ARTICLE

SECURITIZATION

AN ATTRACTIVE OPTION FOR CLOSING THE LIQUIDITY GAP

Middle market companies that entered into credit facilities on highly favorable terms are now finding that they must refinance in a much more difficult environment. Securitization can close that gap. Here are some factors to consider.

Today, both the number of banks and the overall bank lending capacity have declined, making it virtually impossible to fully replace the attractive revolvers of the past. As these revolvers mature, the lack of bank credit resources will leave a liquidity gap that could hamper a company's ability to finance working capital needs and pursue growth opportunities.

Securitization can close that gap. It has enabled many companies to increase liquidity, lower financing costs and diversify their overall capital structure.

WHAT SECURITIZATION DOES

Securitization converts a diverse pool of assets into marketable securities that are sold to investors. The conversion legally isolates the pool of assets from the bankruptcy estate of the company originating them.

Securities backed by these assets and issued into the market are called asset-backed securities (ABS). The assets can be corporate receivables, such as accounts receivable, or consumer assets, such as credit card or auto loan receivables. Depending upon the frequency and characteristics of the cash flows generated by the underlying assets, these securities take the form of bonds or notes, or asset-backed commercial paper.

THREE BENEFITS OF SECURITIZING RECEIVABLES

There are several reasons that middle-market companies might want to consider this financing option.

- **Securitized debt has a lower interest cost** than corporate debt because the assets are legally isolated from the company's bankruptcy estate and the transactions are structured to reflect a lower risk profile than lending directly to the company.

- **Banks are generally willing to commit much larger amounts** in a securitization than to a conventional revolving credit facility, and companies can also benefit by having a smaller bank group provide the securitization.

- **Securitization can increase a company's total liquidity** and diversify its funding sources.

- **Securitization can enhance the enterprise value** of your organization.

TWO COMPANIES' STORIES

To see the benefits of securitization in real life, let's consider two situations.

In one case, a company had a maturing $180 million revolver provided by 10 banks. It needed to maintain that level of liquidity in its capital structure, but the market had changed so

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dramatically that several of the banks no longer existed and terms for conventional credit facilities had become much less favorable. Combining a securitization with a smaller revolver provided this company with $190 million of total financing at an attractive cost and with the involvement of only five banks.

In another case, a company was making an acquisition and needed to refinance the working capital facilities of the company it was acquiring. The bank market did not have the lending capacity to fully cover this need. The fact that the client's primary financing need was for letter of credit issuance presented an additional complication. Securitization alleviated the capacity limitations of the bank group and the company was also able to benefit from a letter of credit issuance capability.

HOW A SECURITIZATION WORKS

Say a company maintains a large pool of accounts receivable. The cash due from these receivables may not be available for 30 days or more, but securitization allows the company to receive financing immediately. The interest cost is relatively low because the receivables' cash flows are legally segregated and protected from other creditors in the event of a bankruptcy.

This legal separation of the receivables has no impact on the company's operations; the business will continue to manage its accounts receivable (and customers) in the same manner as it did before the securitization. However, the proceeds from the securitization can be used to originate more assets, to reduce outstanding debt with higher interest costs or to provide for other capital needs.

TYPES OF ASSETS THAT CAN BE SECURITIZED

Any company with assets that generate relatively predictable cash may be securitized. The most common asset types include corporate receivables, credit card receivables, auto loans and leases, mortgages, student loans and equipment loans and leases.

Generally, any diverse pool of accounts receivable can be securitized. Eligibility criteria generally require that the receivables not be delinquent, not be subject to offset, be fully earned with no future performance required by the company and not be due from an affiliate of the company or the federal government.

HOW TO DECIDE IF SECURITIZATION MAKES SENSE FOR YOUR COMPANY

Securitization may be a source of financing if a company maintains total domestic receivables of $50 million or more.

Through innovative structuring, securitization provides many middle-market companies with direct access to the capital markets. Middle market companies across a wide spectrum of industries have unlocked the value of their assets and obtained the necessary capital to support their current operations and future growth through securitization.

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