WORLD LEASING NEWS

REPRINTED FROM WORLD LEASING NEWS, NOVEMBER 2008

Company Valuation and Implications for Owners and Investors

By John Taylor

It Was the Best of Times, It Was the Worst of Times.

Charles Dickens could have been writing about the leasing industry today instead of London and Paris prior to the French Revolution in his famous novel, a Tale of Two Cities. If you're trying to exit your business or sell portfolio in this environment, it's the worst of times; but if you want to invest in or buy a leasing company, acquire assets or grow your business (assuming you're well capitalized), it's the best of times. Good investments are often the result of good timing and buying and selling at the right point in the economic cycle. Bargains abound today, but in order to generate an attractive investment the owner or investor must execute the business well and deliver consistent and reliable profits. We'll look first at the valuation part of the investment equation, discuss some considerations in increasing business value, and analyze the resultant implications for owners and investors.

Valuation

Historically, a handful of measures are generally used to value leasing companies including: price earnings ratio, multiple of book value and premium on assets. A discounted cash flow approach might be used when the necessary information was available in order to properly do the calculation. The ranges of these measures during normal economic times might be similar to the chart below:

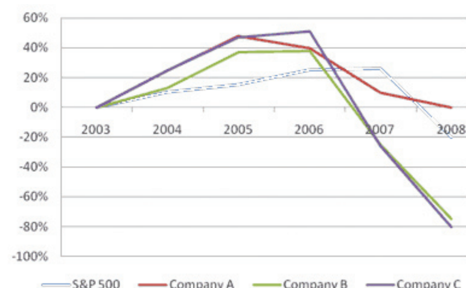
Measure	Range
Multiple of Book	1.0X - 1.5X
Premium on Assets	0% - 5%
P/E Multiple	6X - 15X

Applying these three valuation measures to a hypothetical leasing company with Total Assets of $200 million, Book Value of $30 million and Net Income of $3 million, would yield a reasonably consistent valuation in a range from $30 million to $45 million as follows:

Measure	Low	High
Multiple of Book	$30 million	$45 million
Premium on Assets	$30 million	$40 million
P/E Multiple	$18 million	$45 million

Public Companies as a Valuation Proxy

Public leasing companies used to serve as a bellwether for private company valuation. Public companies generally commanded a premium in valuation over private companies due to their access to public funds and the overall prestige and recognition afforded by public status. But with a limited number of pure public leasing companies and two of them trading below book value, this former benchmark is less useful.



Other public entities that share some commonality with leasing companies, like CapitalSource, are more akin to banks, asset managers or REIT's than lessors and are not suitable proxies. The following index chart displays the five year stock price history, in percentages, for the S&P 500 and several public leasing companies. Only one is in marginally positive territory from where it was five years ago and the others down approximately75%.

Translating the current market value, for three public leasing companies, into valuation measures yields the results in the following chart:

Company	Multiple of Book	Premium On Assets	P/E Multiple
Company A	1.43 X	9%	11.52 X
Company B	0.32 X	(12%)	4.35 X
Company C	0.21 X	(6%)	N/A

Only Company A's valuation falls within the ranges that typically apply during a normal economy. So why is Company A's valuation holding up and Company B's and Company C's aren't? The answer, which is highlighted to a much greater degree than ever before by market turmoil, has to do with Company A's ability to generate predictable, growing and high quality earnings, supported by their capital structure—and for an investor, shareholder or owner, a believable path to growth and a strong exit.

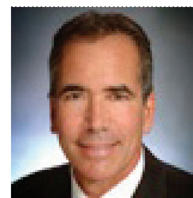
Private Company Valuations

There are many examples of successful models in the leasing industry for private companies, whether it's operating leasing, mid-ticket technology leasing or micro ticket financing. And in many respects, opportunities to grow market share and to generate assets have never been better. Spreads are rising, the value proposition for equipment finance companies is high and large portions of the market are underserved. Ongoing company consolidation is providing a steady source of human and intellectual capital. The leasing industry is undergoing a de-commoditization and returning more to its basics. Value will be determined more by attractive profitability/cash flow on a risk-adjusted basis, a well capitalized and flexible balance sheet, experienced management and core competencies in asset underwriting, structuring and servicing.

Trends and Impact on Leasing

On-going trends in the leasing industry will continue and maybe intensify. Consolidation will continue to occur as some banks exit the business and weaker independents are consolidated. The search for liquidity will continue through asset sales, recaps and equity infusions. Spreads will continue to increase as a result of less competition and higher cost of funds. Equity investors will demand higher returns as a result of lower leverage and higher perceived risk. Well run companies should enjoy both higher earnings and higher quality earnings.

Assuredly, valuations will recover in three to five years and when they do, owners and investors will want to maximize their company's value by taking advantage of the above opportunities today.



ABOUT THE AUTHOR

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