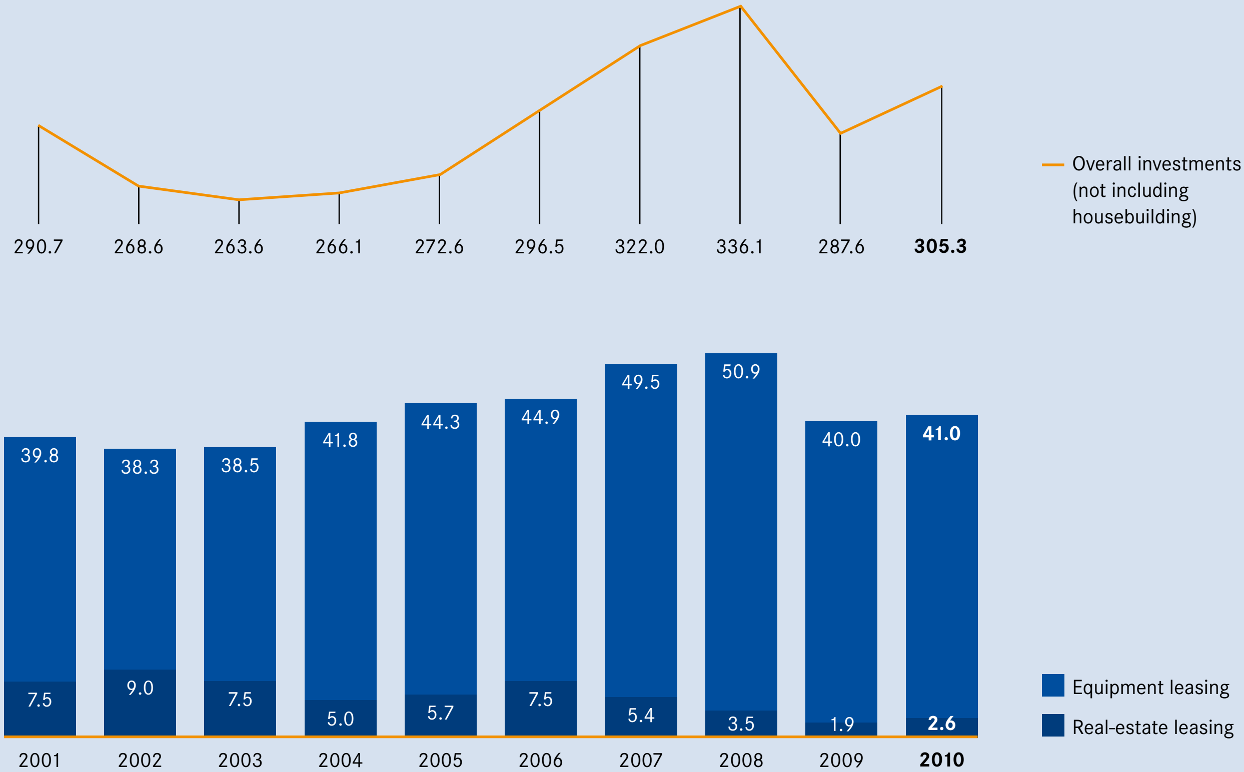
The Leasing Sector in Germany

The Ifo Institute's Survey of the Leasing Market

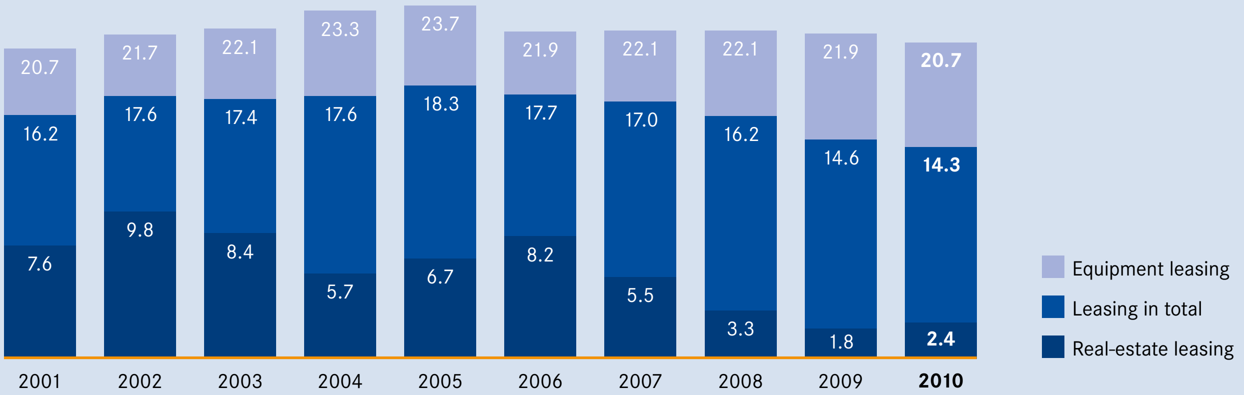
As an engine for investment, it took the leasing industry some time to get going in 2010. After a bad start to the year, leasing companies eventually began to benefit from the economic upturn, and a slight increase in leasing activity was already perceptible in the second quarter. However, it was only in the final quarter that there was really significant growth in the volume of leasing investment. This may be explained by the fact that companies in Germany initially viewed the indicators of an economic upturn with scepticism, and financed a large part of their investments out of their cashflows. Certainly, the volume of loans taken up by companies failed to reflect the improvement in the overall economic picture. One further factor to be borne in mind is the unusually long delivery times that manufacturers of vehicles and machinery were quoting last year. Leasing agreements become effective when delivery has been taken of the leased item; only at this stage will the transaction show up in statistics as "new business". Considerable numbers of leasing agreements initiated in 2010 were not recorded in statistics until after the turn of 2011. As the situation is similar in the current year, new business which to all intents and purposes has already been transacted will once again make a belated appearance in balance sheets.

According to the Ifo Institute's survey, to which every company active in the leasing sector responded, there was an overall year-on-year increase of 4.0 percent in leasing business in 2010, with new leasing business acquired rising from 41.9 billion euro to 43.6 billion euro. However, the leasing sector's share of aggregate investment (the so-called leasing penetration rate) fell from 14.6 percent in 2009 to 14.3 percent.

Leasing Investment/
Overall Investment in Germany
in billions of euro



Penetration Rates
in percentages



Source: Ifo Institute for Economic Research, Federal Statistical Office (05/2011)

The volume of business transacted in the “movables” leasing segment (i.e. through the leasing of equipment) increased by 2.5 percent to 41.0 billion euro. As this rate of increase did not quite keep pace with the overall increase in investments in equipment last year, the leasing penetration rate in the “movables” segment (i.e. the proportion of overall investment in equipment accounted for by leasing) fell to 20.7 percent, which was slightly down on the rate for 2009 (21.9 percent). The proportion of external financing transactions accounted for by leasing remained stable at just under 50 percent.

The volume of business achieved through the leasing of non-residential real estate increased by 35.6 percent to 2.6 billion euro. The leasing penetration rate in the non-residential real-estate sector rose from 1.8 percent in 2009 to 2.4 percent. This vigorous rate of growth resulted from a small number of high-value transactions.

The marked difference in the leasing penetration rates in the equipment and real estate sectors may be explained, first, by the fact that equipment is inherently more leasable, and, second, by differences in the competitive structures in the two respective market environments. While leasing has established itself as a tool for the financing of equipment, it is rarely used to finance building projects – for a variety of legal, fiscal and commercial reasons. Furthermore, other, competing forms of structured financing have in recent years gained considerable ground in the real-estate sector.

Member Companies of the BDL

The new leasing business generated by the member companies of the BDL accounts for between 90 and 95 percent of the value of the German leasing market as measured by the Ifo Institute. The data relating to their leasing transactions are incorporated in the Ifo Institute’s statistics. In addition, the BDL conducts its own annual survey of its members’ business performance; the aim of this study is to acquire rather more detailed information about the business transacted by member companies. The BDL includes hire-purchase contracts as well as leasing agreements in its statistics on equipment transactions, whereas the Ifo Institute concentrates solely on leasing.

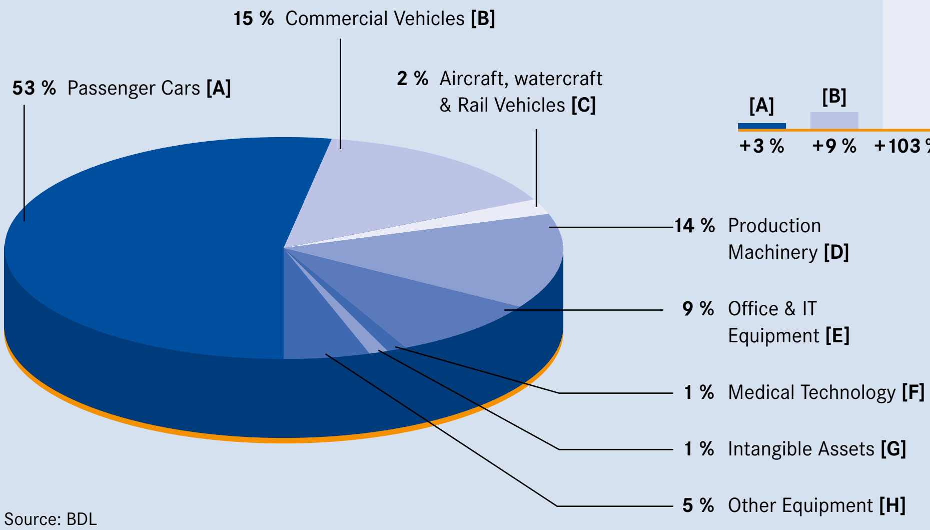
The volume of new equipment business acquired by BDL members last year rose by 2.5 percent to 39.5 billion euro. (This figure includes 4.5 billion euro’s worth of new hire-purchase business.)

Developments in the equipment leasing sector in 2010 tended to reflect the ownership backgrounds of the various leasing companies. The volume of new business acquired by bank-owned leasing companies fell by 2.3 percent. Leasing companies with close ties to manufacturing companies, on the other hand, outperformed the sector as a whole with an increase of 7.4 percent. The independents, however, saw new business decline by 5.1 percent.

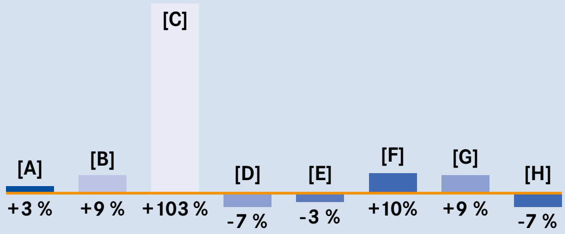
Road Vehicles the Most Popular Leased Item

In 2010, Road Vehicles were, as ever, the most important asset group in the leasing market. Passenger Cars (53 percent) together with Commercial Vehicles, i.e. Trucks, Trailers, Buses & Transporters, (15 percent) accounted for the lion’s share (68 percent) of all new equipment leased. The second-largest class of capital goods in the equipment sector was Production Machinery (14 percent). Next in the rankings came Office Equipment & IT Systems (9 percent), followed by so-

Breakdown by Asset Type of New Equipment Leasing Business in Germany



Trends in 2009 – 2010



Source: BDL

called Other Equipment (5 percent), and then Aircraft, Watercraft & Rail Vehicles (2 percent). Bringing up the rear were Medical Technology and Intangible Assets, each of which accounted for one percent of all new business. In overall terms, the relative importance of the various asset categories was the same as in 2009; however, there were noticeable variations in the rates of growth or contraction within the individual asset groups.

In 2010, growth was recorded in the following asset groups: Aircraft, Watercraft & Rail Vehicles (+103 percent), Medical Technology (+10 percent), Intangible Assets (+9 percent), Commercial Vehicles (+9 percent), and Passenger Cars (+3 percent). Downturns in new business were recorded in three groups: Other Equipments (-7 percent), Production Machinery (-7 percent), and Office Equipment & IT Systems (-3 percent).

Road vehicles constitute the largest group of leasable investment assets, and the leasing penetration rate in this segment now stands at 63 percent (calculated in terms of acquisition costs). The number of new vehicles leased last year fell by 0.5 percent, while new car registrations fell by a dramatic 23.4 percent. This sharp decline in the number of new registrations can be seen as the aftermath of the German government's scrappage scheme, which led to a significant increase in the registration of privately owned vehicles in 2009. Unsurprisingly, the leasing sector reaped few benefits from the cash bonuses on offer in 2009 for the purchase of new cars, so as far as leasing companies were concerned, the basic effect of the scrappage scheme was negligible. Last year, however, this worked to their advantage, for in terms of new vehicle registrations, the leasing penetration rate in this segment rose from 27 to 33 percent.

Numbers of newly leased commercial vehicles (i.e. vans, trucks etc.) rose by 12.3 percent. However, this increase did not keep pace with the rise in new commercial-vehicle registrations, which were 16.5 percent up on the figure for 2009.

After Road Vehicles, the next most important investment category for the leasing industry is Production Machinery. The leasing penetration rate in this segment was last year slightly lower than in 2009, and stood at nine percent.

Office Equipment & IT Systems is the third-largest group of leasable assets, and the penetration rate in this segment remained little changed at twelve percent. At the beginning of the eighties, the penetration rate for Office Equipment & IT Systems was still around the 50 percent mark, but thereafter it went into steep decline. In recent years, it has remained stable, though at a relatively low level. Over the years, technical developments have dictated the pace of business in this segment. Hardware has become more efficient and less expensive, and increasingly large portions of companies' IT budgets are being invested in software. For the leasing sector, this has meant concentrating on the supply of smaller hardware packages at competitive rates, and offering separate software-leasing agreements.

In 2010, there was a substantial increase in the amount of new leasing business acquired in the Aircraft, Watercraft & Rail Vehicles segment. This area of the leasing market tends to be dominated by small numbers of big-ticket transactions.

Investments in medical technology account for a very small fraction of all new leasing business, and in 2010 the value of this market segment stord at just below 0.5 billion euro. This area of investment is not much affected by the ups and downs of the economic cycle, and the steady rates of growth being recorded (ten percent last year) would appear to indicate that health-care professionals have come to view leasing as an attractive financing and investment option. The penetration rate in the field of health care has remained low, which means it still offers considerable growth potential. Leasing companies active in the health-care sector are extremely well placed to help investors take advantage of the latest innovations in the field of medical technology.

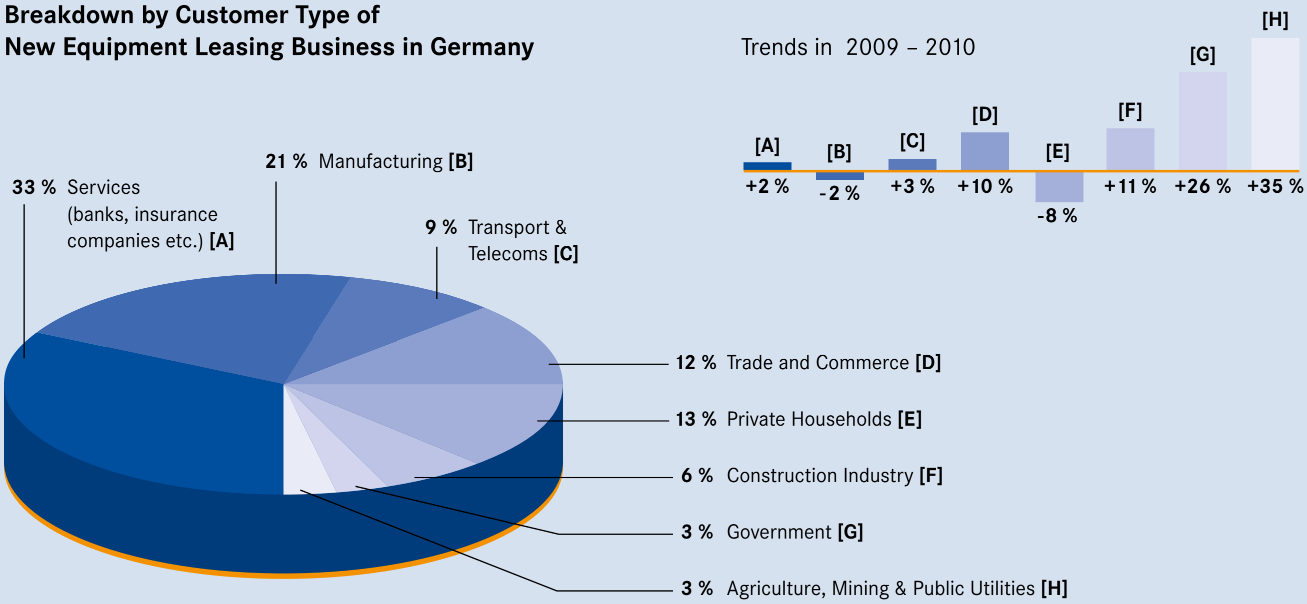
Intangible Assets, which covers, for example, software, patents and brands, has always been a low-volume segment, and last year was no exception. The problem with assessing developments in this niche market is that small numbers of high-value transactions tend to determine the amount of new business acquired in any given year.

Other Equipment is a hold-all category for items that do not fit in any of the other investment groups. Examples of such items are information and signalling systems, electrical equipment, optical goods and shop fittings.

Services: the Leasing Industry's Main Customer Group

Demand for leasable equipment last year increased in the following sectors: Agriculture, Mining & Public Utilities (+35 percent), Public Authorities (+26 percent), Construction Industry (+11 percent), Trade & Commerce (+10 percent), Transport & Telecoms (+3 percent), and Services (+2 percent). However, the volume of new business acquired from Private Households and

Breakdown by Customer Type of New Equipment Leasing Business in Germany



Source: BDL

the Manufacturing sector was down (by 8 percent and 2 percent, respectively).

Since the mid-nineties, German service companies have been the powerhouse of the national economy, and Services generates more equipment leasing business than any other customer group. In 2010, Services accounted for around 33 percent of all new business transacted, which was two percentage points more than in the preceding year. This heterogeneous sector includes credit institutes, insurance companies, hotels, pubs, restaurants, business consultancies and IT service providers. The leasing penetration rate in Services remains relatively low (11 percent), so this sector still offers considerable potential for growth. Cars and office equipment (including IT systems) remained the leasable commodities most sought by service companies.

The manufacturing sector is the equipment leasing industry's second most important source of business, and was responsible for around 21 percent of all equipment-leasing investments made in 2010. Overall, Manufacturing is a heavily export-oriented sector, and last year it performed well. However, on account of the long delivery times already referred to, increases last year in foreign demand, in utilization rates, and in equipment orders have still to make their mark statistically. The leasing penetration rate for Manufacturing is 16 percent, which is slightly above the across-the-board average.

Private Households are the equipment leasing sector's third most important customer group. However, in 2010, the volume of new business obtained from private households was sharply down, and they accounted for just 13 percent of the overall equipment leasing market, which was two percent less than in 2009. Passenger cars remained the items most frequently leased by private households, and accounted for over 90 percent of the new business transacted with this customer group. The Private Households sector is dominated by captive leasing companies, who have won over large numbers of customers by combining innovative types of agreement with supplementary service packages.

Trade & Commerce came fourth in the customer rankings. Its relative importance as a customer group grew marginally, and its share of new leasing business crept up to twelve percent. The leasing penetration rate in Trade & Commerce is 28 percent, which is fairly high.

There was a slightly above average rise in the volume of new business transacted with transport and telecoms companies. However, the portion of the overall leasing market accounted for by Transport & Telecoms only increased by a small amount (to nine percent). This customer group is particularly sensitive to the state of the economy: if there is growth in economic activity, demand for telecommunications and transport capacity will also increase.

The Construction Industry is the sixth-largest customer group. Its contribution to the total volume of new equipment-leasing business increased marginally (to six percent). In recent years, the leasing penetration rate in the construction sector has been high, and in 2010 it stood at 62 percent.

The seventh and final place in the equipment-leasing customer rankings was shared (at three percent) by two sectors: Public Authorities and Agriculture, Mining & Public Utilities. Since there was an above-average rise in the volume of new business obtained from both these sectors, their relative importance as customer groups also increased (in both cases by one percent). Measured in terms of Public Authorities' overall investment in equipment, the volume of new leasing business paid for out of the public purse is still minimal. As regards the Agriculture, Mining & Public Utilities sector, agricultural and forestry equipment remained the category of goods most frequently leased.

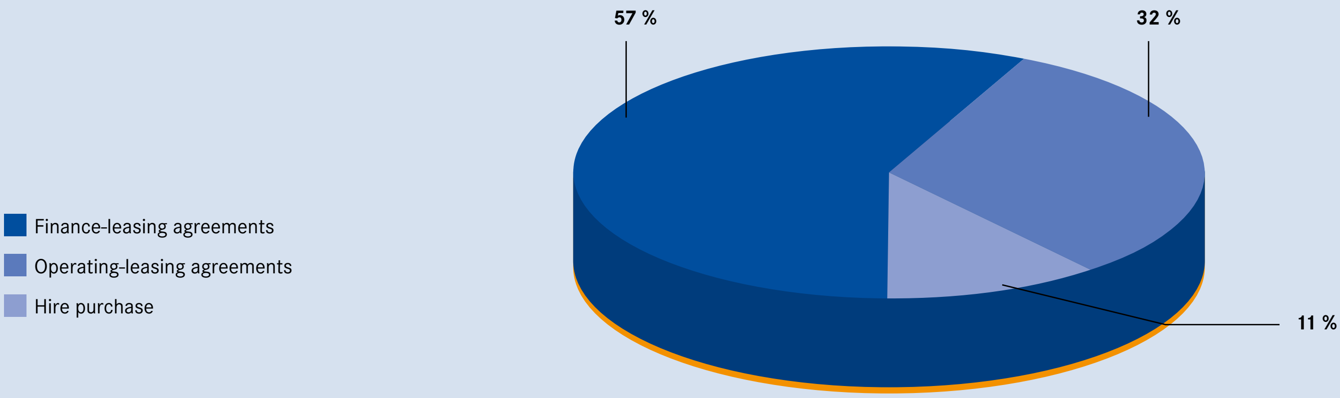
Types of Equipment Leasing Agreement

The number of newly concluded equipment leasing agreements rose in 2010 by 0.6 percent to 1.3 million. The average value of a new agreement was 30,400 euro, which, in nominal terms, was 1.9 percent greater than in the preceding year.

In 2009, the sum total of the costs incurred by leasing companies in connection with their acquisition of new equipment rose by 2.5 percent to 39.5 billion euro. 89 percent (i.e. 35.0 billion euro's worth) of this equipment was leased to end users, while the remaining 11 percent (worth 4.5 billion euro) was supplied on hire purchase. Hire-purchase transactions increased by six percent, whereas the value of leasing agreements rose by just two percent.

If hire-purchase transactions are left out of consideration, it can be said that almost two thirds of all German leasing business (64 percent) is transacted in accordance with the so-called Leasing-Erlasse. These are the legal guidelines that govern all medium- and long-term agreements whose basic lifetimes are shorter than the ordinary useful life of the items being leased (in other words, the classical forms of leasing agreement).

Breakdown by Agreement Type of New Equipment Leasing Business in Germany



Source: BDL

Operating-leasing agreements accounted for all the other leasing business conducted in Germany last year (36 percent). With this type of agreement, the financial/investment risk is borne by the lessor, for the leasing company can only recover the residual value of the asset it has leased by selling it on after the agreement expires, or by persuading the lessee to sign up to a new leasing agreement. Operating leasing agreements have become a preferred instrument for the leasing of IT equipment and motor cars, particularly when service components form part of the package on offer.

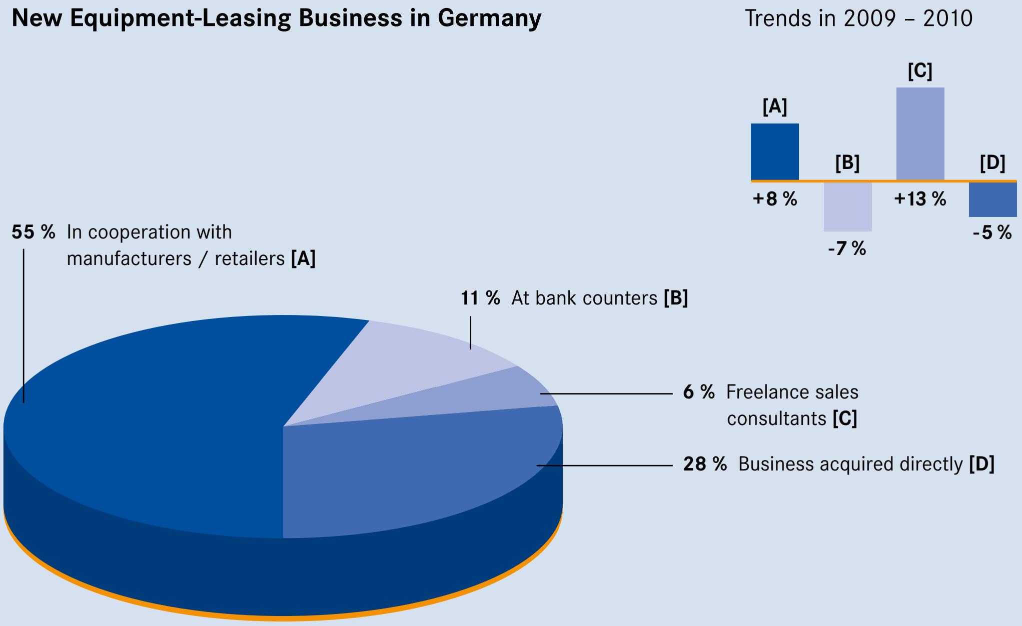
Equipment Leasing Sales Channels

Leasing companies reach their customers in a variety of ways:

- In direct selling, the leasing companies' own sales teams establish direct contact with the customer. In 2010, the volume of business acquired by such teams was five percent down on the figure for 2009. The proportion of new business acquired by means of direct selling thus fell back to 28 percent.

- In manufacturer leasing, manufacturers offer the end customer leasing facilities either through their own subsidiary leasing companies, or through a captive leasing partner. A variant of this approach is so-called vendor leasing, where the manufacturer relies on a dealer to set up contact between the customer and the leasing company. In 2010, there was an eight percent rise in the volume of business acquired in these ways. Having outperformed other leasing channels since the advent of the worldwide recession, manufacturer leasing now accounts for 55 percent of all new equipment leasing business transacted.

Channels for the Acquisition of New Equipment-Leasing Business in Germany



Source: BDL

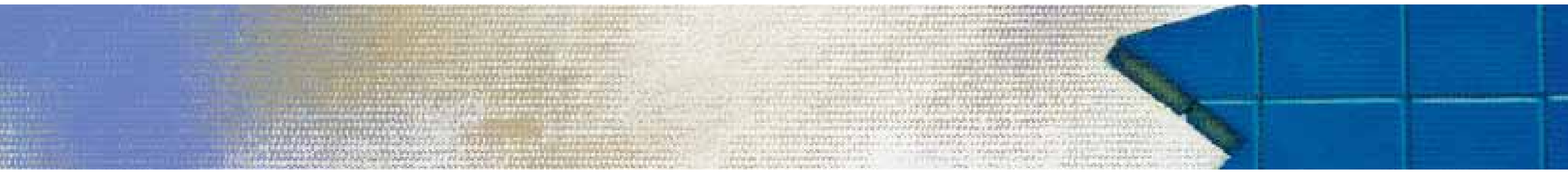
- Leasing facilities are frequently offered by banks as an alternative to normal bank loans. However, there was a steep drop (- 7 percent) in the amount of leasing business acquired through banks last year, and their share of the equipment leasing market fell to eleven percent.

- Freelance sales consultants find customers, negotiate leasing agreements with them, and then call in the leasing company. Business acquired by freelance consultants last year increased by 13 percent, and this group's share of the equipment leasing market rose to six percent.

- In e-commerce, potential customers bypass vendors and sales consultants by seeking out companies' internet sites for themselves. Although the internet is, in principle, a highly efficient medium for the marketing of small-ticket items, the amount of business transacted online fell last year. Internet transactions have in recent years accounted for less than one percent of the value of all equipment leased in Germany. As it is only of marginal importance, e-commerce is not represented in the graphic above.

International Leasing Business

Foreign leasing business can be conducted by means of cross-border agreements, or in the form of domestic operations directed by leasing providers based in the country in question. German leasing companies started to grow their foreign businesses in the early eighties by means of cross-border leasing. In this type of operation, the leasing agreement is concluded directly between the German leasing company and the foreign lessee. In domestic leasing, the agreement is concluded between a local subsidiary of the German parent leasing company and the foreign lessee. The setting up of foreign



subsidiaries with local expertise offers some clear advantages: on-the-ground representation increases service efficiency, and also makes it easier to assess customers' creditworthiness, the state of the local financial markets, and the demand that exists for specific types of goods.

German leasing companies' foreign operations were last year severely affected by the poor performance of various national economies. Once again, there was a dramatic contraction (- 24 percent) in the volume of cross-border leasing, which tends to be dominated by small numbers of high-value transactions. This form of leasing last year generated no more than 0.2 billion euro's worth of new business. Domestic leasing, in which most agreements are "plain vanilla" transactions, was also in retreat (- 5 percent), and the volume of new business acquired by locally based leasing companies stood at 3.4 billion euro. Domestic-leasing operations outside Germany are not included in the statistics for new business acquired by BDL member companies. Instead, they are included in the investment volumes calculated for the respective foreign countries. In 2010, around a third of the member companies of the BDL had business interests outside Germany.

The Outlook for 2011

In their spring 2011 "Joint Diagnosis", Germany's leading economic research institutes predicted that the country's gross domestic product would grow by a nominal 3.8 percent (2.8 percent in inflation-adjusted terms). They reported that the revival of the economy that had already been observable in 2009 faltered during the winter, but had in the meantime regained some momentum. They predicted that the current low-level rate of growth would be maintained through the course of the year. The research institutes further expect investments in equipment to increase in nominal terms by 9.0 percent, and investments in non-residential real estate by 3.1 percent. They predicted a 4.1 percent increase in the construction of commercial property, and a 0.7 percent increase in the public building sector.

Given that over the years the proportion of overall investment activity accounted for by leasing has remained fairly constant, growth in the acquisition of new business in the leasing sector is expected to remain in line with prevailing macroeconomic conditions. The BDL's Trend Report for the first quarter of 2011 shows that the volume of new equipment-leasing business (including hire-purchase agreements) was 18 percent up on the figure for the first quarter of 2010. Growth was particularly strong in the two categories of goods that most readily reflect the ups and downs of economic activity, namely Production Machinery and Commercial Vehicles. German companies appear confident that an upturn in the economy is underway, and their readiness to invest is reaching record levels. If the current trend continues, the leasing sector could record growth of between 11 and 14 percent in 2011.

This assessment is echoed in the Ifo Institute's latest Business Climate Indicator for the equipment leasing sector. This monthly indicator, which is compiled with the support of the BDL, has been in positive territory since the beginning of 2010. In May 2011, it was at its highest level for years. Leasing companies adjudged their current business situations, and also the outlook for the coming six months, to be extremely positive. Furthermore, the Ifo Institute for Economic Research has predicted continuing strong growth in equipment investment during the second half of that year.