

The State of the Equipment Industry



JAMES WAITE LAW
EQUIPMENT INDUSTRY LAWYERS



September 6, 2023

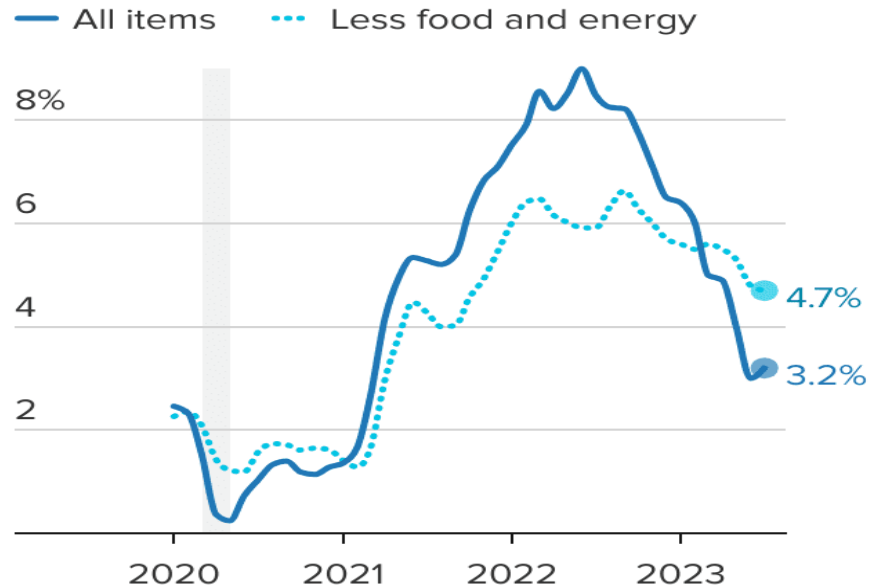
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The World Economy in 2023

Inflation
Remains High
but is cooling.
Now 3.2%
(Was 9.1% in 2022)

U.S. consumer price index

Year-over-year percent change through July 2023



Note: Shaded area indicates recession.

Chart: Gabriel Cortes / CNBC

Source: U.S. Bureau of Labor Statistics

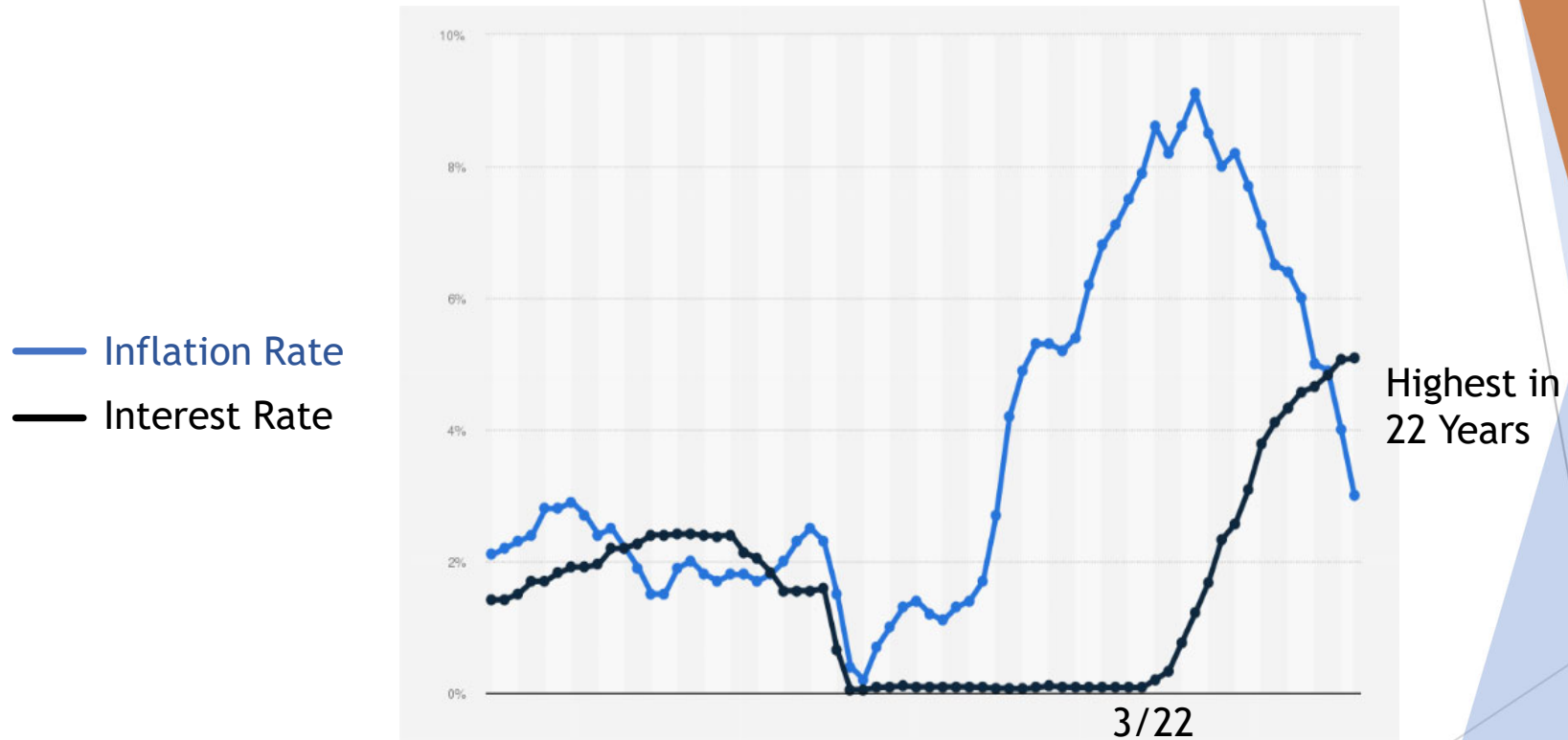
Data as of Aug. 10, 2023



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The World Economy in 2023

... As the Fed Raises Interest Rates



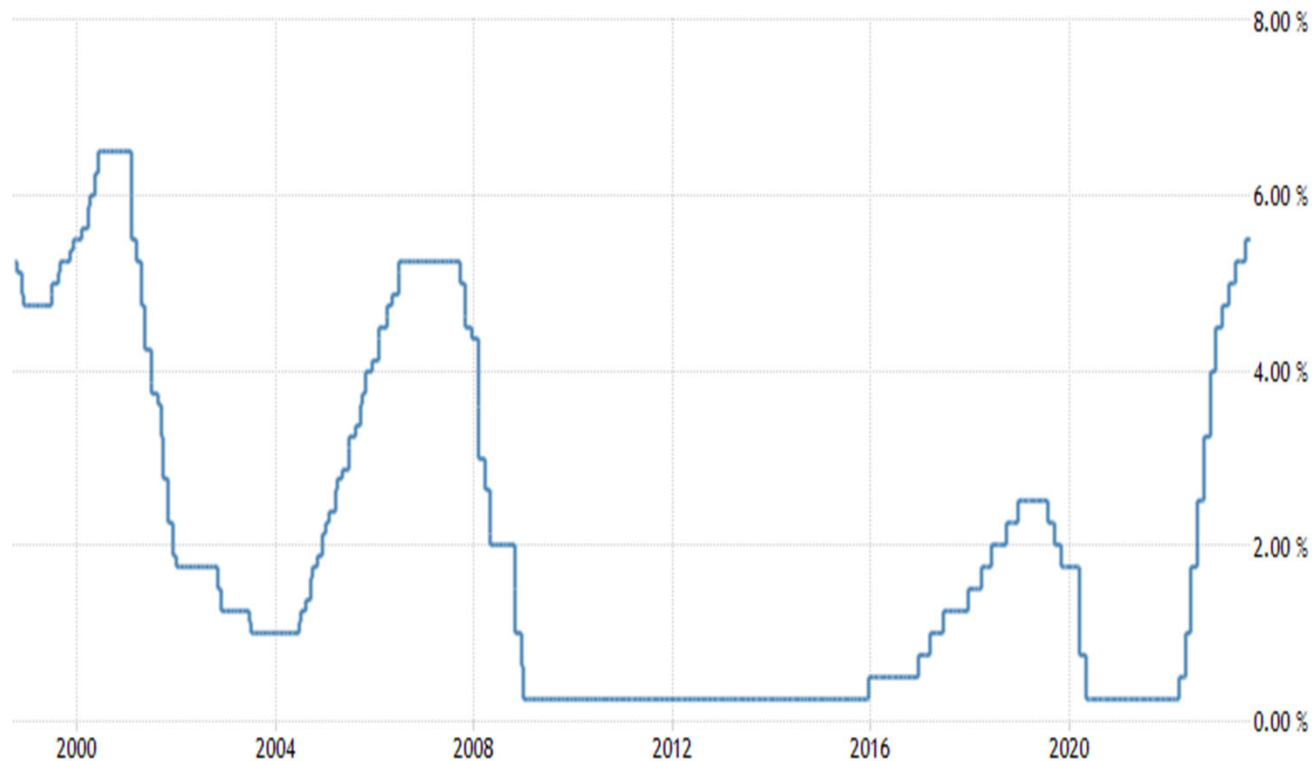
General Consensus: 90% chance no rate hike at next meeting on 9/19.

Note: We believe at least one more rate hike will occur before year-end.

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Interest Rates (Past 25 Years)



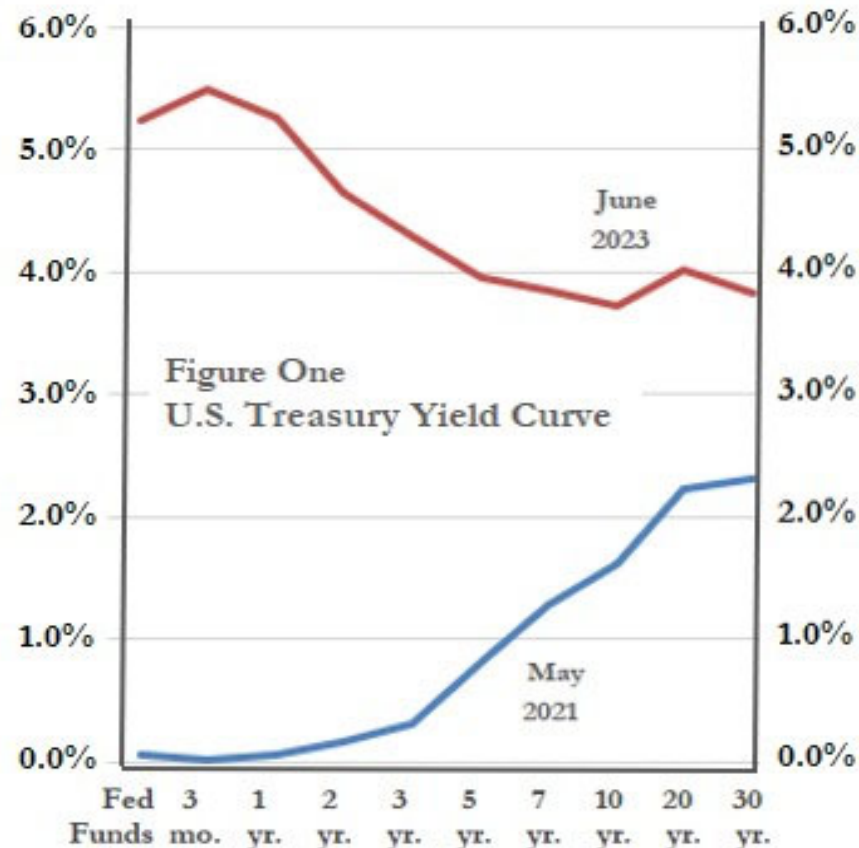
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The World Economy in 2023

The Yield Curve has Inverted

- Usually, treasuries must pay *higher* yields over longer terms to account for the tie-up. But now, investors feel safer buying low-return treasuries than they do risking more in the market (because they think it may crash).
- Increased demand for treasuries has driven down their yields.
- Since the 1960s, ***inversions have predicted all eight US recessions***, beginning ***roughly one year in advance***.
- Not only has each inversion been followed by a recession, but no recession has occurred in the *absence* of a prior yield curve inversion.



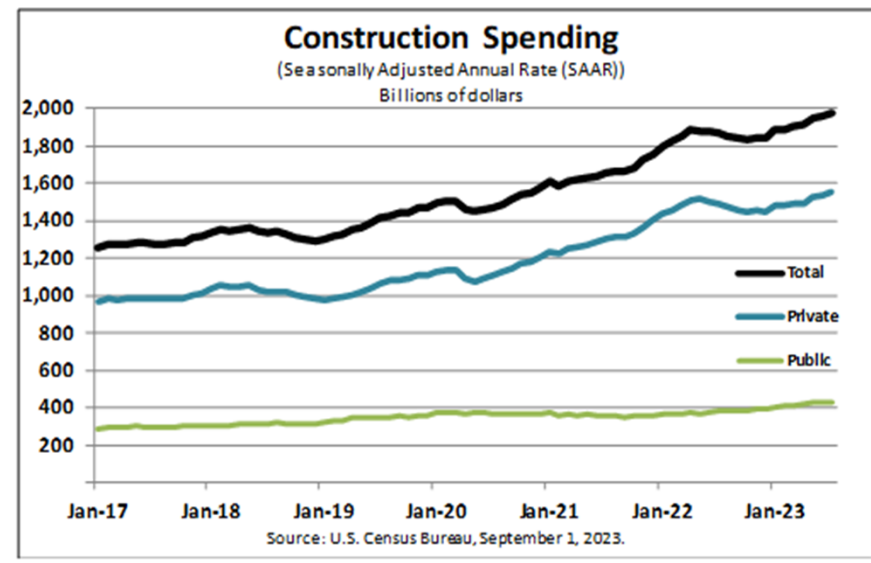
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WHAT ELSE - NATIONALLY / GLOBALLY?

- **Growth** is cooling
 - GDP Growth was 2.1% in 2022
 - It was 5.9% in 2021
- **Credit Availability** is tightening (M2 down, savings reduced, banks' cost of funds is rising = limited cash available to lend)
- **Credit Card Debt** is Growing Rapidly:
 - U.S. Credit Card Debt exceeded \$1 trillion for the first time ever in August, 2023.
 - 20% of Consumers are now buying groceries on credit cards
 - Avg. U.S. Credit card rate is now 27.99% (*Forbes*);
- **Savings are Dwindling:**
 - U.S. Savings down from \$2.1 trillion in 8/2021 to \$500 billion today (per SF Federal Reserve)
- **Adjustable Rate Mortgages:** 18.6% of new applications in April (up from 4% after the last downturn).
- **Defaults are Rising:**
 - 3.2% corporate default rate as of 6/23;
 - S&P forecast for 2024 is 4.5% base case and 6.25% pessimistic case
- **U.S. Commercial Vacancies** hit a record in Q1 (18.6%)
- **Insurance Market for Equipment:** Tightening and becoming more expensive
- **Fuel Prices:** Gas and Diesel prices are soaring (diesel up over 40% since May, 2023). Saudi Arabia and Russia extended production cuts through 12/31.
- **U.S. Homebuilder Confidence** fell in August (the first time this year)
- **Chinese Real Estate** is Collapsing (approx. \$390 billion in defaults)
 - China drives over 40% of global economic growth (the U.S. drives 22%)
 - U.S.-China trade declined by 15.4% from 2022 to 2023

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WHAT'S THE GOOD NEWS?

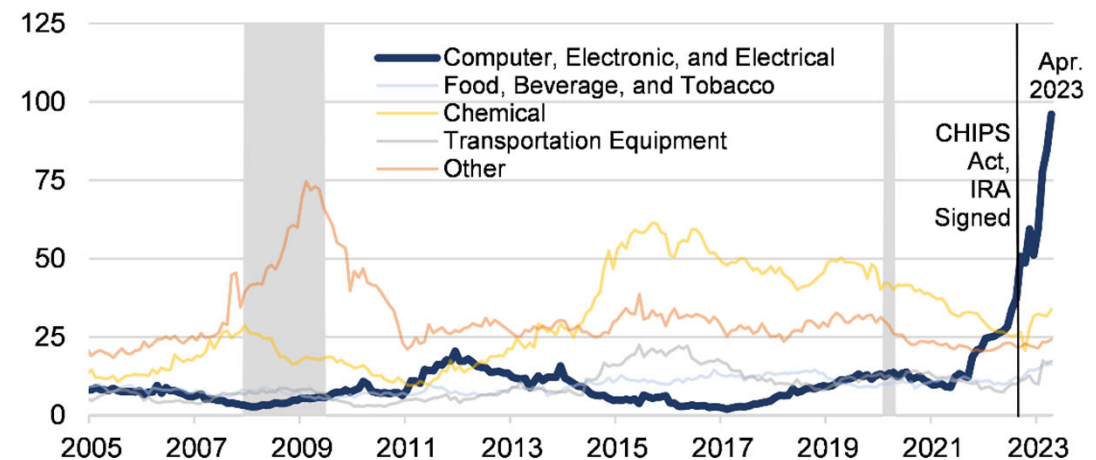


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- ▶ Infrastructure: \$1.2 trillion per IIJA for roads, bridges, transit systems, airports, waterways, drinking and waste-water systems, and energy infrastructure.
- ▶ Manufacturing: Surprise upturn in construction spending (doubled since 12/21).
- ▶ Power and Utilities: 8% growth anticipated;
- ▶ Data Centers: Driven by increased demand for online shopping and work-from-home employees.

Figure 2: Real Manufacturing Construction Spending by Type

Billions of 2022 U.S. Dollars

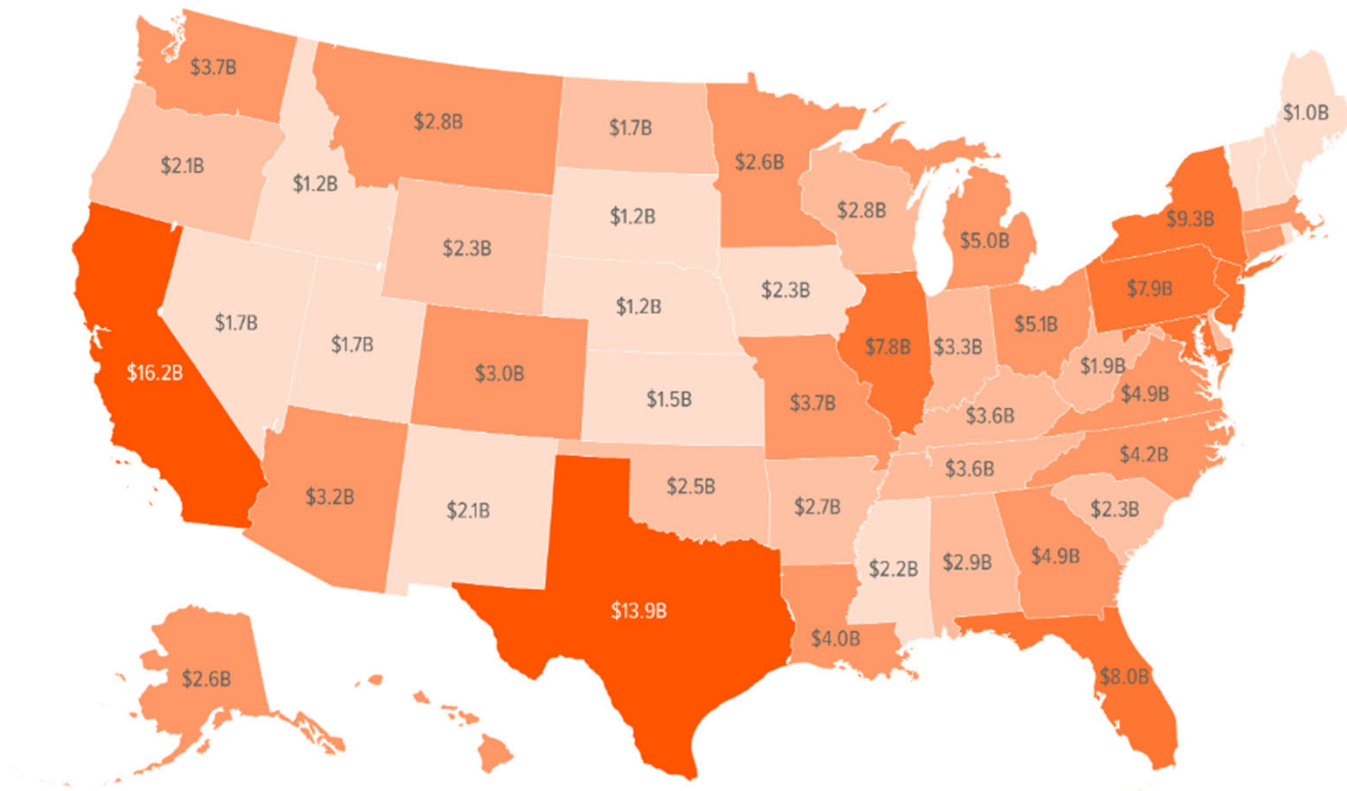


Notes: Value of Private Construction Put in Place for Manufacturing, U.S. Census Bureau, decomposed by Detailed Type. Monthly at a seasonally adjusted, annualized rate. Nominal spending deflated by the Producer Price Index for Intermediate Demand Materials and Components for Construction, Bureau of Labor Statistics.

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ANNOUNCED INFRASTRUCTURE INVESTMENT AND JOBS ACT FUNDING BY STATE (\$,BILLIONS)

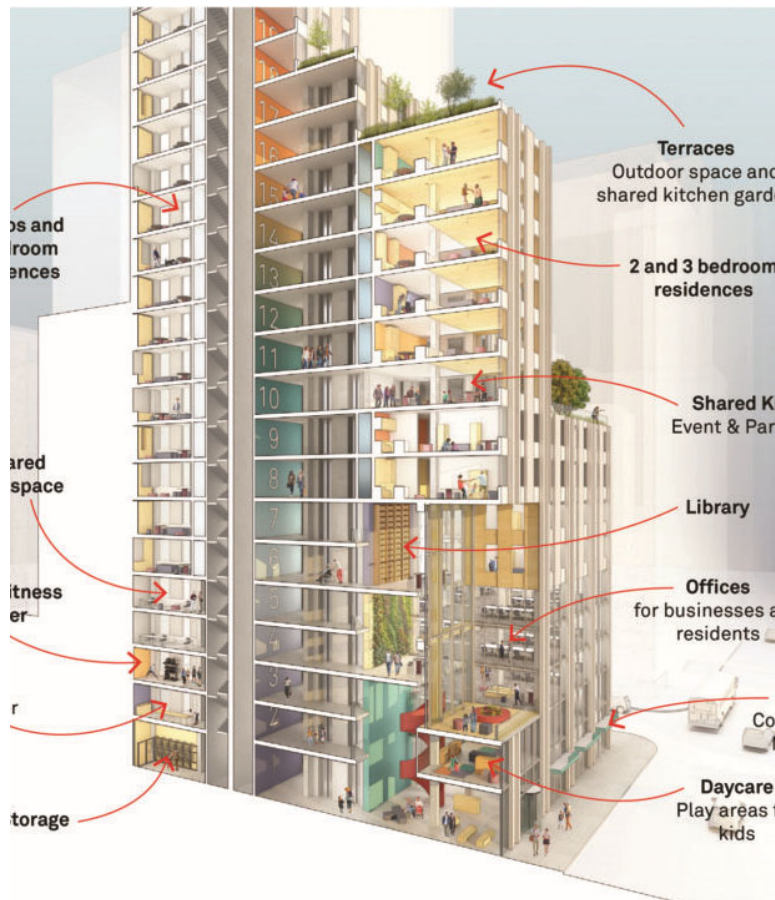
Source: Data to Decisions (D2D). (2022, October 25). Bipartisan Infrastructure Law (BIL) maps dashboard. General Services Administration.



Note: As of October 25, 2022.

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► Office Conversions being considered in multiple cities, including New York, San Francisco, Boston, Denver, Pittsburg, Seattle and Washington D.C.
(Is this adjusting inventory composition?)



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Shifting Sands:

- “Up” (?) Markets:
 - **Commercial:** Up 0.1% in July to \$1.08 trillion.
 - **Manufacturing:** Up 70.8% over 12 mos. 1.1% growth in July.
 - **Warehouse:** Now over 50% of commercial investment.
 - **Lodging:** Planned new hotel construction up by 7% through 8/23.
 - **Transportation:** Grew 8% annually, but down .9% in July.
 - **Hwy & Street:** Up 11.9% annually, but down .7% in July.
 - **Water Infrastructure:** Up 10% for year; 0.5% in July.
 - **Healthcare:** Despite 10.9% annual growth, down 0.8% in July.
 - **Amusement & Recreation:** 8.2% annual growth; down 0.4% in July.
 - **Sewage & Waste Disposal:** Despite prior growth, down 1.2% in July.

Net Result: Total construction spending increased by 0.7% in July (but declined in real terms when adjusted for inflation).

“Despite solid expectations for construction spending growth, drops in public construction spending categories jolted expectations.” *Construction Dive 9/5/23.*

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Shifting Sands:

- **Down Markets:**
 - **Residential:** Unaffordability driving down confidence (new home sales down 20% year over year, and new home prices are down more than 10%).
 - **Office:** Rising vacancies resulting in stalled / abandoned projects.
 - **Warehouse:** Down by 25% in 2023 in the U.S. and Europe.
 - **Retail:** Growth in on-line shopping and theft are taking a toll.



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OVERALL IMPRESSIONS

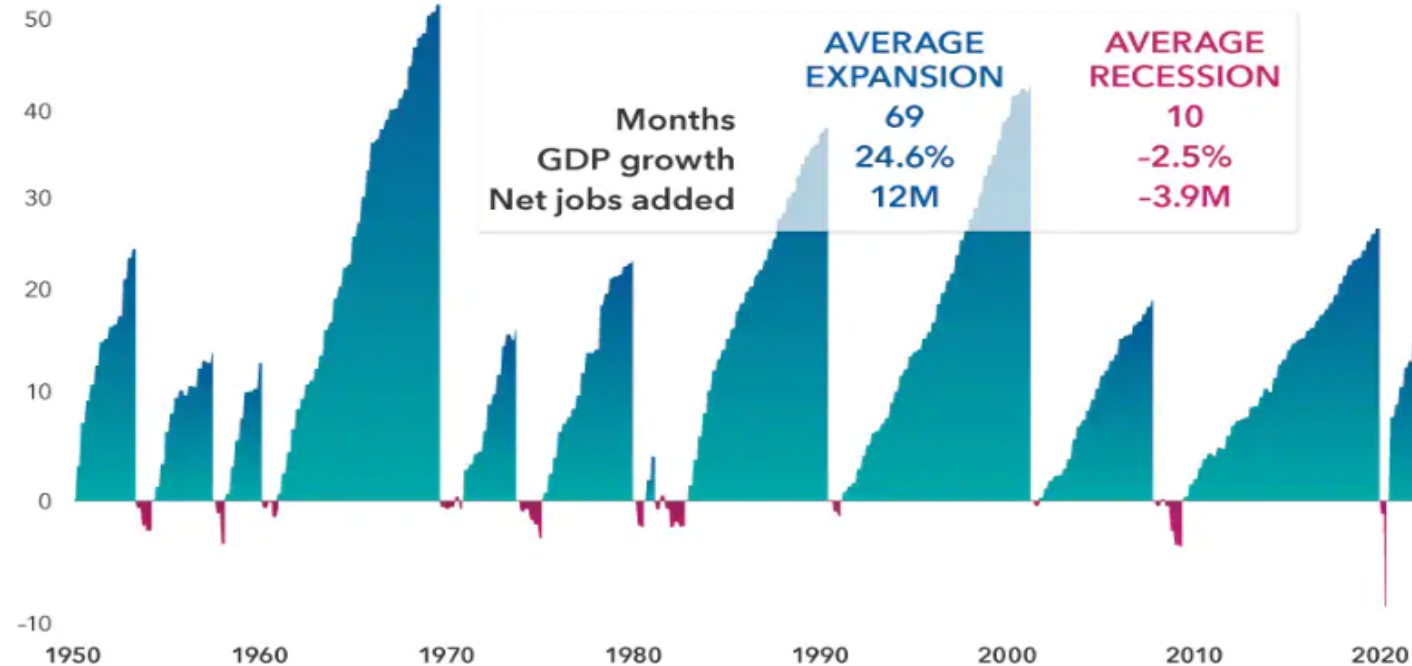
- **Construction:** The current picture is generally positive, but the pace of construction is slowing (cancellations and delays) and the landscape is shifting and a contraction is expected.
- **Equipment Prices:** Up roughly 10% (FMV) over 2022, but price increases are moderating, and FLVs are showing significant weakness (particularly aerial, earthmoving & excavators -10%).
- **Financing:** Equipment financing is becoming more costly and more difficult to find.
- **World Economy:** The world economy is experiencing significant headwinds. Higher interest rates, a Chinese real estate implosion and slowing economic activity have resulted in downturns outside of the U.S.
- **U.S. Economy:** Global challenges, coupled with rising interest rates, tightening credit, persistent inflation and rising defaults may result in an extended recession that derails the positive construction outlook.

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The World Economy in 2023

Recessions are painful, but expansions have been powerful

Cumulative GDP growth (%)



Sources: Capital Group, National Bureau of Economic Research, Refinitiv Datastream. Chart data is latest available as of 8/31/22 and shown on a logarithmic scale. The expansion that began in 2020 is still considered current as of 8/31/22 and is not included in the average expansion summary statistics. Since NBER announces recession start and end months, rather than exact dates, we have used month-end dates as a proxy for calculations of jobs added. Nearest quarter-end values used for GDP growth rates.

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The World Economy in 2023

WHEN?

Table One
**Lags from Yield Curve (YC)
 Inversions to Recessions**

U.S., 1969-2022

<u>YC Inversion</u>	<u>Beginning of Recession</u>	<u>Lag in Terms of</u>	
		<u>Days</u>	<u>Months</u>
6/18/69	1969.12	166	5.5
6/1/73	1973.11	153	5.0
11/1/78	1980.01	426	14.0
10/27/80	1981.07	247	8.1
5/24/89	1990.07	403	13.2
7/7/00	2001.03	237	7.8
7/17/06	2007.12	502	16.5
5/22/19	2020.02	255	8.4
10/26/22			
averages, pre-1985:		248	8.2
averages, ALL YEARS:		299	9.8
averages, post-1985:		349	11.5

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RECOMMENDATIONS

- **Cash:** Accumulate cash
 - Equipment prices remain high but are starting to decline).
- **Debt:** Use debt sparingly for the time being.
 - It is currently expensive.
 - Carefully review leases and financing agreements for hidden renewals and variable interest rates.
 - Credit will loosen and become less expensive if the Fed begins reducing rates to counter a recession.
- **Receivables:** Carefully monitor days outstanding.
- **Customer Defaults:** Be prepared for the worst; Defaults increase, and customers disappear in recessions.
- **Employees:** Carefully document issues. If you need to let people go, good recordkeeping can discourage lawsuits.
- **Rentals:** Consider expanding capacity (rentals tend to weather downturns better than sales), but make sure GPS/telematics are installed and monitored (**theft and overuse**). Consider re-renting.

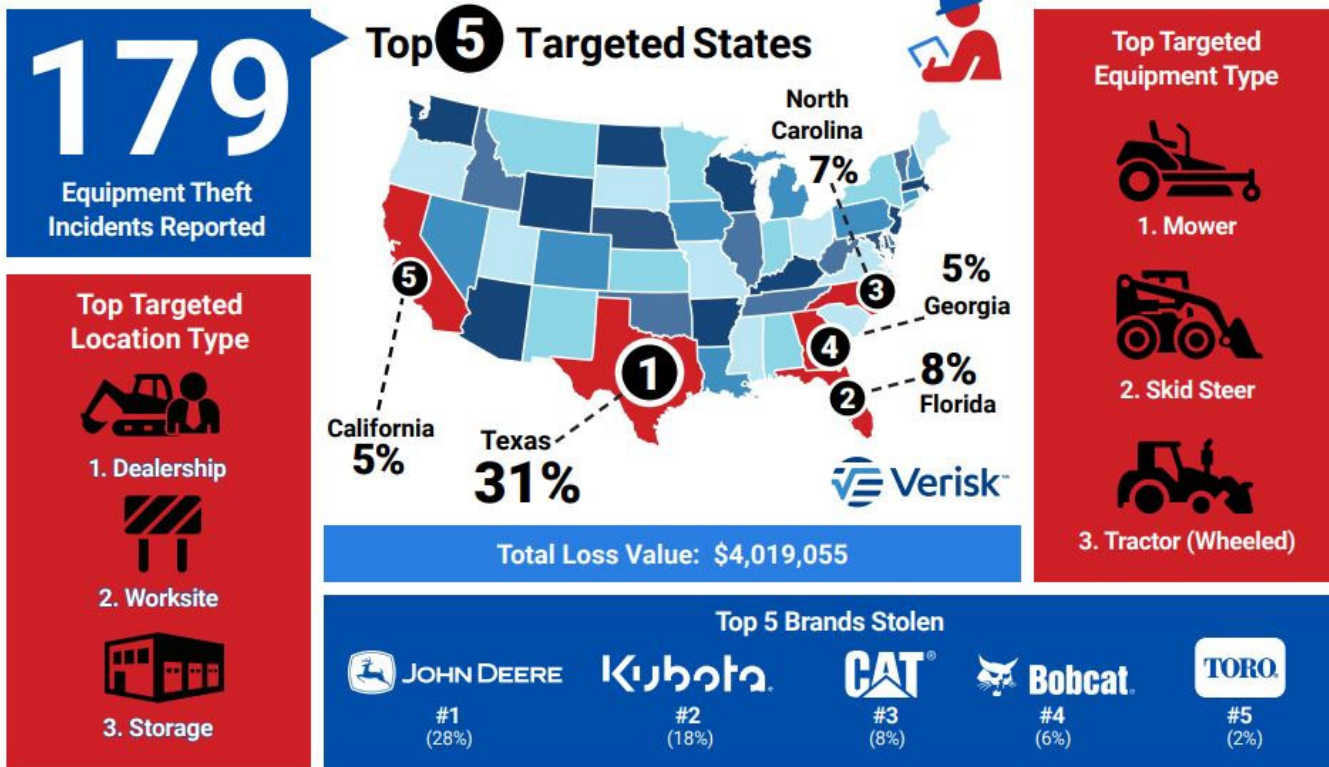


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NER's Labor Day Heavy Equipment Theft Trends 23'

Over the last five years, there has been a rise in theft incidents reported to NER® during the Labor Day holiday. Here is a snapshot of the events, including theft by state, equipment type, location type, theft type, and loss value from the Thursday before Labor Day to the Wednesday after.



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DEFAULTS BY CUSTOMERS AND LESSEES

PREPARE NOW:

- **Update Contracts:**
 - Purchase Agreements
 - Sale Agreements
 - Rental Contracts
 - Consignment Agreements
 - Maintenance, Service and Storage Contracts
- **Customer Financing and Purchase Options:**
 - Be careful with them - they can create “ownership” interests
 - You can lose your equipment to a Bankruptcy Trustee
- **Liens: Timing is Crucial:**
 - Record UCC-1s (20 days for non-inventory / in advance for inventory)
 - File pre-lien statements where necessary
 - Record Mechanics’ Liens
- **Collect Receivables ASAP and Avoid Litigation and Claims**
 - Use your contracts.
 - Delivery and Acceptance
 - Payment obligations
 - Guarantees (Personal and Corporate)
 - Repossession rights
 - Repo / Collection Costs
 - Releases of liability / Hold Harmless
 - Indemnity and Defense
 - Title retentions
 - Security Interests
 - Credit Card Charges
 - Waivers of Stalking laws
 - Interest and Attorneys’ Fees
 - Install and monitor telematics (status, use, maintenance, safety systems, damage, pre-breakdown service etc.)

Contract Language

▶ (This Can Help You or Hurt You)

- ▶ **As-Is Clauses**
- ▶ **Warranty Waivers**
- ▶ **Hour-Meter Waivers**
- ▶ **Defect Waivers**
- ▶ **Inspection and Testing Acknowledgments / Limitations**
- ▶ **Limited Inspection Rights / Periods**
- ▶ **Records Waivers (and/or no, limited, or suspect records)**
- ▶ **Reps / Warranties re: “Complete, in Working Order,” etc.**
- ▶ **Reps/Warranties as to Title, Liens, Right to Sell, etc.**
- ▶ **Reps / Warranties as to Legal Compliance**
- ▶ **Indemnity by Buyer or by Seller? (it depends)**

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Purchases - Other Legal Issues

Other Issues and Potential Threats:

- Waivers of Consequential Damages
- Waivers of Setoffs and Counterclaims
- Peculiar / Suspicious Acknowledgments (damage, repairs, submerging, overturning, compliance failures, salvage titles, etc.)
- “Ex Works” or “FCA” or Lack of UCC/Incoterms
- Shipping Costs
- Taxes and Duties Not Covered
- No (or adjustable) Delivery Date
- Flexible Pricing Terms / Adjustment Mechanisms
- Claim Ceilings
- Personal Guarantees
- Remote Venue Provisions
- No Attorneys’ Fee Provision

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- ▶ Require (and thoroughly complete) inspections prior to payment whenever possible.
- ▶ Delete (line through) anything you don't like in the Bill of Sale or Purchase and Sale Agreement (the Seller may object, but that might tell you something; if not, you win) - *for example, short time limits on claims.*
- ▶ Conduct a UCC Search in each state where the Seller does business, but particularly, in the state of the Seller's original organization - which is where a proper UCC-1 should have been filed (proper names are critical; look for blanket liens) (Note: UCC Sec. 2-312 implies a warranty of clear title *from the Seller*, but the lienholder may ignore this despite UCC Art. 9-320 - "OCB Buyer takes free of even perfected interests").
- ▶ Withhold payoff amounts from seller / pay directly to lienholder(s).
- ▶ Require lienholders to file UCC-3 (partial) terminations.
- ▶ See Contract Issues below (include specific contract terms)

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▶ LIMITING DOWNSIDE RISK:

- ▶ Require Reps and Warranties, including for example:
 - ▶ “The Equipment is free and clear of any and all liens,”
 - ▶ Seller is the Sole and Exclusive Owner of the Equipment;
 - ▶ Seller has good and marketable title to the Equipment;
 - ▶ Seller is duly authorized and has all necessary right, power and authority;
 - ▶ No liens, claims or taxes, pending or threatened, not cleared or paid in full as of the Closing Date;
 - ▶ The Equipment is complete, (new or) in reasonably good order, condition and repair, free of defects and fit for its intended use, operation and environment,”

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Other Legal Issues

LIMITING DOWNSIDE RISK:

- **Also Require:**
 - Seller's consent to contact lienholders directly for Liens and Payoff Amounts.
 - **Closing Contingency:** Buyer's obligation to close contingent upon satisfaction by the Seller of all reps and warranties and receipt/filing of UCC-3 Terminations.
 - **Buyer's Right to Withhold Payments to Seller / Pay directly to lienholder(s).**
 - **Further Assurances:** Seller's agreement to take any and all other actions and execute and file such other documents as may be necessary
...

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Dealer Agreements:

- Dealer Laws can overcome a great many problems in a Dealer Agreement by, among other things:
 - Prohibiting termination without “cause,” “good cause” or “just cause”;
 - Creating Repurchase Obligations of OEMs on termination;
 - Requiring manufacturers to consent to inter-family transfers (in some cases);
- But state dealer laws may not: (a) apply to some or all of your equipment; or (b) address all of the issues created by the dealer agreement (e.g., warranty waivers, damage limitations, expanded termination rights, price increases, and many more).

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Dealer Agreements: Some Key Considerations

- Dealer Laws (Multistate?)
- Authorized Territory
- Authorized Products
- Exclusivity
- Out of Territory Sales Penalties
- Ordering Process
- Product Pricing
- Payment Terms
- Shipping and Delivery Timing and Terms
- Service Obligations
- Warranty Reimbursement Rates
- Warranties by Manufacturer
- Facilities Requirements
- Modifications to Products, Pricing and/or Terms
- Purchase and Stocking Obligations of the Dealer
- National / Institutional Accounts of Manufacturer
- In-Territory Sales by Other Dealers
- Assignment Rights
- Financing / Floor planning Terms
- Terminations – Rights of Manufacturer (“Good Cause?”)
- Notice & Opportunity to Cure Defaults
- Terminations - Effects
- Terminations - Repurchase Obligations of Manufacturer





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EQUIPMENT INDUSTRY LAWYERS

FOR DEALERS

RELATIONSHIPS WITH MANUFACTURERS

- Dealer and Distribution Agreements
- Warranty Obligations
- Service Obligations
- Repurchase Issues

INTERNATIONAL

- Regulatory Compliance
- International Law
- Import/Export Issues
- International Law

CUSTOMER RELATIONSHIPS

- Sales
- Services
- Financing/Floorplanning
- Disputes

LITIGATION

- Arbitration and Mediation
- Insurance
- Liens
- Payment Disputes