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Canadian Finance & Leasing Association

Association canadienne de financement et de location

Asset-Based Finance in Canada
Market Overview
2017 – 2018

October 2018

Prepared for CFLA by QEDinc

Contents

Introduction

Economists, like broken clocks, occasionally get it right. The long-promised rise in interest rates has finally started as the Canadian economy powered ahead in 2017. While the general economy performed well, spending on machinery and equipment rose a disappointing 1.4% in 2017. Motor vehicle sales set new records, and this led to an overall increase in new assets financed of 5.3% to $128 billion in 2017 for a total of $402 billion in assets financed.

Key Numbers

- Value of new assets financed rose 5.3% in 2017 to a record-setting $128 billion
- The value of assets financed in Canada rose 6% to $402 billion in 2017
- The outlook for 2018 remains positive for all market segments with new business expected to rise 3%

The Canadian Finance and Leasing Association (CFLA) represents the asset-based financing, equipment and vehicle leasing industry in Canada. This industry is the largest provider of debt financing in this country after the traditional lenders (banks and credit unions). CFLA's membership includes companies that finance machinery and equipment including commercial vehicles as well as vehicles for the consumer market. This article was prepared for CFLA by *Quantitative Economic Decisions, Inc.* (QEDinc) and provides a review of recent trends along with the outlook for and highlights of major directions in the asset-based finance sector.

Economic and capital investment outlook

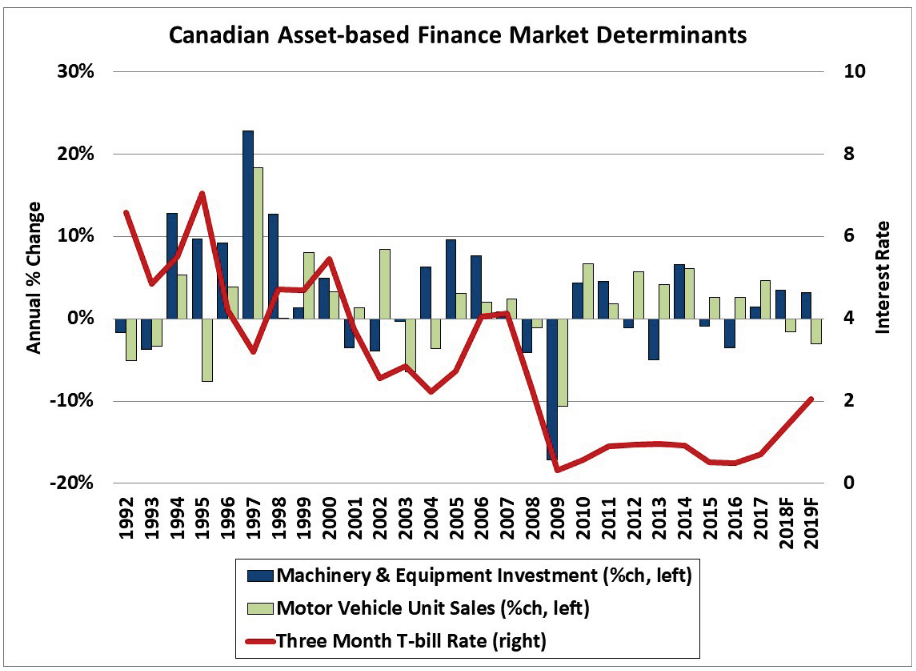
Canadian economic growth rebounded in 2017 following the oil price collapse in 2014 and the period of slow growth that followed. Real GDP grew 3% in 2017, up from 1.4% in 2016 and public and private investment spending on machinery and equipment rose 1.4% in 2017 after a decline of 3.5% in 2016.

The improving commodity price environment, higher minimum wages, strong spending on public infrastructure and a low Canadian dollar helped fuel rapid economic growth in 2017. Recent increases in interest rates and the Canadian dollar will likely dampen some of that enthusiasm over the next few quarters. Uncertainty over our trading relationship with the US along with domestic tax and regulatory policy are also considered responsible for lackluster business investment spending. Looking forward, the Canadian economy is expected to grow by 2.2% in 2018 but slow to 1.7% in 2019. Business and government capital spending together with exports are expected to lead growth in 2018 and this is expected to remain the case in 2019.

Economists anticipate reasonable economic growth in most major markets around the world in 2018 and 2019. The US economy will continue to expand, growing 3% in 2018, while Europe and Japan will grow about 2.1% and 1% respectively. China's growth will continue to slow from its torrid pace of the last decade but at 6.5% is still leading all other major markets. Geo-political risks to the outlook remain dramatic with the looming threat of escalating trade disputes having the potential to significantly disrupt economic growth around the world.

Economic growth was positive across the country in 2017 with British Columbia continuing to lead the country at 3.8% followed by Prince Edward Island at 3.7% and Ontario at 3.5%. Newfoundland and Labrador and New Brunswick lagged at 1.8% and 2.1% respectively. The difference between fastest and slowest growth is expected to narrow in 2018 with British Columbia retaining its lead at 2.6% while Newfoundland and Labrador continues to struggle with just 1% growth.

The following chart shows the determinants of asset-based finance market growth along with their outlook for 2018 and 2019. Statistics Canada's national accounts expenditure data for the first half of 2018 reports an increase in machinery and equipment spending of 7.6% relative to the same period last year. This suggests that spending could be stronger than anticipated by respondents to Statistics Canada's public and private investment intentions survey conducted earlier in the year. It remains to be seen whether the recent increase in interest rates will dampen spending on new capital over the remainder of the year. Sales of new motor vehicles have set new records over the last few years, but DesRosiers Automotive Consultants anticipate a slightly softer market in both 2018 and 2019.



Source: Public and Private Investment Survey, Statistics Canada; Bank of Canada; 2018 Summer Forecast, Quantitative Economic Decisions, Inc.; DesRosiers Automotive Consultants

Statistics Canada's survey of public and private investment intentions for 2018 anticipates a 3.5% or $2.8 billion rise in public and private machinery and equipment capital spending this year following the 1.4% increase in 2017. Growth in spending on new equipment varied across the country in 2017 with strong gains in Quebec, Saskatchewan and Ontario being offset by declines in Manitoba and Alberta. Spending patterns are expected to shift slightly in 2017 with British Columbia making strong gains while Saskatchewan loses ground.

Public & Private Spending on New Machinery & Equipment				
	Millions of Dollars		% Growth	
	2018 F	2017	2018 F	2017
Canada	83,372	80,552	3.5%	1.4%
Atlantic Provinces	4,600	4,625	-0.5%	1.0%
Quebec	14,608	13,775	6.1%	8.1%
Ontario	31,330	29,865	4.9%	4.8%
Manitoba	2,757	2,875	-4.1%	-12.7%
Saskatchewan	4,297	4,582	-6.2%	7.2%
Alberta	13,796	13,830	-0.2%	-9.8%
British Columbia	11,296	10,463	8.0%	2.8%

Source: Statistics Canada (34-10-0035-01)

On an industry-by-industry basis, the weakest sectors for public and private machinery and equipment spending in 2017 continued to be mining and oil and gas extraction along with arts, entertainment and recreation, and accommodation and food services. Areas of strength include: the public sector, health care and social assistance, and finance and insurance. In 2018, the mining and oil and gas extraction sector is expected to rebound and strong growth is anticipated for the utilities and manufacturing sectors. Public sector spending is also expected to continue to expand as governments across the country continue spending to renew and expand public infrastructure.

Public & Private Spending on New Machinery & Equipment by NAICS Sector				
	Millions of Dollars		% Growth	
	2018 F	2017	2018 F	2017
All Industries	83,372	80,552	3.5%	1.4%
Agriculture, forestry, fishing and hunting	4,073	4,159	-2.1%	1.9%
Mining, quarrying, and oil and gas extraction	4,576	4,150	10.3%	-28.3%
Utilities	6,302	5,547	13.6%	2.7%
Construction	5,377	5,373	0.1%	6.4%
Manufacturing	12,521	11,433	9.5%	-4.7%
Wholesale trade	2,377	2,454	-3.1%	2.5%
Retail trade	2,977	2,944	1.1%	-3.3%
Transportation and warehousing	11,519	12,178	-5.4%	9.6%
Information and cultural industries	5,524	5,167	6.9%	-2.2%
Finance and insurance	2,413	2,714	-11.1%	11.8%
Real estate and rental and leasing	8,809	8,141	8.2%	4.8%
Professional, scientific and technical service	1,751	1,825	-4.1%	-1.7%
Management of companies and enterprises	215	257	-16.3%	34.7%
Administrative and support, waste managem	1,270	1,023	24.1%	-2.9%
Educational services	1,809	1,920	-5.8%	7.2%
Health care and social assistance	3,008	3,155	-4.7%	15.0%
Arts, entertainment and recreation	648	548	18.2%	-28.4%
Accommodation and food services	1,291	1,221	5.7%	-22.9%
Other services (except public administration	520	485	7.1%	-31.6%
Public administration	6,395	5,859	9.2%	33.4%

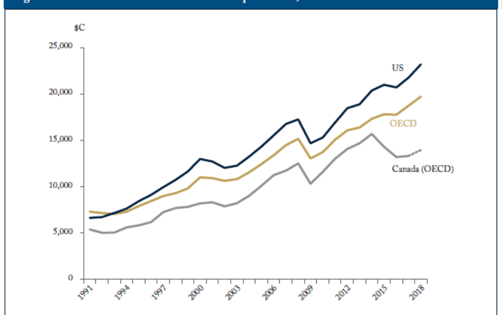
Source: Statistics Canada (34-10-0035-01)

In a recent study[1], the C.D. Howe Institute benchmarked Canada's investment performance and identified a persistent and growing gap between business investment spending per worker in Canada

[1] William B.P. Robson, Jeremy Kronick and Jacob Kim, "Tooling Up: Canada Needs More Robust Capital Investment" (C.D. Howe Institute, Commentary No. 520, 2018).

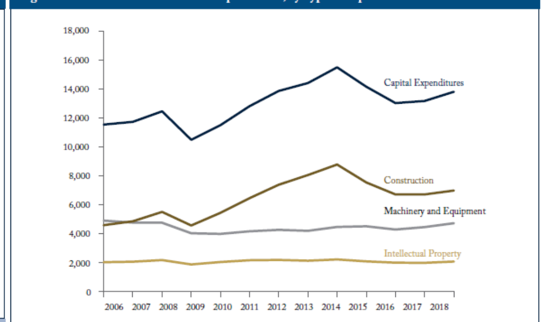
compared not only with the United States but also against average spending across OECD nations. Part of the rise in this gap can be attributed to the significant decline in non-residential construction spending associated with the collapse in oil prices but perhaps of more significance is the lack of appreciable increase in machinery and equipment spending per worker in Canada for over a decade. Other reasons cited in the report for the Canada's weak investment spending performance include: obstacles to fossil fuel investment, an uncompetitive tax environment, obstacles in international and interprovincial trade, uncompetitive electricity prices, obstacles to investment in intellectual property, and a relatively unsupportive financial system.

Figure 1a: Non-residential Business Investment per Worker, 1991-2018



Note: 2018 numbers for Canada are based on first-half non-residential fixed investment and OECD forecasts.
Source: Authors' calculations from Statistics Canada and OECD.

Figure 5: Canadian Business Investment per Worker, by Type of Capital



Source: Statistics Canada's National Economic Account (NEA). 2018 numbers is the average Q1 and Q2 seasonally adjusted at annual rates.

Source: C.D. Howe Institute Commentary No. 520, Figures 1a and 5.

Financial market developments

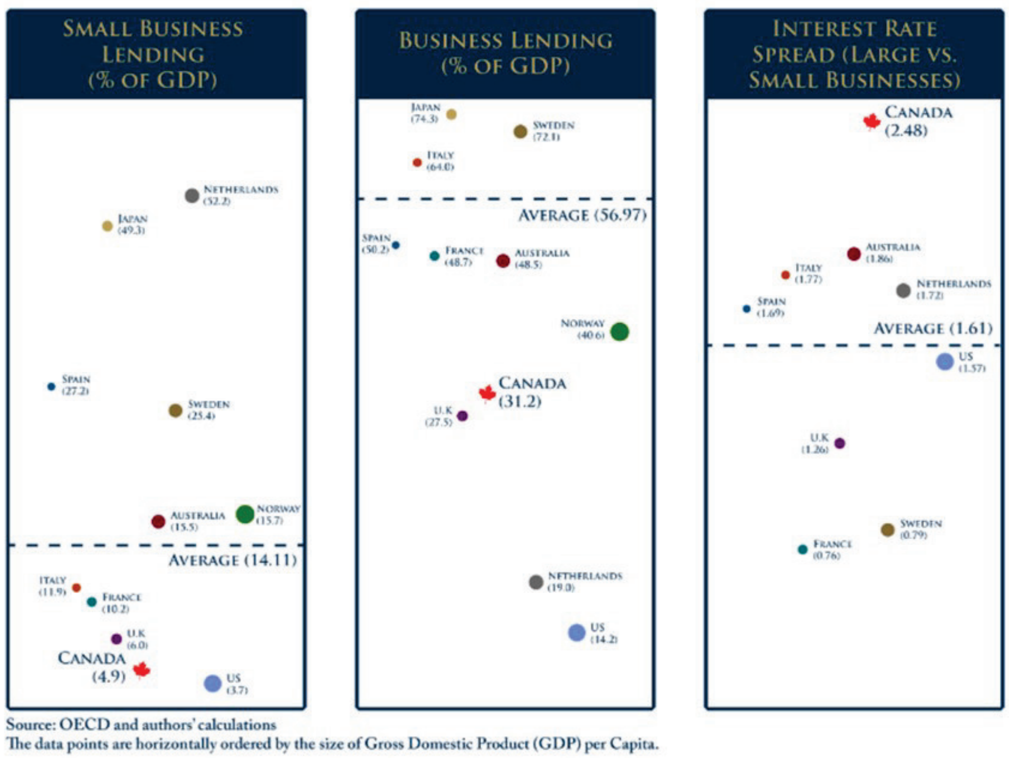
Interest rates, after remaining at historically low levels for nearly a decade following the financial crisis, are rising in Canada. As of writing, the Bank of Canada has raised its benchmark interest rate four times since July 2017 and is expected to continue to raise rates over the next couple of years. The Bank of Canada cites strong economic growth, low unemployment rates, and the risk of rising inflationary pressures in Canada as the reasons for this increase. While this is true, there are significant risks to our continued economic growth arising from: uncertainty over trade; households – and some governments – ability to cope with higher interest payments on their debt; and potentially large reversals in prices and activity in residential housing markets.

Short term rates, as measured by the 3-month treasury bill rate, rose to 0.7% in 2017 from 0.5% the previous two years and are expected to average 1.4% in 2018 and 2.1% in 2019. The yield on 10-Year Government of Canada bonds is expected to average 2.4% in 2018 and rise to 2.8% in 2019.

As a major producer of oil, the Canada-US exchange rate often tracks the price of oil quite closely, but it has deviated from that relationship and remained largely unchanged versus the US dollar despite the partial recovery in crude oil prices. Once again uncertainty over our trading relationships is likely undermining the strength of our currency. The Canadian dollar is forecast to average $US 0.77 in 2018 and to appreciate marginally to $US 0.78 in 2019. The value of the Canadian dollar, however, remains vulnerable - both on the up and the down side - to external shocks in commodity prices, US and domestic public policy and other global events.

The federal government continues to support the securitization of equipment and vehicle lease and loan portfolios through the Funding Platform for Independent Lenders (F-PIL) program.[2] The program is a public-private partnership between the BDC and TAO Asset Management that provides funding on commercial terms and on a match fund basis to independent small and medium-sized finance or leasing companies that extend financing for vehicles and/or commercial equipment.

While the F-PIL program provides some support, the C.D. Howe Institute has raised concerns about the efficacy of Canada's financial system in providing access to finance to business in general and small business in particular.[3] Their study finds that Canada ranks near the bottom among OECD nations in terms of overall lending to business as a share of GDP. Canada's performance is even worse when confined to lending to small businesses as a share of GDP. This lending pattern may be driven, in part, by the OECD leading spread between the interest rate for loans to SMEs and those offered to large firms.



Source: C.D. Howe Institute (https://www.cdhowe.org/graphic-intelligence/missing-productivity-canada-playing-catch)

Equipment and Commercial Vehicle Finance Customer Profile

CFLA commissioned a market research survey of equipment and commercial vehicle finance activity and factors and perceptions affecting the Canadian asset-based finance market for those assets in 2017. The survey was conducted by PMG Intelligence and follows up on surveys also conducted by PMG in 2013 and 2015.

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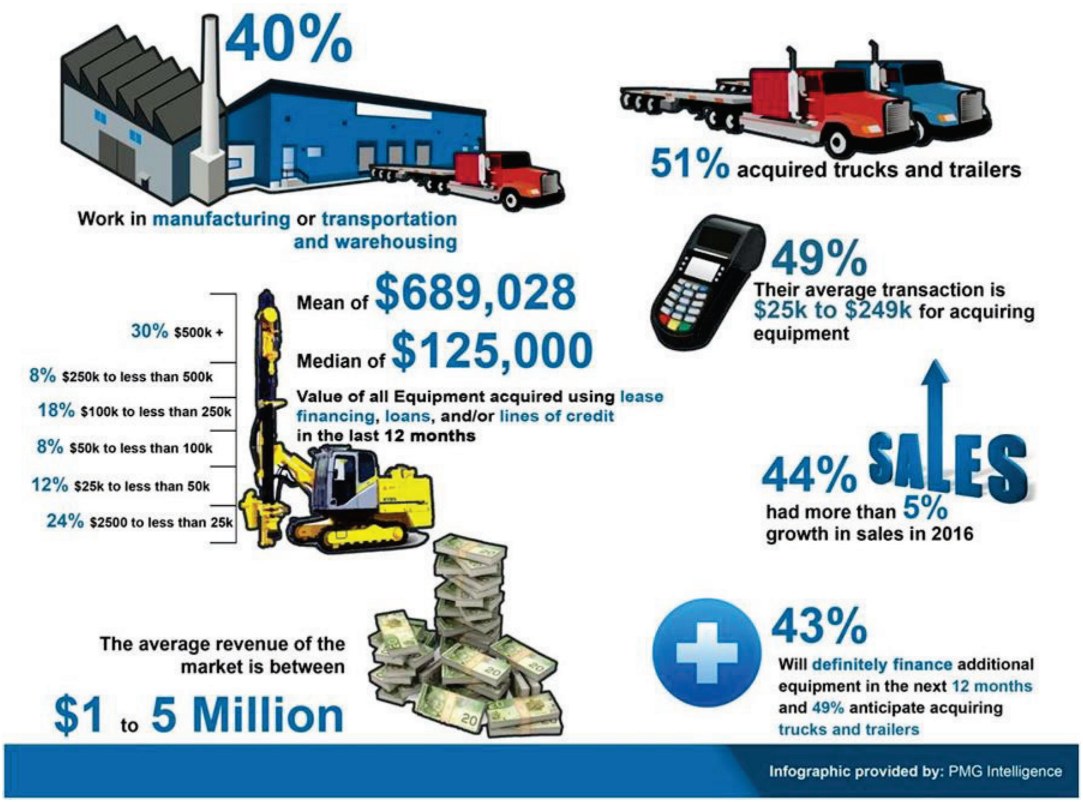
[2] This program was formerly known as the Vehicle and Equipment Finance Partnership (VEFP) and was introduced as part of the federal government's response to the 2009 financial crisis.

[3] Jeremy Kronick, "Productivity and the Financial Sector – What's Missing?" (C.D. Howe Institute, Commentary No. 508, 2018).

The survey was conducted by telephone during the Summer of 2017 and targeted private sector organizations who have acquired and financed equipment and commercial vehicles of value greater than $2,500 in the last 12 months. Approximately 30% of organizations contacted met these criteria yielding a total sample size of 300 companies located across Canada and distributed by NAICS industry and company size.

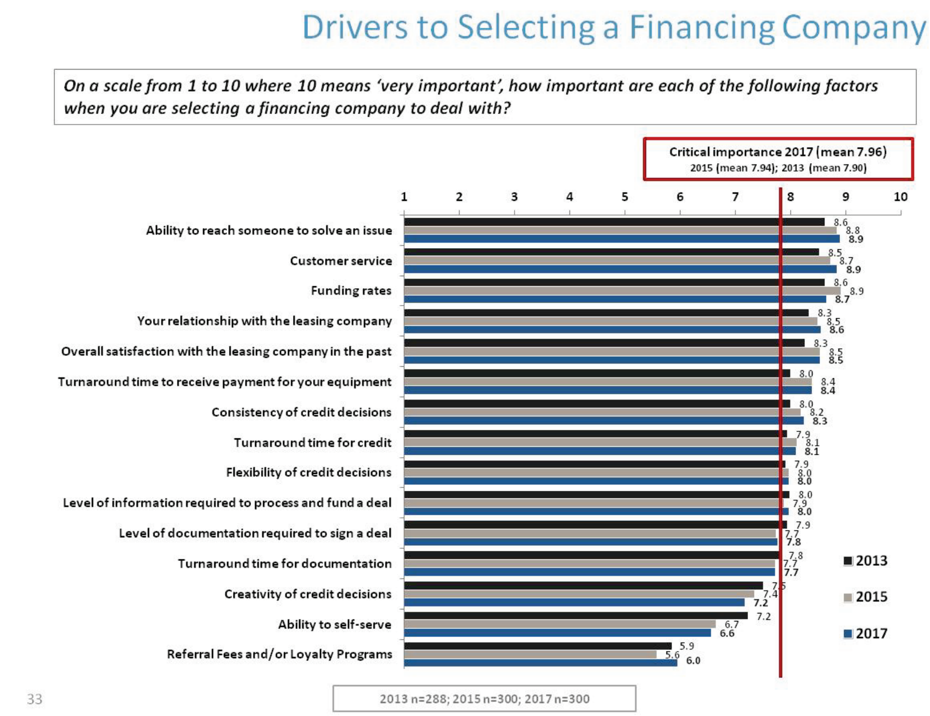
The following infographic provides a summary of PMG's survey findings on the finance market for equipment and commercial vehicles in 2017. More information is available within the full report of findings provided to CFLA.



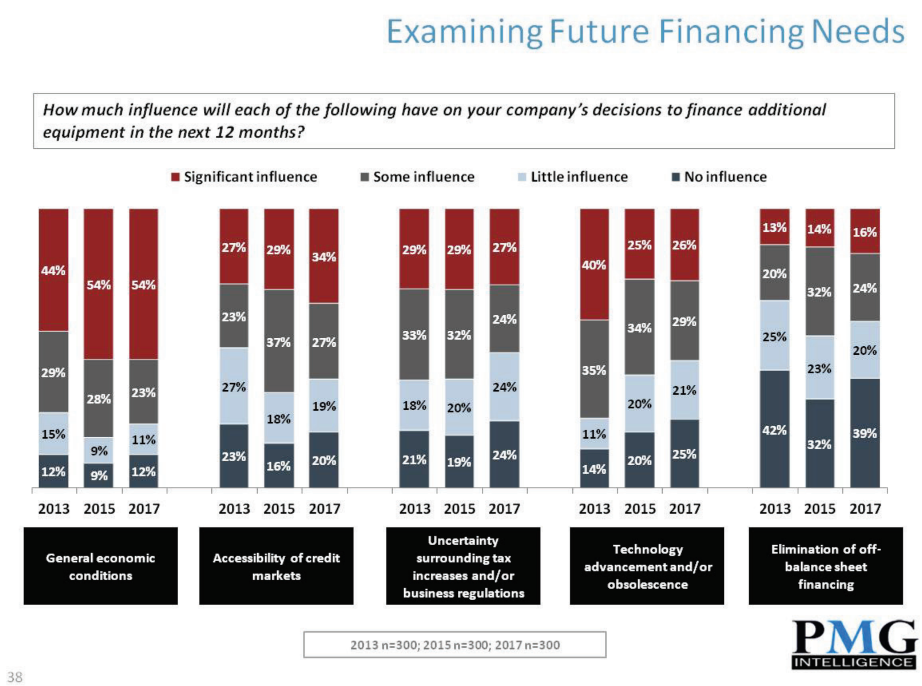
Source: PMG Intelligence

PMG's survey asked respondents to identify the factors that influence which financing company and method is chosen. Customer service - including the ability to reach a qualified representative - is at least as important as the funding rate and has, in fact, steadily increased in importance since 2013.

The state of the economy has been and remains the most significant factor determining future financing needs. Significant gyrations in economic growth in 2015 and 2017 have served to elevate attention to general economic conditions when making important business decisions. Technological advancement was ranked second in importance in 2013 but that has been overtaken by concerns about credit access in 2017.

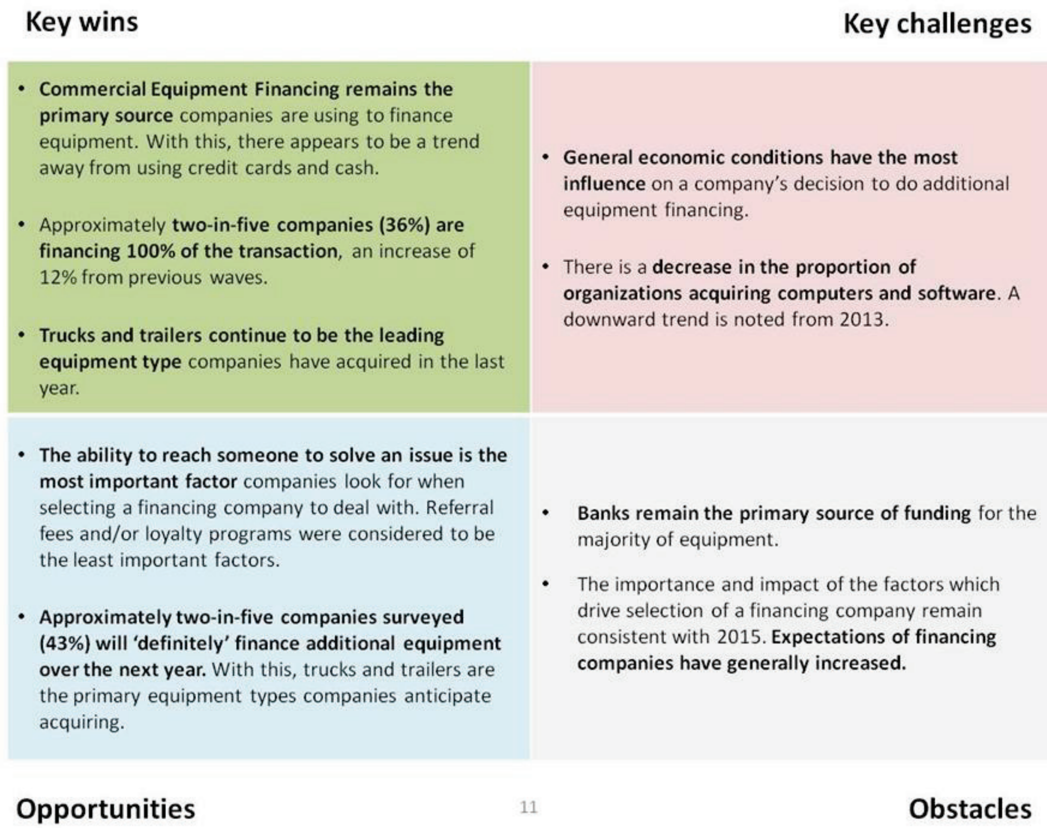


Source: PMG Intelligence



Source: PMG Intelligence

PMG Intelligence's 2017 survey revealed several important findings that they characterized as either key wins, opportunities, key challenges or obstacles for the asset-based finance industry.

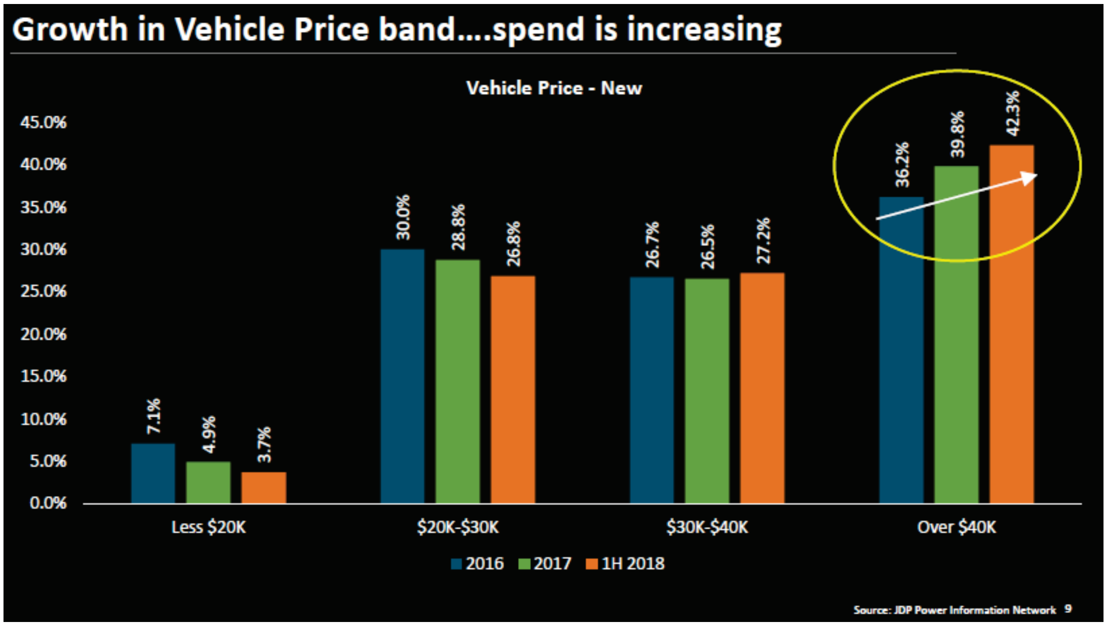


Source: PMG Intelligence

Retail Vehicle Finance Customer Profile

Canadian consumers are among the most indebted in the world as they embraced the low interest rates of the last decade. The series of interest rate hikes this year have already slowed new vehicle sales in 2018 and are likely to lead to other changes in consumer behaviour.

J.D. Power reports that the average transaction price for new retail vehicles rose to $33,500 in 2017 from $32,400 the previous year but declined slightly through the first half of 2018 to $33,400. The increase in 2017's average transaction price was fueled by a jump in the share of over $40,000 vehicles purchased and an ongoing decline in popularity of vehicles priced under $30,000. The increase in popularity of expensive vehicles is driven, in part, by rising dealer and manufacturer incentives in the luxury segment of the market. With low interest rates, the industry has increasingly relied on longer financing terms to encourage spending. In 2017, 55.2% of mainstream vehicle transactions were financed with a term of 84 months or longer, up from 51.8% in 2015; but higher interest rates in the first half of 2018 have already pushed that share back down to 51.1%. Term length has also risen for leasing. The share of mainstream vehicle transactions for 60 months and over lease terms has risen to 29.5% in 2017 from 27.1% in 2015 while 24 months and under lease terms fell to 3.6% from 7.9% in 2015. Interestingly, the share of lease transactions with a term of 60 months or over has continued to rise through the first half of 2018 to 31.2% as lessors continue to aggressively pursue new business.



Reproduced by kind permission of J.D. Power

A younger demographic (age <44) appears to be driving the purchasing of used vs new vehicles

Vehicle Condition Distribution by volume

	New Origination Distribution		2014	2015	2016	2017	YTD 2018
Pre-work force 0-25	10%	New	35%	35%	33%	31%	28%
		Used	65%	65%	67%	69%	72%
Millennials 26-35	22%	New	43%	44%	42%	41%	38%
		Used	57%	56%	58%	59%	62%
Generation X 36-45	22%	New	48%	50%	49%	47%	44%
		Used	52%	50%	51%	53%	56%
Baby Boomers (late) 46-55	22%	New	51%	52%	51%	50%	47%
		Used	49%	48%	49%	50%	53%
Baby Boomers (early) 56-65	14%	New	56%	55%	54%	52%	50%
		Used	44%	45%	46%	48%	50%
Silent Generation 65+	9%	New	35%	35%	33%	31%	52%
		Used	65%	65%	67%	69%	48%

Source: Dealertrack and Equifax Canada Co. Database as of Q2-2018
Auto financing includes bank, captive and non-bank auto lenders; bank auto financing is measured by installment loans with credit limits between $5,000 and $100,000

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Equifax Canada research reveals that car ownership is still important to 83% of Canadians and that younger people still want cars: 81% of persons aged 25-34 and 75% of persons aged 18-24. Two thirds of new and used vehicles are purchased by persons between the ages of 26 and 55 with a record number of used vehicle sales in 2017 of 3.2 million vehicles eclipsing the 2.0 million new vehicles sold. Equifax notes that persons younger than 44 years old have become increasingly likely to purchase a used rather than a new vehicle over the last few years.

Asset-based Finance Market in Canada

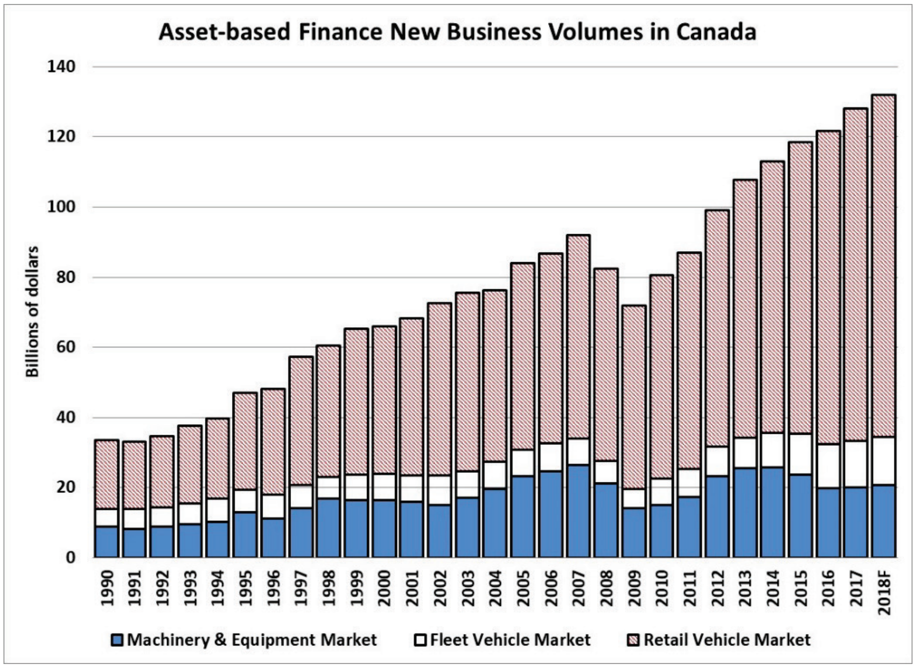
The asset-based finance market in Canada continued to grow in 2017 with new business volumes up 5.3% to $128.1 billion which was faster than the 2.6% growth in 2016. New business activity was again led by the automotive sector as the consumer vehicle market grew 6.3% and the fleet vehicle market 5.8% in 2017 while machinery and equipment (excluding commercial vehicles) limped along at 0.8%. As a result, total assets financed rose 6.0% in 2017 to $401.5 billion; improving on the 5.7% growth of the year before.

Asset-based Finance Market in Canada				
	Millions of Dollars		% Growth	
	2017	2016	2017	2016
Total Finance Assets	**401,537**	**378,923**	**6.0%**	**5.7%**
Machinery & Equipment Market	75,922	77,103	-1.5%	-3.7%
Fleet Vehicle Market	39,827	36,219	10.0%	11.9%
Retail Vehicle Market	285,788	265,602	7.6%	8.0%
Equipment & Commercial Vehicles	115,748	113,321	2.1%	0.7%
Total Vehicle Market	325,615	301,820	7.9%	8.4%
Total New Business	**128,074**	**121,597**	**5.3%**	**2.6%**
Machinery & Equipment Market	20,044	19,887	0.8%	-16.4%
Fleet Vehicle Market	13,230	12,510	5.8%	7.9%
Consumer Vehicle Market	94,800	89,200	6.3%	7.2%
Equipment & Commercial Vehicles	33,274	32,397	2.7%	-8.4%
Total Vehicle Market	108,030	101,710	6.2%	7.3%

Source: Canadian Finance and Leasing Association, DesRosiers Automotive Consultants Inc.

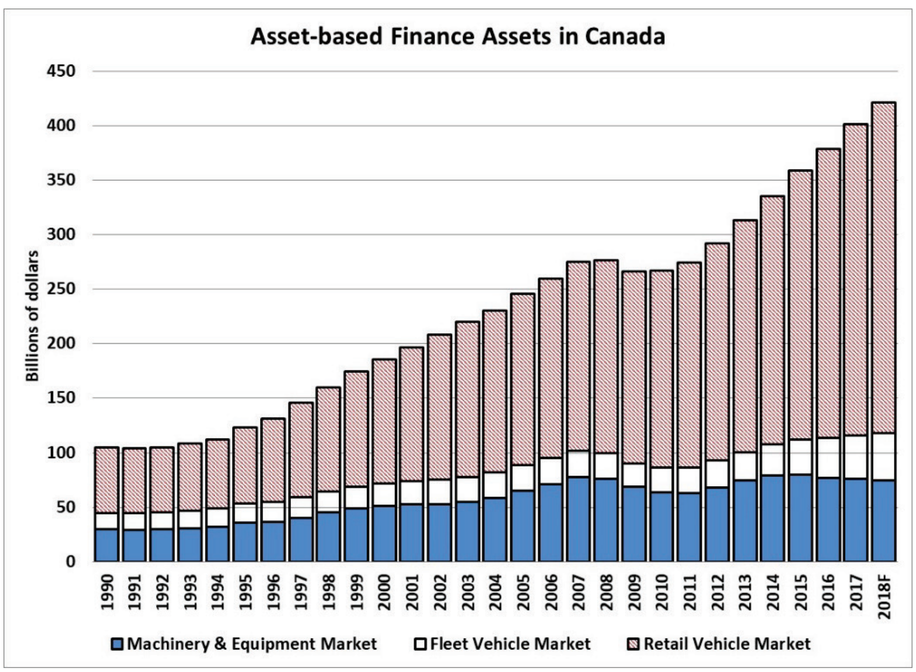
New light vehicle sales in Canada have risen rapidly since the 2009 financial crisis (over 4% a year) and, for the first time, exceeded 2 million units in 2017. DesRosiers Automotive Consultants Inc. expects sales of new light vehicles to slow in 2018 and 2019 as the recent sales growth far exceeds the rise in the driving age population leaving the sector vulnerable to a shift in economic factors - such as rising interest rates. The fleet vehicle market segment has also performed well since 2009. The fleet share of total new vehicle sales has recovered from a financial crisis low of 12% to about 17% which is similar to its share from 1997 to 2006. The fleet segment's high market share from 1991 to 1996 was a result of weakness in the retail vehicle market during and after the 1990s recession rather than a sign of robust business activity.

New business volumes in Canada have risen 5.3% a year on average since 1990 with the consumer vehicle market outpacing the equipment and commercial vehicle market at 6.3% and 3.2% a year respectively. As a result, the consumer vehicle share of total new business has risen from 58% in 1990 to an estimated 74% in 2017. The fleet vehicle share of new business has averaged about 11% since 1990 and is expected to be 10% in 2017. Machinery and equipment, excluding commercial vehicles, share of new business has slid from 26% in 1990 to 16% in 2017.



Source: Canadian Finance and Leasing Association, DesRosiers Automotive Consultants

In 2017, the value of assets financed in Canada exceeded $400 billion for the first time; representing an average annual growth of 5.3% since 1990. The consumer vehicle market accounts for 71% of that total, up from 58% in 1990 with the fleet vehicle market accounting for 10% in 2017 down from 14% in 1990.



Source: Canadian Finance and Leasing Association

Market Penetration Rates

Estimates of equipment and commercial vehicle new business activity in 2017 were generated using PMG Intelligence's 2017 survey, Paynet's Canadian Equipment Lending Index, CFLA's membership information, and from DesRosiers Automotive Consultants vehicle finance model for the consumer and fleet vehicle markets.

The finance penetration rate for equipment and commercial vehicles is derived as the share of new business in that segment divided by Statistics Canada's public and private investment spending intentions survey. The equipment and commercial vehicle new business penetration rate has varied over the last few years - reaching a low of 26% in 2009 and bouncing back to a high of 44% in 2013. In 2017, the penetration rate remained unchanged from 2016 at 41% and is expected to remain there in 2018.

Canadian Asset-based Finance Market Penetration Rates			
	2018 F	**2017**	**2016**
Equipment & Commercial Vehicles New Business	34,439	33,274	32,397
Spending on New Machinery & Equipment	83,372	80,552	79,432
Finance Penetration Rate	*41%*	*41%*	*41%*
Consumer Market New MV Sales (units)	1,652,473	1,689,205	1,598,228
Lease	641,000	622,000	524,000
Loan	886,000	931,000	938,000
Lease Penetration Rate	*39%*	*37%*	*33%*
Finance Penetration Rate	*92%*	*92%*	*91%*

Source: CFLA, Statistics Canada, DesRosiers Automotive Consultants Inc.

The penetration rates for the consumer new motor vehicle sales segment are based on units sold (the dollar value ratios are very similar to those for the units).[4] The value of new and used retail vehicle leases declined rapidly after 2007 from $20 billion down to just $3 billion in 2009. New leasing of new and used retail vehicles recovered to $24 billion in 2017 and is forecast to reach $26 billion in 2018. While the lease rate on new vehicles is still below the 2005 peak of 45% it is rapidly approaching that level. The lease penetration rate rose to 37% in 2017 and expected to be 39% in 2018. The overall share of new consumer vehicles financed is relatively constant at just over 90%.

New Business Finance by Region

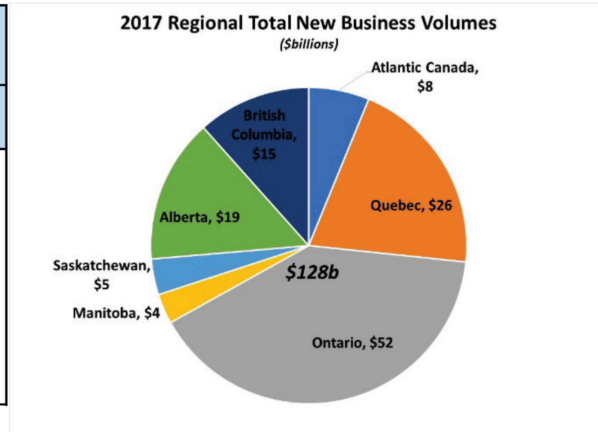
This year's report includes estimates of new business financed by region for equipment and commercial vehicles, retail vehicles and the total market. These estimates are derived from the national totals using information from Statistics Canada, PayNet and DesRosiers.

In 2017, Ontario accounted for 40% of total new business finance volumes followed by Quebec with 20%. On average, new business finance volumes have grown 3% a year nationally over the last decade. Growth across most regions is close to this average over the last decade with the notable exception of Alberta, where the severe slump following the collapse of oil prices in 2014 left the province with no growth at all over the same decade.

[4] Note: this table excludes consumer purchases of used motor vehicles.

2017 Regional Total New Business Finance Volumes	**Share**	**Avg %ch 2007-17**
Atlantic Canada	6%	4%
Quebec	20%	3%
Ontario	40%	4%
Manitoba	3%	4%
Saskatchewan	4%	5%
Alberta	15%	0%
British Columbia	12%	3%
Canada	**100%**	**3%**

Source: Canadian Finance and Leasing Association



Ontario accounts for 37% of the $33 billion in equipment and commercial vehicle new business finance in 2017 followed by Quebec with 19%. Nationally, new business finance volumes for equipment and commercial vehicles have been stagnant over the last decade. Over the last decade, Saskatchewan defied the national average with growth of 4% per year. Alberta also outperformed the nation with average annual growth of 2% over the same decade.

2017 Regional Equipment & Commercial Vehicles New Business	**Share**	**Avg %ch 2007-17**
Atlantic Canada	6%	0%
Quebec	19%	1%
Ontario	37%	0%
Manitoba	3%	-1%
Saskatchewan	6%	4%
Alberta	19%	-2%
British Columbia	10%	-1%
Canada	**100%**	**0%**

Source: Canadian Finance and Leasing Association

Ontario accounts for 41% of the $95 billion in retail vehicle new business finance in 2017 followed by Quebec with 19%. Nationally, new business finance volumes for retail vehicles have grown, on average, 5% over the last decade. Growth across most regions is close to this average over the decade with the notable exception of Alberta where the severe slump following the collapse of oil prices in 2014 left the province trailing with 2% growth over the decade.

2017 Regional Retail Vehicles New Business Finance Volumes		
	Share	Avg %ch 2007-17
Atlantic Canada	6%	5%
Quebec	21%	5%
Ontario	41%	6%
Manitoba	3%	6%
Saskatchewan	3%	5%
Alberta	13%	2%
British Columbia	12%	5%
Canada	**100%**	**5%**

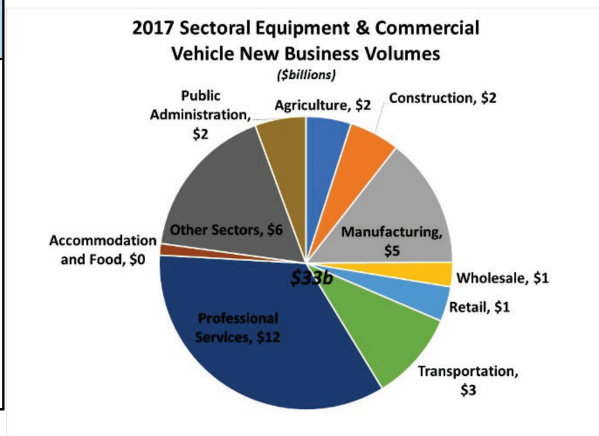
Source: Canadian Finance and Leasing Association, DesRosiers Automotive Consultants

New Business Finance by Sector

This year's report includes estimates of new business financed by sector for equipment and commercial vehicles. The professional services sector accounts for 35% of the $33 billion in equipment and commercial vehicle new business finance in 2017. As previously noted, national new business finance volumes for equipment and commercial vehicles have been stagnant over the last decade. There is, however, significant variation in growth among sectors over this period. The agriculture and public administration sectors led with 7% and 6% average annual growth over the decade while spending by the professional services sector shrank 3% a year over the last decade.

2017 Sectoral Equipment & Commercial Vehicles New Business		
	Share	Avg %ch 2007-17
Agriculture	5%	7%
Construction	6%	2%
Manufacturing	14%	0%
Wholesale	3%	2%
Retail	4%	3%
Transportation	10%	3%
Professional Services	35%	-3%
Accommodation and Food	1%	3%
Other Sectors	17%	1%
Public Administration	6%	6%
All Industries	**100%**	**0%**

Source: Canadian Finance and Leasing Association



New Business Finance by Credit Instrument and Source

New business finance by credit instrument and source is estimated for equipment and commercial vehicles from PMG Intelligence's surveys and from DesRosiers Automotive Consultants' vehicle finance model.

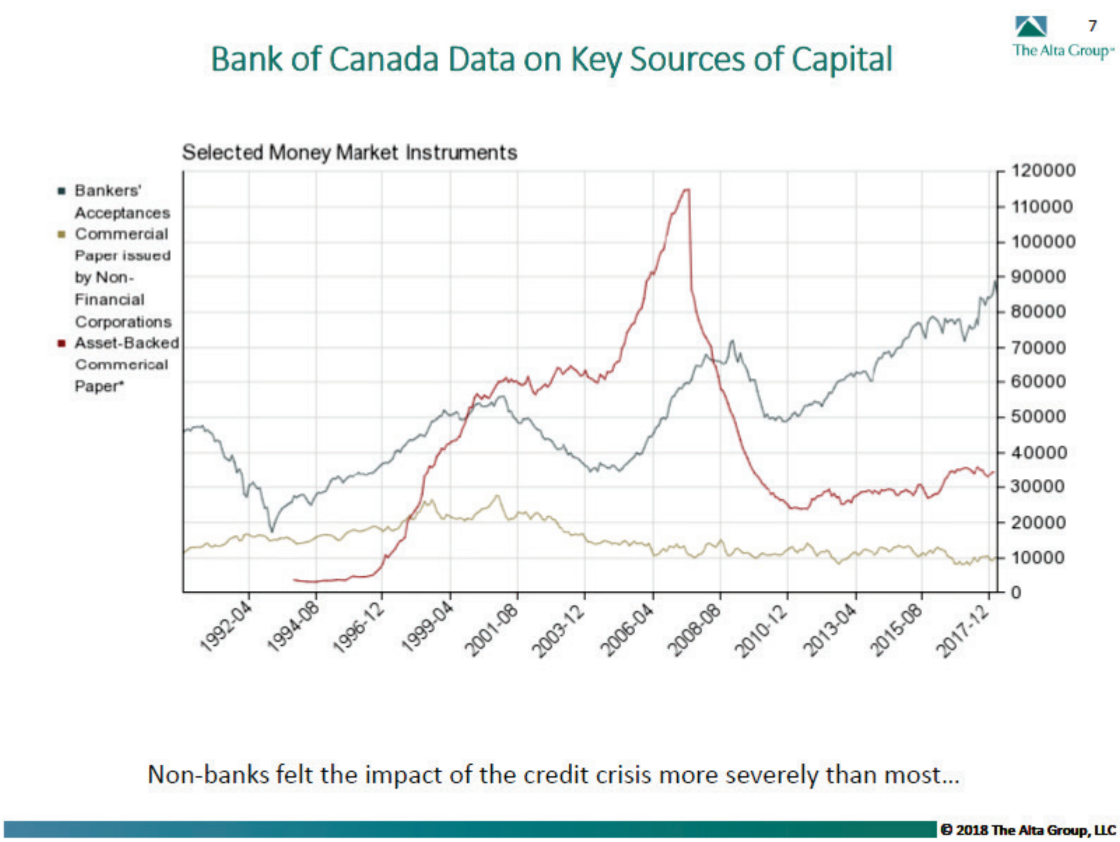
At 38%, leases are the top credit instrument for financing equipment and commercial vehicles followed by lines of credit at 28% with banks supplying 42% of this credit in 2017.

Secured loans account for 73% of new and used retail vehicle finance with 50% of this credit supplied by manufacturers' captive finance companies in 2017. Banks supplied 39% of this credit and independent finance companies supplied the remaining 11%.

New Business Finance by Credit Instrument and Source in 2017

	Equipment & Commercial Vehicles		Retail Vehicles	
	$ millions	% share	$ millions	% share
Finance by Credit Instrument				
Lease	12,610	38%	26,000	27%
Secured Loan	7,501	23%	68,800	73%
Line of Credit	9,318	28%		
Credit Card	3,844	12%		
Finance by Source				
Banks	13,924	42%	36,644	39%
Independent Finance Companies	8,917	27%	10,519	11%
Manufacturers' Captive Finance Co.	7,621	23%	47,636	50%
Other Finance Companies	2,811	8%		

Source: Canadian Finance and Leasing Association, DesRosiers Automotive Consultants Inc.



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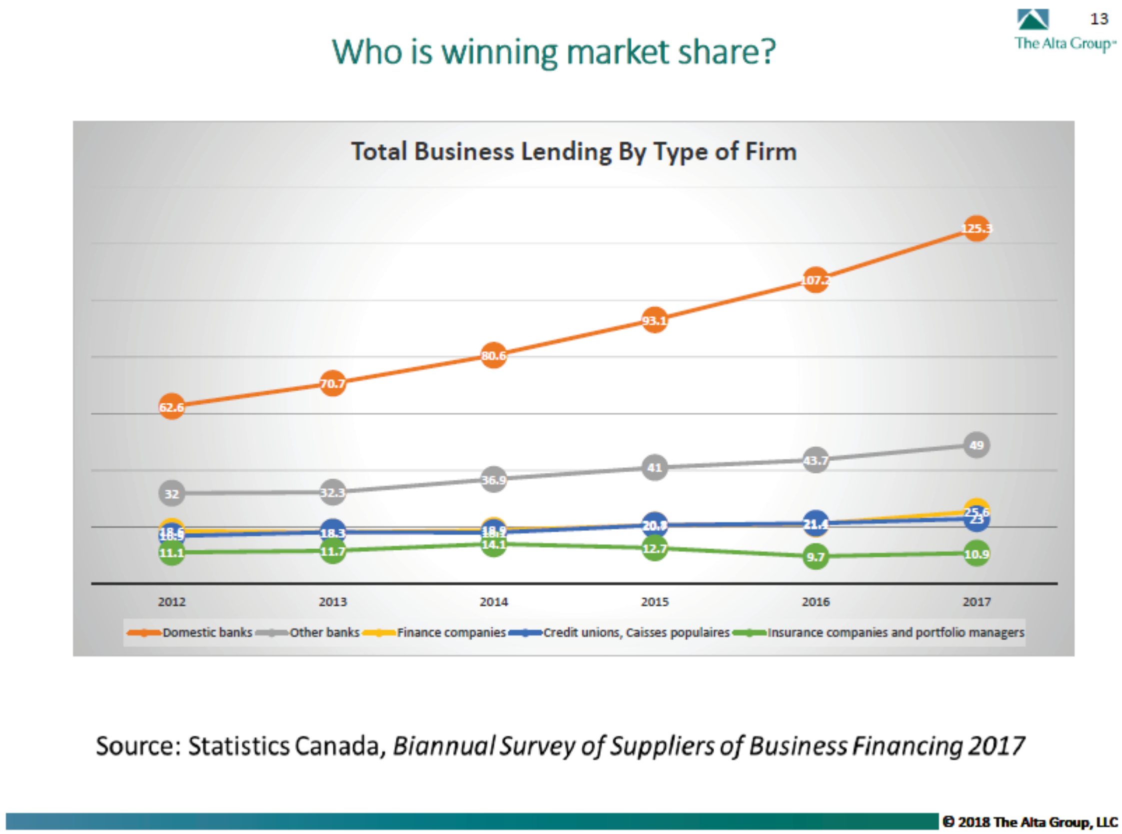
Official government statistics for sources of business financing do not distinguish between the various uses for those funds. As such, it includes financing for operations, mergers and acquisitions, investment in real estate as well as spending on machinery and equipment.

The Bank of Canada's data on sources of capital shows that commercial paper issues by non-financial corporations and asset-backed commercial paper volumes have experienced modest growth since 2010 while bankers' acceptances volumes have risen substantially since then. Although this financing supports much more than just spending on new machinery and equipment, it clearly highlights the rising importance of the banking sector as a source of capital.

The dominance of the nation's banking sector in business financing is reinforced by Statistics Canada's Biannual Survey of Suppliers of Business Financing. Data from this survey shows that lending by domestic banks to businesses has doubled since 2012 while lending by all other sectors has grown by less than half as much.



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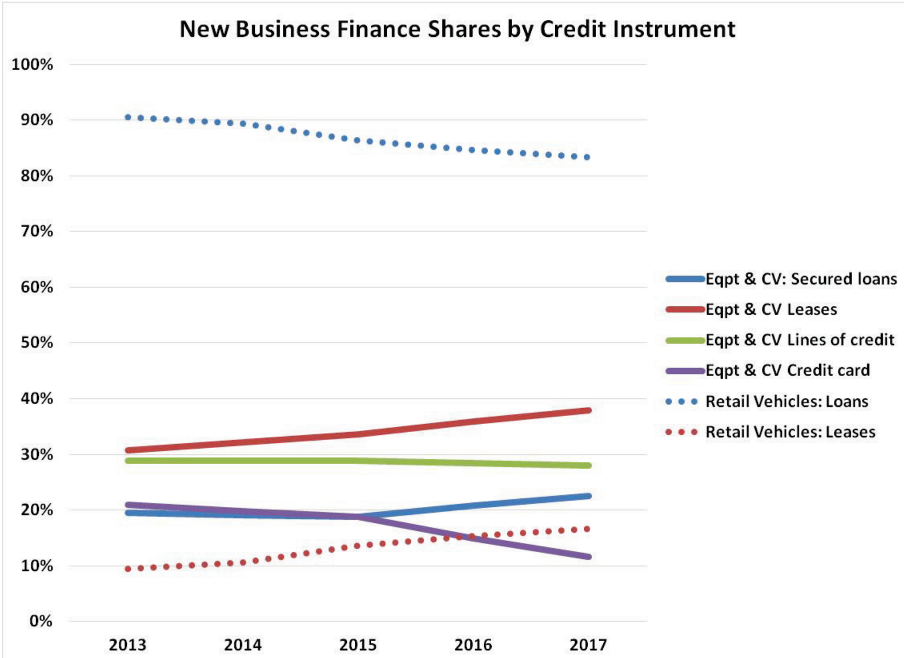
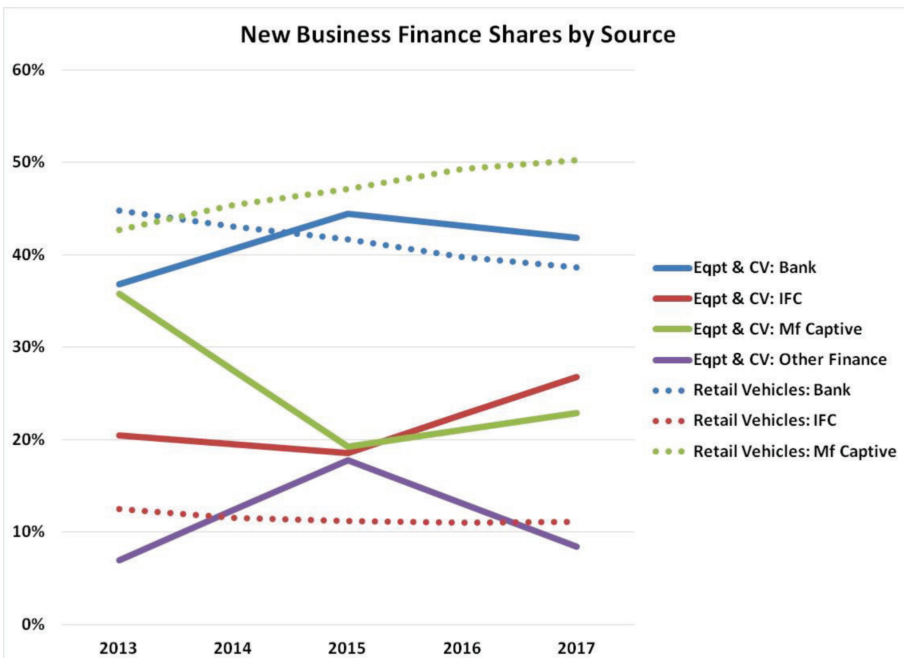
While Canada's domestic banks have made significant gains on their already solid position as a source of business finance since the financial crisis, CFLA estimates that their dominant position as a source of finance for the asset-backed acquisition of retail vehicles may have slipped slightly in the last few years given recent shifts in consumer vehicle financing patterns.

CFLA's estimates, derived from the PMG Intelligence survey and DesRosiers Automotive Finance model data, are shown for the years 2013 to 2017 in the following charts. The lease shares of equipment and commercial vehicles (red line, 31% to 38% in 2017) and retail vehicles (red dot, 9% to 17% in 2017) have both risen since 2013. Trends for other credit instruments used to finance equipment and vehicles are less clear.



Source: Canadian Finance and Leasing Association, DesRosiers Automotive Consultants

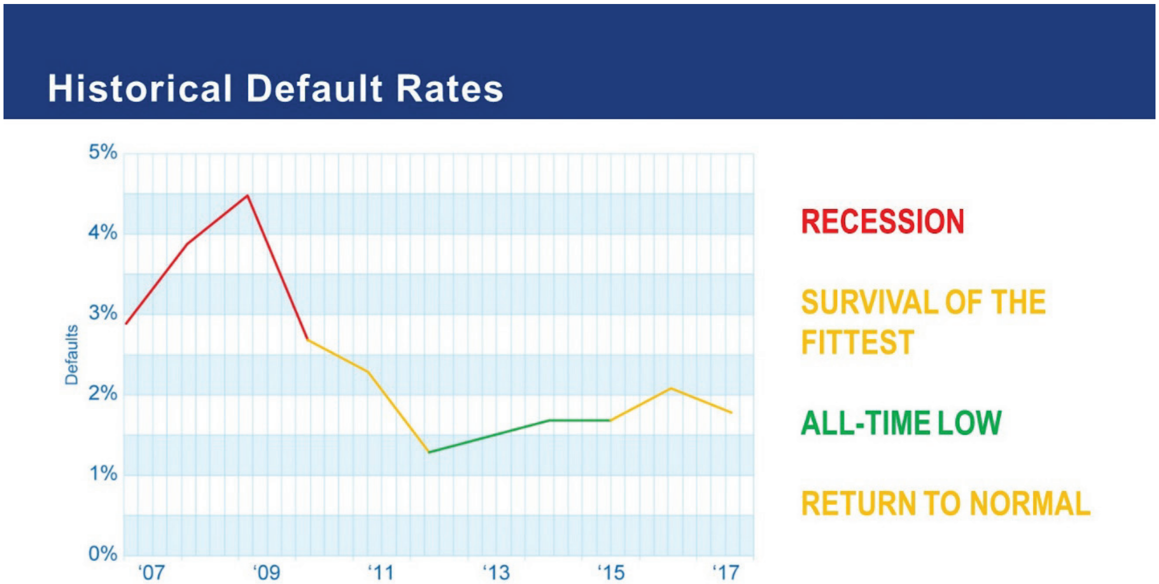


Source: Canadian Finance and Leasing Association, DesRosiers Automotive Consultants

When allocated by source of financing, the banks (blue line) can be seen to have made limited gains since 2013 while manufacturers captive finance companies (green line) share of the market has declined from 36% in 2013 to 23% in 2017. The shares of new and used retail vehicles financed by banks (blue dot) has fallen from 45% in 2013 to 39% in 2017 while manufacturers captive finance companies (green dot) share has risen from 43% to 50%.

Credit Quality

The distinct nature of asset-based financing of equipment and vehicles ensures that delinquency rates are low relative to other types of lending. The economic slump arising from the collapse in global oil prices eventually fed through to a minor increase in equipment and commercial vehicle default rates in 2016 which improved, along with the economy, in 2017. Default rates, however, remain well below the peaks seen after last decade's financial crisis.



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Equipment and commercial vehicle 30 day and 90 day delinquency rates both fell in 2017 and have remained low through the first half of 2018. Low interest rates have enabled households to maintain payments on their motor vehicles with delinquency rates remaining largely unchanged over the last few years. Recent increases in interest rates may well yield higher delinquency rates for retail vehicles over the next few years.

Asset-based Finance Delinquency Rates in Canada				
	Equipment & Commercial Vehicles		Retail Vehicles	
	30 day	90 day	30 day	90 day
2018 (1st half)	1.0%	0.3%	1.4%	0.7%
2017	1.0%	0.3%	1.4%	0.7%
2016	1.2%	0.4%	1.5%	0.7%
2015	1.0%	0.3%	1.4%	0.7%

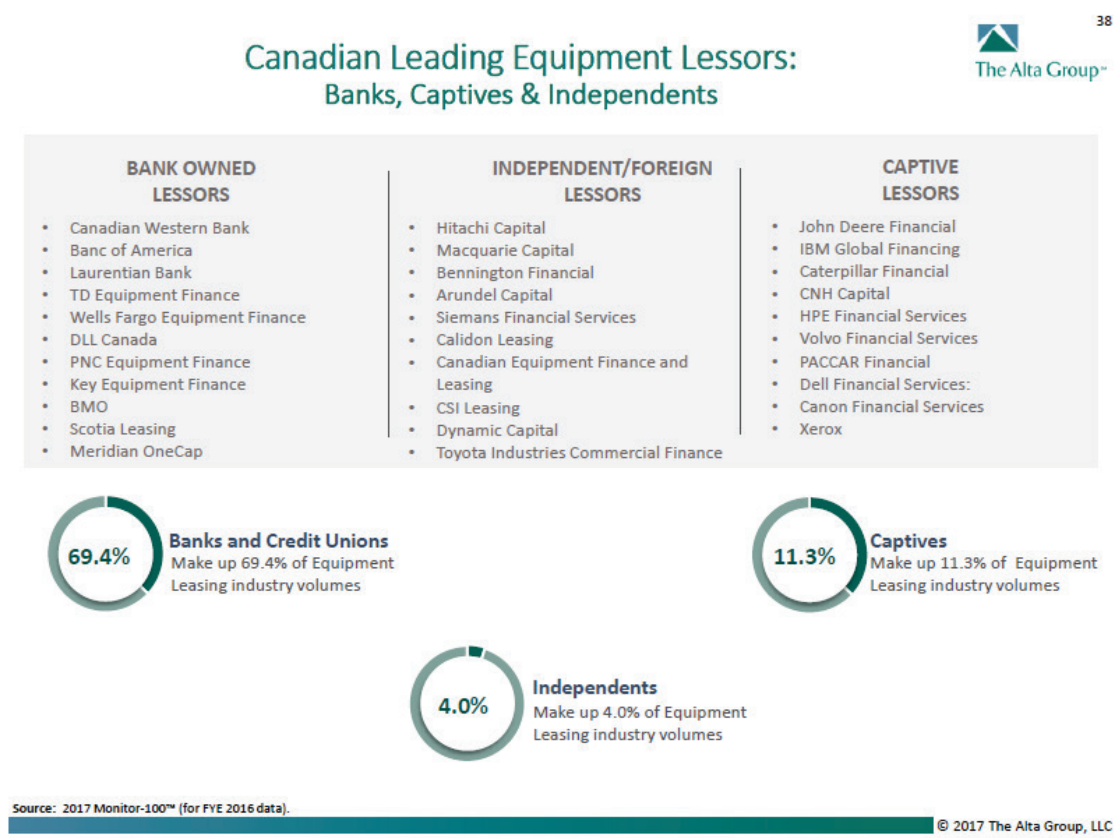
Source: Paynet, Equifax Canada Co.

Paynet's small business delinquency indices show that 30 day and 90 day rates are low by historical standards for all sectors but the accommodation and food services sector which continues to experience the highest delinquency rates of all the sectors followed by Paynet. Small business delinquency rates in 2017 are lowest in Saskatchewan and highest in Ontario for 30 day and in Quebec for 90 day rates. The gap between top and bottom is about 60 bps for 30 day and 30 bps for 90 day delinquencies. Equifax Canada notes upward trends in 90 day automotive finance delinquency rates in British Columbia, Alberta, Ontario and Prince Edward Island in the second quarter of 2018 over year ago rates provide some cause for concern.

Focus on Large Companies

The asset-based finance sector is home to a large number of companies operating in a highly diverse and competitive market. As is the case for many industries, a few large companies dominate the market. The Alta Group has compiled a list of the top 10 companies by 2016 new business volumes for each market vertical: bank owned, independent and captive. The top 10 banks and credit unions account for 69.4% of equipment and commercial vehicle asset-based financing volumes; a massive lead over the top 10 manufacturers' captive finance companies which account for just 11.3% of financing volumes. Independent finance companies are typically much smaller than their counterparts in the bank owned and captive verticals with the top 10 accounting for just 4.0% of the market.

The Alta Group has also tracked noteworthy exits, mergers and new entrants since 2007, just prior to the financial crisis. Their list contains 27 lessor departures where companies have sold their portfolios or platforms and exited the market. There were a further 10 major deals that involved mergers or acquisitions of lessors and banks. Offsetting this industry consolidation was the creation of 10 new companies over the last decade. While this provides evidence of consolidation and concentration in the sector, it still leaves a large number and wide variety of companies that compete vigorously to finance new equipment and vehicles in Canada.



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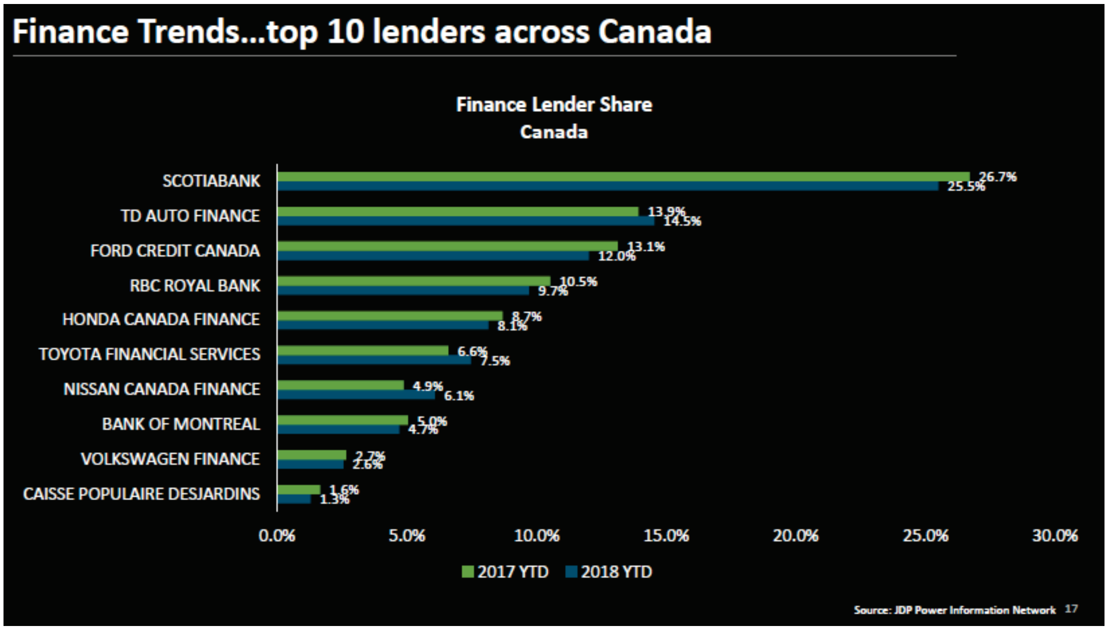
A list of the top 10 retail vehicle finance companies across Canada is compiled by J.D. Power in their Power Information Network (PIN) Canada transaction database. The five banks in the list account for 57.7% of the activity in 2017 while the five manufacturers' captive finance companies account for 36.0%.



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Focus on Small Companies

One of the unique aspects of the asset-based finance sector in Canada has been the significant presence of small companies in the industry. Many of these companies appear to have thrived despite low lending volumes as they have remained in business for many years or even decades. Data for the last two years may, however, signal a significant shift in the structure of the industry as the number of small companies has declined rapidly.

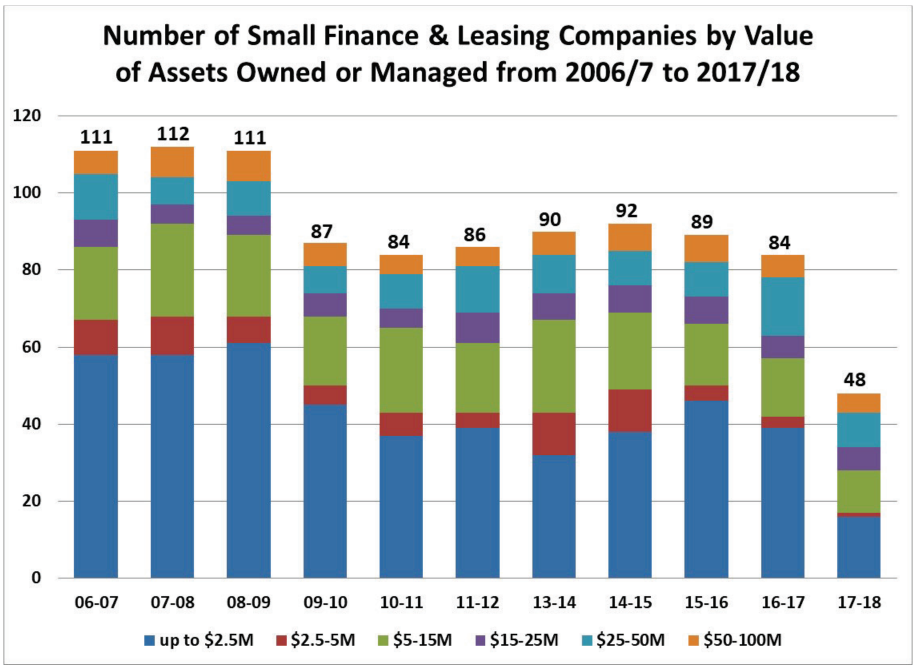
Industry news is typically dominated by larger companies; and so it is perhaps hardly surprising that the small companies can get lost in the crowd as the value of assets owned or managed by these companies represents less than 0.5% of financed vehicle and equipment assets in Canada. But, arguably, the most significant development highlighted in this year's report of industry activity is the rapid decline in the number of small asset-based finance companies. This shift may represent the end of the era of small, independent entrepreneurs as retirement takes its toll on the generation of innovators from the 1980s and 1990s. Alternatively, it may also signal that scale is now increasingly important for success in this market. Finally, the association may just be experiencing more difficulty getting small member companies to renew their memberships. As is often the case, the truth may be a combination of these explanations.

For the purposes of this section, 'small' companies are defined as CFLA member companies that report assets owned or managed of $100 million or less.[5] These companies have typically represented a

[5] CFLA's membership information is used to construct the data reported in this section. QEDinc maintains the confidentiality of that information and only uses it for purposes authorized by CFLA.

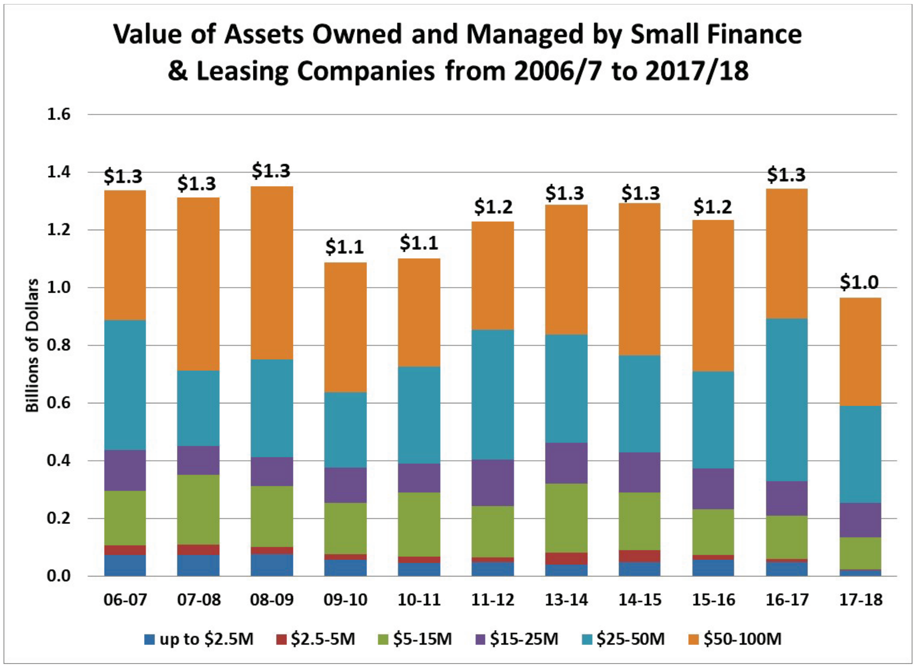
majority of member companies - about 80% of regular members prior to 2017/18. The financial crisis had a dramatic impact on the number of small companies in the industry. Over 20% of small companies left CFLA - and likely the industry - in 2009/10 and, while this number recovered slightly over the next few years, they have been declining since 2014/15. In 2017/18, the number of small companies dropped by over 40% and they now represent just 56% of all CFLA regular member companies.

The decline in small member companies appears to be concentrated amongst the smallest of these companies: those with assets owned and managed of $5 million or less. These companies now represent just 35% of all small member companies where they were over 60% of them before the financial crisis and still 50% of them last year.



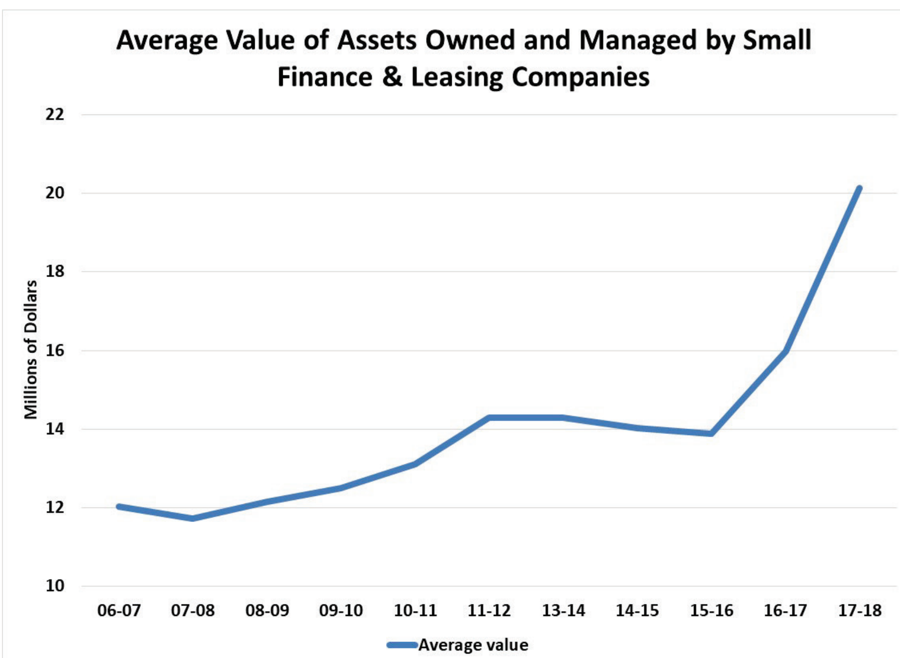
Source: Canadian Finance and Leasing Association

The total value of assets owned and managed by small member companies is estimated based on their self-reported value for purposes of membership dues. The value of assets held by these companies plunged by nearly 20% in 2009/10 but recovered in 2016/17 to near pre-crisis peak levels before falling nearly 30% in 2017/18. Again, the value of assets owned and managed by companies with less than $5 million in assets have shrunk in the last few years. Indeed, the value of assets held by companies with less than $25 million in assets has also fallen since 2013/14.



Source: Canadian Finance and Leasing Association

It should come as no surprise that the average value of assets owned and managed by small companies has grown over time. Part of this phenomenon can simply be attributed to inflation, but the average value jumped to $16 million in 2016/17 and then to $20 million in 2017/18 from about $14 million in the period 2011/12 to 2015/16. This result supports the observation that size is becoming a more important factor in determining profitability throughout the industry.



Source: Canadian Finance and Leasing Association

Appendix: Market Size Methodology

CFLA's definition of the asset-based finance market is broader than that used before 2013 but the core principle remains consistent: the financing is used to purchase machinery, equipment and vehicles where the finance company retains ownership of the asset for the life of the contract. Asset-based finance remains significantly different from traditional lending in the structure of the finance contract, the pricing of risk and the assessment of value of the asset during and after the contract ends.

This year's estimates for industry activity are derived from a variety of sources: PMG Intelligence, PayNet, DesRosiers Automotive Consultants Inc, Equifax Canada Co, CFLA and Statistics Canada. A survey by PMG Intelligence of end-user finance of spending on machinery, equipment and commercial vehicles in the private sector was commissioned by CFLA to follow up on the previous surveys conducted in 2013 and 2015. PayNet's Canadian Equipment Lending Index (CELI) provides insight on the finance of machinery, equipment and commercial vehicles on a monthly basis by region and sector. Data for the consumer and fleet vehicle market segments is derived from DesRosiers Automotive Consultants Inc.'s vehicle finance model and Equifax Canada Co's Auto Credit Trends publications. CFLA's membership data provides information on the activity of member companies with under $100 million in assets financed. And finally, Statistics Canada's Capital and Repair Expenditures Survey provides a benchmark for the estimates and is used to estimate public sector finance of new assets.

While there is no change in the type of assets included in the statistics, lines of credit have been added to the list of credit products (that is, to leases, secured loans and conditional sales contracts). Lines of credit using equipment as the main collateral have long been common for key segments of the industry, particularly in the farm sector, and are now growing in importance for mid-ticket business where all of a customer's equipment financing needs can be met by providing them with a line of credit secured against the equipment acquired with that credit.

Finally, the list of credit providers is now an economy-wide, comprehensive list that includes banks, credit unions, insurance companies, government agencies, the finance affiliates of manufacturers (the so-called “captive finance companies”), independent finance companies and vendors, many of whom were not included in CFLA member surveys in the past.

PMG Intelligence's survey of end-user activity is used to generate a set of estimates of the value of new finance in the private sector of equipment and commercial vehicle assets. The methodology is summarized in the figure below and yields a range of estimates that vary from a low of $19.1 billion to a high of $45.4 billion representing either an increase of 28% or a decrease of 46% from the estimate for new business in 2015. The average across all estimates was $30.3 billion representing a 14% decline from activity in 2015. CFLA estimate of private sector new business in 2017 was adjusted up from this level to $33.3 billion (a decline of 6% from activity in 2015) so as to better reflect the year to date strength in Paynet's CELI.

Number of businesses in Canada
X
Proportion that purchase M&E in 2017
X
Mean % of time transaction is financed
X
Median value of equipment financed
=
Estimated market

By:
Customer Sector (Goods/Services)
Customer Size (Small/Medium/Large)

Asset-Based Finance in Canada: Market Overview 2017 – 2018

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