Why do corporates use business securitisation?

Dennis Vink

Vink, Dennis, D. Benima, G. Mertens, R.J. Wollerich. "Why do corporates use business securitization?" Tijdschrift voor Corporate Finance 4 (2002): 34-36.

Keywords:
activa securitisatie, asset securitization, asset securitisation, whole business, bedrijfsfinanciering.

www.dennisvink.nl

WHY DO CORPORATES USE BUSINESS SECURITISATION?

D. BENIMA, PROF. DR. G. MERTENS, DRS. D. VINK, ING. R.J. WOLLERICH

Practioners in continental Europe have been discussing business securitisation transactions, following the completion in recent years of several high profile transactions in the United Kingdom, Germany, Belgium, and France. Since 1998 companies have been increasingly using this technique to refinance whole lines of businesses that are frequently a substantial portion of the assets of the parent company. In fact, companies refinanced more than Euro 15 billion of assets via business securitisation in 1998 until 2001 involving assets as diverse as pubs, service stations, hotels, theme parks, ferry services, airports, care homes, theatres, bakeries, and water companies. The decision to use business securitisation involves an explicit choice regarding both the financial structure as well as managerial involvement and control. Given the limited understanding of why and how business securitisation creates value, the purpose of this article is to analyse the structural features and to provide an answer to the interesting question why corporates use business securitisation.

INTRODUCTION

Basically, business securitisation lies midway between standard securitisations and secured corporate debt. Similar to secured corporate debt, the business securitisation debt is a direct or indirect liablility of the operating company. Ownership of the assets remains with the operating company, and bondholders are only granted a charge over those assets. Typically, the operating company continues to manage the assets under the terms of a management agreement with the issuing vehicle. According to Skelton (2002) from Moody's, the difference between business securitisation and secured corporate debt is the credit rating improvement derived from the reduction in the expected loss. The probability of default is reduced because the event risk is lower. In other words the risk that the strength of the business will be impaired through mismanagement is lower in the situation of business securitisation.

The similarity with standard securitisations (where the assets are sold to a bankruptcy remote special purpose vehicle) is that the assets that secure the debt are intended to be isolated from the insolvency of the operating company. The difference however is that standard securitisation transactions often isolate the assets from the orginator via true sale. These assets usually require no more than relatively passive servicing, which is typically the case with collection of contracted debt. Such 'true sale' structures are unfortunately unsuitable for assets that require active management and investment where significant levels of management flexibility must be build in. The desired goal can therefore be met through business securitisation.

Business securitisation is a relatively new form of financing. Its growing importance is highlighted by the fact that rating agencies such as Moody's and Standard & Poors (hereafter: S&P) are giving increasingly attention to this type of financing in the recent years. Moody's as well as S&P have already published a number of documents solely devoted to the business securitisation market and the related rating methodology. We will start by introducing the reader to the terminology framework for this specific type of securitisation as introduced by Sprokholt and Vink (2001) among others. The purpose is to provide an analysis of the structural features. Next a case analysis will be presented of the 'Tenovis transaction', the first company in Germany financed by business securitisation. Finally, we will provide a preliminary answer to the question why firms use business securitisations.

BUSINESS SECURITISATION

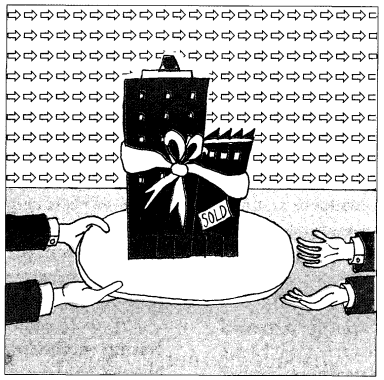
In order to provide the reader a good understanding of business securitisation, we will start with the definition presented by Vink (2002).

Definition

Business Securitisation can be defined as: *a form of asset-backed financing by which operating assets are financed in the bond market via a bankruptcy remote special purpose vehicle (hereafter: SPV[1]), and the operating company keeps complete control over the assets securitised. In case of default the control[2] is handed over to the security trustee for the benefit of the noteholders in the SPV for the remaining term of financing.*

Term loan agreement

The SPV issues bonds with the future cash flows of the underlying assets as collateral. The bonds are sold to a large group of investors. With the debt proceeds, the SPV grants a loan to the operating company (the borrower), secured on the assets of the borrower. This loan agreement is the central contractual agreement for the securitisation where the borrower commits to repay the loan out of the cash flows generated from its securitised business. It is tranched to correspond to the classes of bonds issued by the SPV. By this agreement the security trustee on behalf of the SPV has the ability to monitor management by financial reporting standards, and asset based and operating covenants that are designed to protect the value of the assets securitised also in standard events of default.

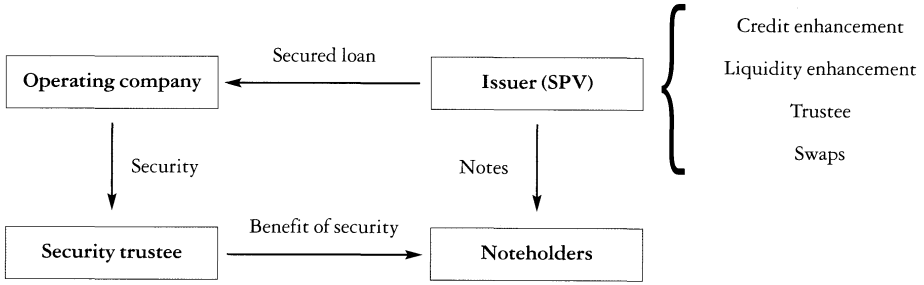


Secured Loan Structure

In case of default of the borrower the SPV receives complete control over the securitised assets by means of appointing a receiver for the full term of financing. On behalf of the SPV the receiver has authorisation to seize control over the securitised assets at the loss of any other creditor and eliminate the risk of external activities of management decisions reducing the return to bondholders. This is called bankruptcy remoteness. Therefore, business securitisation efficiently uses the privileges of bankruptcy law that gives the bondholders extensive security in case of default. The transaction structure and credit features of business securitisation are illustrated in figure 1.

The idea of secured loan is that title doesn't pass and that the legal ownership remains with the operating corporate, and bondholders are only granted a charge over those assets. This feature makes it difficult in some countries to structure a business securitisation deal. In fact it is proven that it is hard to separate assets legally while the originator

Figure 1: Secured loan structure



Source: Andrew Palmer (2002), Standard & Poors

still retains operating control and services these assets. Under U.K. law this difficulty is almost eliminated by the 1986 Insolvency Act, which permits the holder of a charge over substantially all of the assets of a corporate to control the insolvency proceeds of that corporate through an administrative receiver. The English appellation of this bankruptcy remote structure is the so-called secured loan structure. To amplify, in case of default 'petition language' prevents other creditors from petitioning a court for the appointment of an administrator. This allows the security trustee on behalf of the SPV to control the assets securitised in default. These privileges are based on the very favourable insolvency regime present in the U.K. that allows the so-called fixed and floating charges[3] of a corporate to be passed over to a specific creditor. This gives the creditor three major rights, namely:

- control in a liquidation;
- the right to block an administrator;
- the right to appoint an administrative receiver to enforce security on their behalf.

The passing of the fixed and floating charges can be identified as the main value driver in a business securitisation transaction

This passing of the fixed and floating charges can be identified as the main value driver in a business securitisation transaction. According to Skelton (2002), the severity of loss is mitigated due to the bankruptcy remote structure in the case of default of the borrower. The SPV increases the likelihood that the business can continue as a going concern rather than to have a 'fire sale' of the individual assets (one could argue that this argument only holds in the case when a 'fire sale' is not efficient). A liquidity facility ranking in priority to the rated debt is then operational reducing the risk of payment interruptions on the rated bonds. Also a replacement manager is found for the business reducing the severity of loss. He or she is able to manage the assets and meet the existing debt obligations. This preserves the value of the assets securitised, which is of great importance to the investors

Structural features and a raised rating

According to Macy (2002) the result is that the SPV generally issues securities that are rated higher (and sometimes significantly higher) in comparison to the issuance of secured debt by the operating company. The business continues to function more or less as before (subject to the important contractual constraints due to securitisation) but with a lower cost of capital. The key point is the level of protection in the situation of insolvency of the borrower. According to Folkerts-Landau (2001) there is a potential to raise the rating for secured creditors even if the company has already been provided a corporate (unsecured) credit rating (all other factors remain equal). This is the result of the risk mitigation generated by isolating the transaction structure from the financial risks of the borrower via the secured loan structure.

Rating methodology

Moody's approach to rating business securitisation transactions is based on the same expected loss methodology it applies to evaluating the credit risk of any structured security: expected loss equals the product of default probability and loss severity, summed over all possible scenario's. The probability of default is determined through an analysis of sector-specific and transaction-specific risks. The severity of loss is determined by assessing both the ease of finding and installing a replacement operator in case of default, and also the alternative use value of assets.

The credit rating improvements of debt issued via business securitisation over the rating of the underlying corporate essentially derive from the reduction in the expected loss. Structural features mitigate the probability of default on the event of default, such as:

- prevent dividend payouts;
- permit the replacement of management if the business under-performs;
- control over acquisitions and disposals of the business's assets (to prevent diversification away from the stable core business, or uncontrolled expansion of that business);

Figure 2: Gain in expected loss versus costs of business securitisation structure

Maintained Hypothesis: the gain in expected loss is higher than the cost of setting up a business securitisation structure. If held true, the the net benefit must be calculated according to:

Alternative financing:	prob. of default x loss severity =	expected loss
Business securitisation:	prob. of default x loss severity =	expected loss -/-
		Gain in expected loss
		Cost of setting up structure -/-
		Net benefit

Source: Vink (2002)

- controls over mergers, acquisitions and change of control (to ensure continuity and focus of the original management);
- controls over minimum levels of capital expenditure (to ensure that the assets essential for the core business are maintained).

These features are designed to decrease the moral hazard of the borrower, and potential investment conflicts between borrower and bondholder. The severity of loss is mitigated due to the bankruptcy remote structure that increases the likelihood that the business can continue and be sold as a going concern. In summary, structural features mitigate the probability of default and the severity of loss is reduced by the secured loan structure.

According to the hypothesis in figure 2 the net benefit of adopting a business securitisation is realised if the choice of financial structure, and managerial involvement and control is more efficiently implemented in comparison to the alternative. The fact is that the transaction costs are considerable, due to the highly qualified expertise hired for establishing the structure and the issuance of the bonds. *Intuitively one could argue that the net benefit will be a function of the debt quote since debt is cheaper than equity in the presence of taxes. So one should have a relatively higher leverage in order to realise a net benefit due to the high costs of setting up a business securitisation structure.* According to many practioners the high-debt quote is achieved by the inclusion of triggers to reduce conflicts between bondholders and the borrower. Nevertheless, this remains an empirical issue that needs further investigation.

Examples of business securitisation transactions

Table 1 presents a number of business securitisation transactions that have been successfully executed in recent years, most of them lead managed by Morgan Stanley. All of the mentioned transactions were business activities of which the cash flows could be accurately estimated due to long term contracts and a well-documented history of stable cash flows through which the business risk and financial risk was considered low, or could be significantly mitigated by structural features. Also, all the companies have a well-defined source of income, for example: rent income, or contracted beer sales, catering sales on specific locations, or gate ticket sales for popular entertainment attractions. Notice that in all cases the ratio of investment grade debt to cash flow was considerable in comparison to the financing alternative (see table 1).

To date, Standard & Poors has been involved in rating the debt of business securitisation transactions, which, in the UK, has benefited from un uplift ranging between one and four notches (and averaging two notches) over the corporate (unsecured) credit rating of the issuer. According to Folkerts-Landau (2002) operating sponsors whose business risk corresponds to a rating below 'BB' are unlikely to benefit from a

business securitisation. This is so because their future cash flows are, by definition of the rating, so uncertain that in the opinion of Standard & Poor's they cannot justify stretching the maturity of the debt, not supporting a larger debt quantum than in a pure corporate risk transaction. Furthermore, Folkert-Landau stated that certain kinds of businesses are unlikely to benefit from a business securitisation transaction. These include businesses that are capital intensive, are reliant on unique management skills, or are rapidly evolving.

Intermediate summary

In the first part of this article we have argued that the structural features of a business securitisation transaction can mitigate the agency costs of debt. By the term-loan agreement the bondholders are guaranteed that the assets financed are optimally managed, especially in the situation of an inefficient bankruptcy procedure of the borrower. The interests of the bondholders are not jeopardised by time-consuming bankruptcy procedures and overdue payments. The secured loan prevents this. This does not alter the fact that moral hazard is to be taken into account due to the relatively long maturity of debt and

Table 1: Examples of business securitisation

Companies	*Sector*	*Ratio of Investment Grade Debt to Net Cash Flow from operations*
Wellington Pubs	Pubs	10.3x
GPA Airplanes	Aircraft	9.8x
London City Airport	Transportation	9.7x
Unique Pubs	Pubs	9.5x
Welcome Break	Motorway Services	9.0x
Tees and Hartlepool	Pubs	8.9x
Glas Cymru	Water	8.8x
Premier Pub Co.	Pubs	8.7x
Wightlink	Ferries	8.7x
Alehouse Finance	Pubs	7.9x
Formula One	Motorsport	7.5x
Punch Taverns	Pubs	7.3x
Excel	Conferende Facilities	7.2x
General Healthcare	Private Hospitals	7.0x
Madame Tussauds	Entertainment	6.6x
Rank Hovis McDougal	Food	4.4x
Average		**8.5x**
Financing Alternatives		*Typical Ratio of Debt to Net Cash Flow from Operations*
High Yield Bonds	Divers	5.1x
BBB rated Corporate	Divers	3.0x

Bron: Steve Din, Morgan Stanley, Securitisation Conference, November 2001, London

the high debt quote. The necessity to impose strict covenants is therefore essential. The result will be that the security trustee can relatively easily enforce an optimal switch of control rights due to the high leverage and strict covenants.

In the second part of this article we will present the Tenovis case, the first German company ever that has been securitised.

CASE TENOVIS

Background

We will illustrate the effective use of business securitisation by means of a detailed case study of Tenovis, the first business securitisation transaction executed in Germany in November of 2001. Although this deal, like most business securitisations, has its idiosyncrasies, it is in our view nevertheless illustrative of the benefits of using business securitisation on continental Europe. While neither the cost-benefit analysis nor the risk management analysis provides boilerplate answers for structuring future transactions, they should provide some guidance to the process. We address the following questions:

Although the Tenovis deal, like most business securitisations, has its idiosyncrasies, it is in our view nevertheless illustrative of the benefits of using business securitisation on continental Europe

- what is Tenovis and why did Tenovis prefer issuing debt via business securitisation?
- what are the characteristics of the market in which Tenovis operates?
- how does the secured loan work in Germany?
- how does the term loan agreement work in Germany?
- what can we learn from this transaction?

The company: Tenovis GmbH & Co.

Tenovis GmbH & Co. (hereafter: Tenovis) is a leading German provider of business communication solutions. The corporate facilitates the design, planning, and implementation of communication systems with full voice and data integration. Tenovis is ranking second behind Siemens and has a significant market share in the small and medium sized corporate segment. In Germany, Tenovis has a total of approximately 105,000 outstanding contracts, which generate approximately 44% of Tenovis' total revenues of Euro 1,007 billion in 2000. The corporate and also the brand Tenovis was introduced in March 2000 when Kohlberg Kravis Roberts & Co (hereafter: KKR) acquired the private network division of Bosch Telecom GmbH. At that time a new comprehensive strategy was launched to improve the business, establish Tenovis as a brand, and to improve operating efficiency. The Tenovis Group leases private automated branch exchange systems ('PABX') to and provides services and systems solutions for corporate customers.

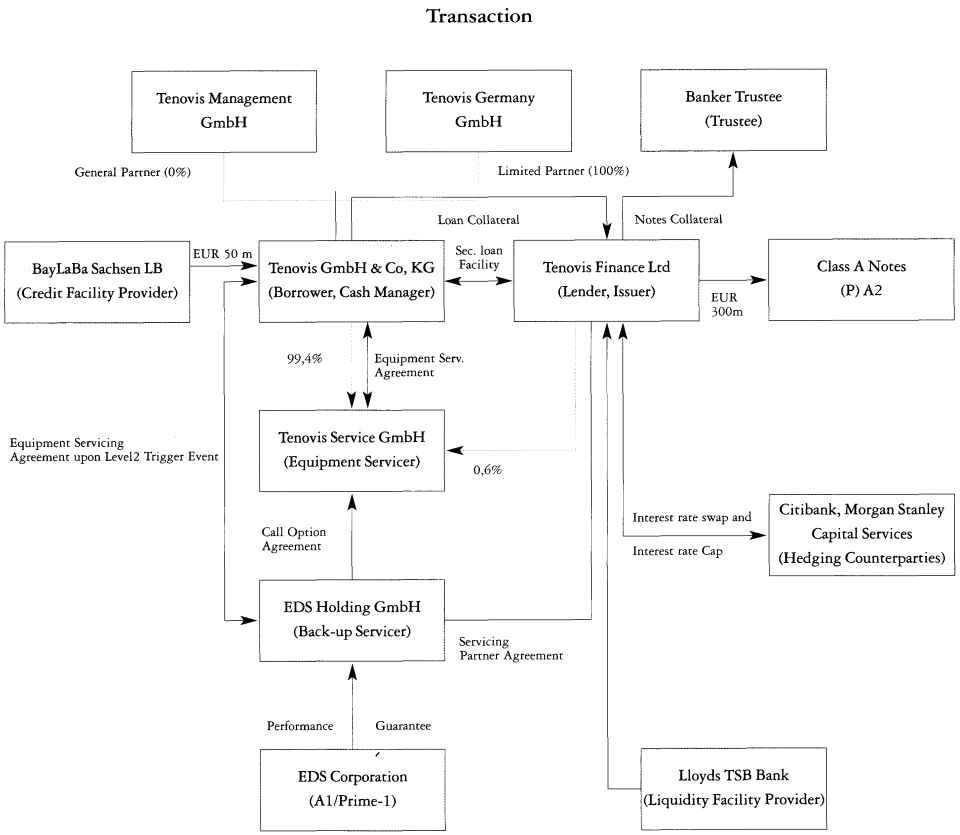
Soon after the purchase in April 2000, KKR wanted to replace existing financing by cheaper alternatives with a variety of vehicles ranging from syndicated loan to tapping the high-yield market. However, lower financing costs and the desire of long-tenor financing encouraged KKR to turn to business securitisation. The lease receivables and the related systems with German customers will constitute the collateral under the Loan facility Agreement. Early retirement of contracts could cause the pool to be insufficient, but this is not likely due to historical data on early terminations. The pool of assets is therefore expected to be large enough to repay the existing debt without the need to replace contracts.

In order to make the refinancing more transparent Tenovis decided to change the corporate structure. They spun-off its servicing business and employees into a separate company, Tenovis Servicer GmbH (hereafter: Tenovis Service), and entered into an equipment servicing agreement with Tenovis Service for the service and maintenance for all lease, outsourcing and maintenance contracts and all PABX systems. According to practioners Tenovis didn't encounter any large problems when executing this change because it proved to be a change on paper rather than a real physical change.

Market characteristics of Tenovis

The market in which Tenovis operates can be characterised as a stable one. Tenovis has a strong market position in Germany owning about 19.5% market share. The corporates Siemens and Alcatel are the main competitors. Tenovis has a strong track record for generating stable cash flows backed by a well-diversified portfolio. The largest share of the cash flow is realised via Tenovis Service, which forms the collateral of the business securitisation transaction. The market segment of Tenovis Service is characterised by high barriers to entry and low growth. Also corporates have to pay a high penalty in case they change suppliers prior to contract maturity. Since most contracts are for the longer term, it is therefore said to be unlikely that there will be a drastic shift in the market in terms of corporates changing suppliers.

Figure 3: Business securitisation structure Tenovis Finance Ltd., Germany



Source: Pre-Sale report Tenovis Finance Limited, Moody's (2001)

To summarise the characteristics of Tenovis Service and its market position:

- Tenovis Service has a strong track record and relatively stable cash flows;
- Tenovis Service has a strong market position;
- high barriers to entry the market;
- market is mature and of low growth.

Term loan Agreement

The structure is based on the term loan agreement methodology, which is central and constitutes the key element in every business securitisation transaction. In Germany the Term Loan Agreement is called Loan Facility Agreement. Via this agreement Tenovis Finance Ltd. (the issuer) will use the proceeds of the notes to make a secured loan to Tenovis (the borrower). The borrower in return will use the loan to repay the existing debt, and to make advances to other affiliated entities within the Tenovis Group. Figure 3 displays the relationship between the transaction parties.

Crucial in the secured loan is the decision of the insolvency administrator in case of bankruptcy of the borrower

Secured Loan Structure

Crucial in the secured loan is the decision of the insolvency administrator in case of bankruptcy of the borrower. A German court chooses the insolvency administrator. The probability exists that the insolvency administrator will terminate the lease and outsource contracts. However, this is not likely to happen because under German law the security trustee is able to hold the insolvency administrator liable if he fails to maximise the value for the benefit of the secured creditors under the Loan Service Agreement. Consequently, it is therefore expected that the insolvency administrator will take that action that is economically most beneficial to the bondholders. In other words, in case of bankruptcy the contracts are not expected to be terminated. It is the job of the security trustee to safeguard the security package.

In addition, German law requires the guarantee of Tenovis Service to continually service rental contracts. If not, clients could terminate their contract, which will lead eventually to a loss of future cash flows and consequently a loss of collateral. In default this situation would make the future cash flow of the borrower uncertain, and therefore a risky situation will occur for bondholders who invested in Tenovis Finance. For this reason a contract with EDS[4] was made. In the contract EDS has agreed upon to take over the management activities of Tenovis Service as a back-up servicer in case of default of the Tenovis GmbH & Co (borrower). According to practioners it was easier this way to sell the bonds to investors when a suitable corporation such as EDS would be standing by to service the contracts and consequently maximise the returns in an insolvency scenario. Besides the back-up servicing agreement, the back-up servicer has entered into a call option agreement, under which it has the right to acquire all shares in or assets of Tenovis Service at fair market value in case of default. The reason is that the back-up servicer will most likely need Tenovis Service employees and know how to perform its obligations as back-up servicer (Kerschkamp, 2001). It is important to note that by entering into the back-up servicing agreement, the back-up servicer becomes liable for the equipment servicing obligations upon default. He also remains liable throughout a potential auction process with third parties if EDS decided not to exercise their right to buy the shares of Tenovis Service.

Finance structure

Tenovis Finance issued one debt tranche of Euro 300 million with floating interest over Euribor and a 12-year final legal maturity (see table 2). According to practioners it should be noted that Tenovis initially pictured a higher rating than was eventually given by the rating agencies. This means that the cost savings

Table 2: Rating of tranche Tenovis Finance Limited

Company	Class	Rating Moody's	Rating S&P	Amount	Interest rate	In %	Legal Maturity
Tenovis Finance Limited	N/A	A2	A+	E 300,000,000	3-month EURIBOR + 150 BP 3.75% after Step-Up Date	100	14-Nov-2013

were lower than initially anticipated. Practioners however argue that this is due to a number of reasons. One reason mentioned was that Tenovis was the first German business securitisation deal. Naturally, investors, rating agencies and banks, involved in the deal, still needed to get comfortable with this new financing structure in Germany. Also no real case law was available to support the assumptions made by the rating agencies under the Loan Facility Agreement, due to relatively new German insolvency regime. Also the events of September 11 played an important role. An employee of Tenovis Corporate Finance said: 'We pictured a lower cost of financing, but September 11 came in between. We were obliged to increase the rates and more efforts were made to get the bonds sold in the market'.

Moody's will monitor the financial performance of the borrower under the secured loan. Management of the borrower must comply with financial reporting standards, and asset-based covenants

Structural features[5]

Moody's will monitor the financial performance of the borrower under the secured loan. Management of the borrower must comply with financial reporting standards, and asset-based covenants. As a result of this so-called 'triggers' are set. Tenovis knows two types of triggers, level 1 and level 2, they are both explained below. Level 1 trigger occurs when: (a) the net worth of the contracts falls below Euro 10 million (b) the debt service coverage ratio falls on a four quarter rolling average basis below 1.1 for two consecutive quarters, (c) a borrower event of default occurs. A level 1 trigger can be remedied by (a) an equity contribution of any kind to lift the borrower's net worth above the trigger level, and (b) the debt service coverage ratio has to exceed 1.1 for two consecutive periods. Level 2 triggers occur upon a non-payment under the secured loan, insolvency of the borrower or Tenovis Service and a breach of operating covenants. Upon a level 2 trigger, the equipment servicing obligations are transferred to the back-up servicer. The occurrence of a borrower event of default under the secured loan leads the trustee to enforce loan collateral.

Short summary and lessons to be learnt from Tenovis

Tenovis operates in the telecommunications business. It leases private automated branch exchange systems, and provides services and systems solutions to corporate customers. The assets securitised are a substantial part of the total cash flow realised. They can be identified as stable contracted cash flows based on operating lease and outsourcing contracts with original tenors of between 5 to 10 years The assets can be characterised as having a limited prepayment risk and protected contract value due to certain preventive termination provisions. Furthermore, the assets have a strong historical performance.

The operations that are securitised remain under the control of Tenovis. According to practioners the business securitisation structure made room for a rebuild- and refocus-strategy by providing stable and relatively longer term financing, at low cost. Looking at table 1 we can conclude that business securitisation provides long term financing although the maturity of this particular transaction is relatively short in comparison to other business securitisation transactions, for example Punch Taverns[6] where the maturity is stretched to more than 20 years. One could argue that the structure has provided opportunities to rebuild- and focus the company's strategy, because the payments under the loan follow a scheduled amortisation profile of which the principal amount to be repaid annually is higher in later years. The amortisation schedule is presented in table 3. The investors clearly appear to have confidence in the cash flows as well as in the structural features of the Tenovis transaction as mentioned previously.

Table 3: Amortisation Schedule at Closing

	Principal
Year 1	10,000.000
Year 2	26,000.000
Year 3	58,000.000
Year 4	74,000.000
Year 5	68,000.000
Year 6	64,000.000
Total	**300,000.000**

Based on the analysis of the Tenovis case we don't have specified information that allows us to conclude that the costs of financing via business securitisation is lower than in comparison to the alternative, taken into account the full (contracting) costs of structuring a business securitisation, like for instance: tax and accounting opinions, due dilligence, legal opinions, financial modelling, market analysis, and independent experts reports. Obviously, both investors and credit rating agencies needed time to get acquainted with this new class of bonds, a new way of financing and a new sector. Because of the unfamiliarity, it appears to be of great importance to fall back on the original bridge financing with a long maturity in such a way that KKR is granted time to establish an optimal structure and sell the bonds at attractive conditions. One could argue that the alternative of business securitisation would be the issuance of long-term debt obligations with a less thorough credit assessment along a strongly fluctuating risk- and liquidity premium for different maturities. In comparison to this, the business securitisation structure is therefore quite unique. The structure is specifically designed upon insolvency of the borrower. The security trustee increases the likelihood that the business can continue as a going concern rather than having the insolvency administrator terminates the lease and outsourcing contracts. For example, in an event of discontinuation and a liquidation of the PABX systems, the insolvency estate will receive very little as there is no second hand value or market value of this kind of highly customised systems (Kerschkamp, 2001). Because the insolvency administrator is obliged to maximise the value of the assets of the secured creditor, the probability that he will terminate the contracts is therefore quite low. Legal uncertainties remain however specifically relating to the lack of German case law supporting that assumption. Nonetheless, the decision to continue servicing the contracts is also facilitated by the availability of a creditworthy back-up servicer (EDS) that makes business securitisation a trustworthy structure in place for realising the higher economic value achievable for the secured bondholders in the situation of insolvency of the borrower.

MOTIVATIONS FOR CORPORATES TO ADOPT BUSINESS SECURITISATION

The starting point for business securitisation is the need for financing. This need stems from the desire to refinance existing debt, serve as cash to be used for a buyout, or serve as a fund to finance other acquisitions or growth opportunities. With this in mind, corporates and facilitating banks analyse the best achievable conditions to finance these needs. Vehicles can be used to facilitate this financing and vary, ranging from: syndicated loan, tapping the high-yield market, business securitisation, and issuing equity. Although there are several motivations for a corporate to adopt business securitisation as a financing vehicle, we discuss

the two most important ones: (1) increasing the leverage by which equity is substituted with investment grade debt and (2) increasing the maturity to reduce pressure on the corporate.

A more attractive credit assessment is an important condition for increasing the leverage by which equity is substituted with investment grade debt and increasing the maturity of the bonds (see for example table 1). Via business securitisation, corporates can issue bonds specifically for those business activities realising a higher rating relative to the rating corresponding to the business risk of the parent itself. This is due to structural features that mitigate the risks relating to the borrower and the underlying assets. In this respect we could argue that business securitisation is more attractive for corporates that have a business risk corresponding to a relatively low rating. In other words, the benefit of a business securitisation structure is a function of the positive difference realised by raising the credit rating: the larger the difference, the larger the benefit (ceteris paribus). The scope of increasing the leverage by which equity is substituted with investment grade debt is then positively influenced by the secured loan under the term loan agreement, financial reporting standards, and asset based and operating covenants. According to Folkerts-Landau (2001) the structure tends to carry a lower nominal cost of debt, due to higher credit ratings, and it usually issues debt with a longer maturity, which reduces pressure on the corporate issuer to plan refinancing.

Conclusion

In this article we have shown that the structural features of a business securitisation transaction can mitigate the agency costs of debt. By the secured loan under the term-loan agreement the bondholders are guaranteed that the assets financed are optimally managed, especially in the situation of an in-efficient bankruptcy procedure of the borrower. The SPV can relatively easily enforce an optimal switch of control rights due to the high leverage and the ability to monitor management by financial reporting standards, and asset based and operating covenants. According to Folkerts-Landau (2001) business securitisation tends to carry a lower nominal cost of debt relative to standard corporate secured lending, due to higher credit ratings. Also the debt issued, usually has a longer maturity that reduces pressure on the corporate issuer to plan refinancing. These benefits arise from the transaction structure's enhanced financial ability to service debt, which is due to the secured loan under the term loan agreement between the SPV and the borrower.

Since a number of years it appears that this financing structure can be used in other countries than the U.K. as well, for example in France, Germany, Belgium and several countries in Asia. Apart from the Tenovis deal there are more examples on the continent. Although these deals contain many interesting features to study, we seem to be at the very early stage of understanding the economics of business securitisation. Perhaps our most important conclusion is therefore that more research into the theoretical and practical dimension is essential in order to properly evaluate business securitisation as an effective financing alternative for corporates.

Notes

1 Securitisation vehicle, also called special purpose vehicle, is an entity that acquires ownership of the transferred assets and issues asset-backed securities. This entity is established only for the purpose of specific securitisation and it is legally different and independent from the original owner of the assets. The securitisation vehicle has a different governance structure than the originating firm. In particular, its specific structure restricts any chance of a standard bankruptcy procedure (Skarabot, 2001).

2 It is essential that the SPV receives the strongest possible rights (fixed and floating) over *all* the assets needed to run the business should a default arise.

3 *A fixed charge* has the attraction of ranking high in the pecking order of creditors in the event of insolvency. However, as its name suggests a 'fixed charge' has the disadvantage of being relatively in-flexible. Therefore it was thought that a fixed charge could not be held over corporates receivables if the corporate was to be left free to collect the relevant accounts and use the proceeds as part of its working capital. A corporate could factor its debts or engage in other means of financing its operations. However, if a lender wanted a fixed charge on book debts, it would have to ensure that the borrower paid the proceeds of each debt to the lender. *A floating charge* hovers over the secured assets until the charge is triggered or 'crystallises' for example upon the appointment of a receiver. Floating charges contrast with fixed charges by offering the borrower flexibility in the use of the charged assets, but at a cost to the lender: in an insolvency floating charges rank behind fixed charges, costs and expenses and preferential creditors.

4 EDS stands for Electronic Data Systems. EDS is a company in global information technologies, and combines Tenovis' voice systems with their own products. For this reason, EDS has a strong interest in a good performance of Tenovis Service.

5 This section draws heavily on the Pre-Sale Report of Tenovis Finance Limited, published by Moody's (author Marie-Jeanne Kerschkamp).

6 In 1998 Punch Taverns became one of the first companies in the market to use business securitisation. The company refinanced its pub estate it bought from Allied Domecq.

Literature

Aghion, P. Bolton, P. An incomplete contract approach to financial contracting, *Review of Economic Studies,* 1992.

Amihud, Y. Garbade, K. Kahan, M. An Institutional innovation to reduce the agency costs of corporate bonds, *Journal of Applied Corporate Finance,* volume 13 number 1, Spring 2000.

Downey, C. Whole business securitisation comes of age, *International Financial Law Review,* September 1999.

Franks, R. Nyborg, K.G. Torous, W.N. A comparison of US, UK, and German Insolvency Codes, *Financial Management, Vol. 25,* Autumn 1998.

Folkerts-Landau, E., Principles for Analyzing Structured Finance/Corporate Hybrid Transactions, *Standard & Poors,* July 2001.

Gertner, R. Scharfstein, D. A theory of workouts and the effects of reorganization law, *Journal of Finance,* 1991.

Hart and Moore, Chapter 5 in: *Firms, contracts, and financial structure,* 1994.

International structured finance deals of the year, runner up: Punch Group, *International Financial Law Review,* London, March 2001.

Jensen, M.C., Agency costs of free cash flow, corporate finance, and take-overs, *American Economic Review,* 1986.

Kappel, P., Whole of Business Securitisation, *Securitisation 2000 Conference London,* 2000.

Kerschkamp, M., Tenovis Finance Limited, *Moody's Investors Service,* October 2001.

Macy, S., Moody's Approach to Rating Operating Company Securitizations, February 2002.

Palmer, A., Evaluating the Potential for Whole of Business Transactions in Australia and New Zealand, *Standard & Poors,* 29 May 2002

Park, C., Monitoring and Structure of Debt Contracts, The *Journal of Finance, Vol. 55, No. 5,* October 2000.
Skelton, G., European Whole Business Securitisation: *The Market comes of Age,* February 2002.

Skarabot, J. Asset securitization and optimal asset structure of the firm, working paper, *Haas School of Business,* 2001.

Stulz, R.M. Managerial discretion and optimal financing policies, *Journal of Financial Economics,* 1990.

Sprokholt, E.M.S., Vink, D., Voort, L.P.F., Innovatie in buy-out financiering: de basisprincipes van bedrijfssecuritisatie, *Tijdschrift voor Financieel Management,* November 2001.

Vink, D., Bedrijfssecuritisatie: een uitdaging voor ondernemingen, *Tijdschrift voor Corporate Finance,* 2002 Nummer 3, Jaargang 7.

Vink, D., Theory on Business Securitisation, *preliminary draft of working paper,* September 2002.

APPENDIX

12 July 2009

Principal

- Vink, Dennis, Frank Fabozzi, 2009. "Non-US asset backed securities: spread determinants and over-reliance of credit ratings". *Yale ICF Working Paper No. 09-13. Top 10 SSRN Downloaded Papers for Journal of European Finance.*
- Vink, Dennis, 2009. "Securitisatie: hoe nu verder?". *Maandblad voor Accountancy en Bedrijfseconomie* 6, 215-223.
- Fabozzi, Frank, Dennis Vink, Andreas Jobst, 2009. "Securitization – differences between mature and emerging markets" [forthcoming]. *International Monetary Fund Research Paper Series, Yale School of Management Research Paper Series.*
- Vink, Dennis, 2008. "Securitisatie: een vergelijkende empirische analyse tussen hoofdcategorieën". *Kwartaalschrift Economie 4,* 415-446.
- Vink, Dennis, André Thibeault, 2008. "ABS, MBS and CDO pricing comparisons: an empirical analysis". *The Journal of Structured Finance* 2, 27-45.
- Vink, Dennis, 2008. "CDOs: super senior of super slecht" [forthcoming]. *Maandblad voor Accountancy en Bedrijfseconomie.*
- Vink, Dennis, 2007. "Securitization: ten lessons to remember." *Management Control & Accounting* 11, 14-21.
- Vink, Dennis, André Thibeault, 2007. ABS, MBS and CDO compared : an empirical analysis. (2007). *Top 10 SSRN Downloaded Papers for Capital Markets Journals and Top 10 SSRN Downloaded papers for Financial Economics Network.*
- Vink, Dennis, André Thibeault. 2007, An empirical analysis of asset-backed securitization. *Top 10 SSRN Downloaded Papers for Theory: Pricing and Top 10 SSRN Downloaded Papers for Journal of Monetary Economics.*
- Vink, Dennis, 2007. Primary market spreads of asset securitization issues : empirical investigation and analysis. *PhD dissertation Nyenrode Business Universiteit.* ISBN 978-9073314979.
- Vink, Dennis, 2002. "Bedrijfssecuritisatie een uitdaging voor ondernemingen." *Tijdschrift voor Corporate Finance* 3, 30-36.
- Benima, Danny, Gerard Mertens, Dennis Vink, Roelof-Jan Wollerich, 2002, "Why do corporates use business securitization?." *Tijdschrift voor Corporate Finance* 4, 34-36.
- Sprokholt, Eduard, Dennis Vink, Leo van der Voort, 2001. "Een innovatie in buy-out financiering: de basisprincipes van bedrijfssecuritisatie." *Tijdschrift voor Financieel Management* 6, 21-30.
- Eenennaam, Fred van, Dennis Vink, Mark Visser, 2001. "Een overname als strategische optie: een waarderingssystematiek." *Tijdschrift voor Financieel Management* 5, 12-22.

Other

- Vink, Dennis, 2008. "Meer bufferkapitaal voldoet niet." *Het Financiële Dagblad.* 7 augustus.
- Vink, Dennis, 2007. "'A primer on whole business securitization." *Fiducie* 1: 6-13.
- Vink, Dennis, 2007. "Nederlandse bedrijven financieren te conservatief." *De Financiële Telegraaf.* 6 juli.
- Vink, Dennis, 2003. "Business securitization, more efficient or not?." *Fiduciair* 1: 21-24.
- Eenennaam, Fred van, Dennis Vink, 2003. "Lach de kleine zaadkorrel niet uit, eens zal hij een palmboom zijn." *Fiduciair* 3: 12-18.
- Vink, Dennis, 2002. "A innovative way of financing leveraged buy-outs." *Fiduciair* 2: 16-24.

Conference proceedings

- Vink, Dennis, André Thibeault, 2008. An empirical analysis of asset-backed securitization. *21st Australasian Finance & Banking conference*, Sydney, Australia, December 16-18.
- Vink, Dennis, 2008. An empirical analysis of asset-backed securitization. *Financial Services Institute's Symposium*, New York City, United States, September 12.
- Vink, Dennis, 2008. An empirical analysis of asset-backed securitization. *International Summer School on Risk Measurement and Control. Contagions, Bubbles and Blackouts in Financial and Commodity Markets*, jointly organized by the Association for Banking and Finance, Rome, Italy, June 30 - July 4.
- Vink, Dennis, 2008. The determinants of asset-backed securitization at issue. *Standard & Poor's*, New York City, United States, June 5.
- Vink, Dennis, André Thibeault, 2008. An empirical analysis of asset-backed securitization. *11th Conference of the Swiss Society for Financial Market Research (SGF)*, Zurich (SWX Swiss Exchange), Switzerland, April 11.
- Vink, Dennis, 2006. Comparison of asset securization issues originated in emerging and non-emerging countries. *Emerging Markets Finance and Economics Conference (EMFE)*, Istanbul, Turkey, September 9.

Specialised courses Dr. Dennis Vink

Dennis Vink lectures Corporate Finance in the MSc, MBA and executive education programs at Nyenrode Business Universiteit in Breukelen, the Netherlands. His ten years of practical and academic experience reflect his interest in corporate finance, structured finance and risk management. With an average rating of 4.3 out of 5 in the MBA program, Dr. Vink qualifies as an excellent lecturer. Next to his work for Nyenrode he has also acted as a visiting professor at the VU University in Amsterdam.

Dennis Vink received a Master of Science degree in Financial Management from Nyenrode Business Universiteit (1999), where he also obtained his PhD degree (2007) with a thesis on Asset Securitization. Additional training was followed through the Tilburg PhD Program in Finance. His academic work deals with empirical research in the field of corporate finance, with a particular focus on structured finance.

Dr. Vink acts as an independent business advisor covering a wide range of disciplines in the world of structured finance. Not only is he the author of over ten articles in this field but he has also participated in the supervision of a number of finance projects. These included asset-backed securitization issues, value-based management and cost of capital issues, to name but a few, carried out for the benefit of multinational corporations and financial institutions.

The following represents a selection of seminars, workshops and courses on specialised topics related to funding and investment offered by Dr. Dennis Vink in recent years.

- **An Overview of Financial Management**
  - The Financial Objective
  - Business Finance versus Accounting
  - How to Evaluate Capital Structure
  - Free Cash Flow to the Firm

- **Financial Statements and Cash Flow**
  - Accounting Numbers
  - Analysis using Financial Ratios
  - Analysis using Cash Flows
  - Economic Profit

- **Time Value of Money**
  - Measuring Wealth
  - Present Value Computation
  - Future Value Computation
  - The Net Present Value Investment Rule

- **Analysis of Investment Projects**
  - The Investment Process
  - Investment Decision Rules
  - Do's and Dont's
  - Sensitivity Analysis Using Spreadsheets

- **Valuation of Common Stocks**
  - The Valuation Problem
  - Projected Earnings
  - Projected Dividends
  - Projected Cash Flows

- **Valuation of Fixed-Income Securities**
  - Using Present Values Formulas to Value Bonds
  - Term Structure of Interest Rates
  - Reading Bond Listings
  - Interest Rate Sensitivity

- **Risk and the Required Rate of Return**
  - The Capital Asset Pricing Model
  - Beta and Risk Premiums on Individual Securities
  - Valuation and Regulating Rates of Return
  - Some Cautions about Beta

- **Gearing and the Cost of Capital**
  - Cost of Debt
  - Cost of Equity
  - Firm Value
  - Adjusted Net Present Value

- **Options and Contingent Claims**
  - Investing with Options
  - The Black-Scholes Model
  - Other Applications of Option Pricing Methodology

- **ABS, CDOs, and Synthetics**
  - Fundamentals of Asset-Backed Securitization
  - Cash Flow Analysis and Pricing
  - Risk Transfer through Credit Default Swaps

- **Leveraged and Mezzanine Financing**
    - Review of Valuation Tools for Acquisitions
    - Implementing Senior, Mezzanine and Equity Finance
    - Modelling an LBO

Contact Nyenrode Center for Finance

Please feel free to contact the Nyenrode Center for Finance if you should require more details regarding my current research themes and for further information about my specialized courses.

Nyenrode Business Universiteit
Center for Finance
Straatweg 25
3621 BG Breukelen
The Netherlands

Dennis Vink
Email: d.vink@nyenrode.nl
Website: www.dennisvinkonline.nl
Tel: +31 346 291 211