EQUIPMENT Insight

A REPORT FROM EQUIPMENT FINANCE

J.P.Morgan

VOLUME 16 | NOVEMBER 2017

Transportation Trends: The Benefits of Fleet Rental

In This Issue:

As a significant factor in commerce across multiple sectors, transportation plays a big part in the overall health of the economy. Companies in the services industry are expecting to add more full-time personnel in the next year, which has likely played a role in the growing demand for transportation equipment—particularly trucks and tractors. But the method for obtaining transportation equipment has evolved—savvy consumers are now demanding more flexibility in the timing, terms and commitment than traditional purchasing can offer, leading to an increased interest in rentals. Although dealerships that consider entering the rental market space must consider different factors in order to successfully expand and optimize their inventory, they stand to generate more revenue and gain repeat business in the process.

The transportation industry largely powers the US economy. According to the Freight Analysis Framework from the Bureau of Transportation Statistics and the Federal Highway Administration, the US freight transportation system moved more than $19.2 trillion in goods in 2015, and a majority of that value (60.8 percent) was carried by truck. The demand for transportation grew 4.2 percent from 2013 to 2014, according to the most recently available data on the subject. This was the highest annual growth rate since the Great Recession—aided by an 11.5 percent increase in private domestic investment in transportation equipment and structures.

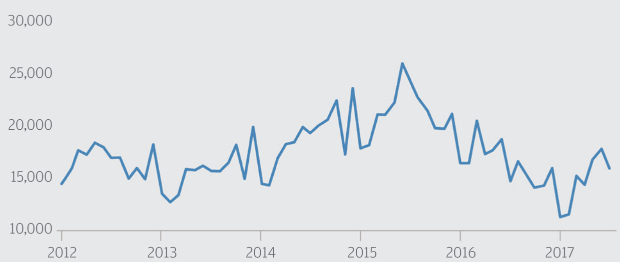
While the relationship between over-the-road equipment to economic activity remains strong, changing consumer preferences are influencing how dealers deliver transportation products and services. Today's clients want to pay for consumption as they use it or need it. They also want more flexibility and lower costs. To that end, there is a growing trend toward equipment rental, with myriad benefits to fleet clients and dealerships alike.

RENTAL BENEFITS FOR CLIENTS

First and foremost, the shift to rental and lease allows clients to conserve capital up front as compared to an outright purchase, even if the purchase was financed through a loan. Later, once it comes time to upgrade to the latest truck or trailer models, clients who lease avoid the risk that purchased equipment won't yield satisfactory returns on the used market. The prospect of diminished resale value has been a real risk in recent years. From May 2016 to May 2017, according to Price Digests, used truck values declined 7.3 percent and auction prices fell 6.8 percent. The drop in values is no doubt spurred by an abundance of supply; ACT Research data shows that class 8 straight truck retail sales have been sluggish in recent years, declining around the 15,000-unit monthly mark after hitting a high point of 25,817 units in June 2015. However, the early months of 2017 showed possible signs of improvement.

Total Class 8 US Retail Sales

January 2012 – July 2017



Source: ACT Research Co.

Having the flexibility to upgrade sooner to newer, more fuel-efficient truck models is an attractive advantage of rental and lease, given that fuel consumption accounts for roughly 70 percent of a fleet's annual operating costs. In 2015's Fleet Advantage survey, 22 percent of fleets said they were operating their trucks on a three- to five-year lifecycle; just two years later, that share jumped to 48 percent. The fuel efficiency of new models will continue to improve over the next decade as the Environmental Protection Agency and National Highway Traffic Safety Administration implement new requirements for medium- and heavy-duty vehicles as part of their greenhouse gas standards.

Moreover, many clients simply don't want the responsibilities that come along with equipment ownership. They'd rather focus their resources and attention on their core business rather than on maintaining a``w`nd servicing equipment. By renting or leasing, they can completely outsource the maintenance of their fleet and thereby avoid hiring mechanics and managing their parts inventory. This allows the user to lock in those upkeep costs at the start of the rental term rather than dealing with the uncertainty of variable maintenance costs throughout the life of purchased equipment.

Continued on the next page

In many cases, they can even enjoy access to a nationwide network of maintenance facilities, which is especially helpful should a truck break down outside of the client's main geography.

With more fleets turning to rental and lease, dealerships can then expand their inventory to include more highly specialized equipment, thereby making these nontraditional methods an attractive option for an even broader spectrum of clients.

RENTAL AND LEASE BENEFITS FOR DEALERSHIPS

As rentals and leasing become a bigger part of their business, dealerships can take advantage of the opportunity to compete for new clients who, traditionally, may have utilized large national rental chains.

Being in the rental and lease business also alters the client-dealership dynamic. Suddenly, a truck sale changes from a one-time transaction to an ongoing relationship as the dealership services and maintains the client's fleet throughout the lease term. Being in regular contact with the client gives the dealership a better opportunity to keep the client on a regular replacement cycle, thereby generating repeat business.

In addition to creating additional revenue streams through lease contracts, dealerships can capture the maintenance revenue associated with each unit. Being in charge of the maintenance also means that dealerships can be assured that their asset is properly taken care of, thus protecting its future residual value. Leasing trucks and trailers provides a regular source of well-maintained equipment for dealerships to sell later through their used truck channels.

Complexity Meets Flexibility: A Fleet Financing Case Study

A locally owned, full-service tractor and truck dealership recently was looking to refinance their rental fleet, spread across multiple locations in the South. Their large fleet presented challenges due to varying loan maturity dates between 18 and 65 months.

The dealership's J.P. Morgan commercial banker worked with specialists from our Heavy Equipment Distribution group and Equipment Finance team to tailor a solution to the client's unique needs. As rental fleets become a bigger part of their business, dealerships like this one can take advantage of the opportunity to compete for new clients who, traditionally, may have utilized large national rental chains.

The client liked the speed of J.P. Morgan's response and appreciated how the solution offered them flexibility to grow their business. In addition to creating additional revenue streams through lease contracts, the dealership can also capture the maintenance revenue associated with each unit. As the dealership's CFO said, "J.P. Morgan made this process easy and their expertise around the hot points of our equipment financing needs really stood out. Once the deals were on the books, the responsiveness by the Equipment Finance Operations team was tremendous."