

## Structured credit deal of the year

# Hertz \$4.3 billion LBO-related ABS

## Securitization helped the winning sponsor group beat off competition and persuade Ford to sell

BUYOUT ACTIVITY dominated the headlines on both sides of the Atlantic in 2005, but the use of structured finance on the refinancing of the purchase of the Hertz division from Ford gave this phenomenon a new dimension.

The pace of structured finance innovation has slowed of late, especially in areas other than CDOs, so the important developments tend to come about through inventive new applications. Hertz Vehicle Financing's asset backed securitization is a good example of this and was instrumental in Clayton, Dubilier & Rice, the Carlyle Group and Merrill Lynch private equity winning control of the \$15 billion company.

This was the biggest buyout of the year. In addition to running an auction for a sale of Hertz, Ford was also looking at the option of an IPO. Bankers involved with constructing the financing say that one of the main reasons why these sponsors managed to outbid another private equity group and exceed potential IPO proceeds was the use of securitization.

In previous years the use of securitization technology has been prevalent in the refinancing of M&A activity, especially in Europe. But the buyout of Hertz was unique not just because, to a large extent, the ABS drove the higher price that the sponsor was able to pay for the buyout. It is the largest structured financing connected to an acquisition and the first that occurred simultaneously with the buyout deal's closing.

In future, all arrangers of buyouts will consider the possibility of using the Hertz strategy where there are assets in the target company that are securitizable, says Richard D'Albert, co-head of global securitized products group at Deutsche Bank. "The ability to provide financing for the acquisition in a levered context was extremely important," he says. "We needed to refinance the entire balance sheet of Hertz."

So while the \$8.7 billion of structured financing – carved into \$4.3 billion of term ABS sold into the US, \$1.5 billion of asset-backed commercial paper and \$2.9 billion equivalent of bridge financing for Hertz's international operations – was significant, it is the wider context of the innovative use of securitization to cut the cost of capital that is crucial; for understanding the long-term implications.

The structured finance market has an excellent track record for consistent liquidity and depth; it is rarely shut by unforeseen credit events. Another important feature is that the cost savings are immense. Securitization provides the sponsors with higher returns

because of the efficiencies it provides in pricing. The weighted average cost of financing the fleet via an asset-backed securitization was just under Libor plus 22 basis points. Compare that with the cost of the corporate debt used in the buyout – which ranged from Libor plus 200bps for a \$1.6 billion five-year ABL Facility (Ba2/BB+), \$2.25 billion of seven-year term loan (Ba2/BB+) at Libor plus 225bps, \$2.025 billion of (B1/B) nine-year senior unsecured notes at 8.875% and right up to 10.5% for the \$600 million of 11 year senior subordinated notes.

The \$4.3 billion of US term (long-term) ABS was wrapped by MBIA and Ambac, with the exposure split evenly between the two monolines. Fixed-rate and floating-rate tranches were sold in three-, four- and five-year maturities with spreads of 14bps, 20bps and 25bps over Libor and swaps, respectively. The \$1.5 billion variable funded

note was also wrapped by MBIA and Ambac with the funding provided by a group of bank-sponsored ABCP conduits.

The use of monoline credit wraps simplified the credit review for investors, extremely important given the tight time-frame that the leads were operating under according to Deutsche's Elizabeth Whalen.

Not only did securitization cut the weighted average cost of capital on the deal, it also provided a much needed alternative pool of capital – with so much cash to raise, attempting to find it all in just high yield and leveraged loans would have left the sponsors at risk of being held to ransom.

This transaction helped fund the second-largest LBO in history, and the consortium's use of asset-backed financing was critical to its success in the competitive bid process. It provided access to a more efficient cost of funds and a more flexible capital structure. **Alex Chambers**



### At a glance

**Deal type:** Hertz Vehicle Financing \$4.3 billion ABS; part funding of \$15 billion buyout of Hertz.

**Lead managers:** Lehman Brothers, Deutsche Bank, JPMorgan, Merrill Lynch, Goldman Sachs

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