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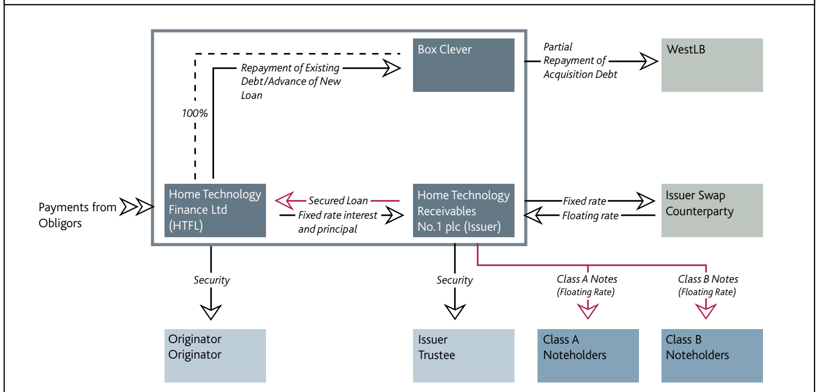
BOXCLEVER
£748m asset securitisation of consumer rental receivables with £120m term mezzanine and £40m working capital facilities, 20 June 2002

CORPORATE PROFILE
Boxclever was formed in June 2000 from the merger of Granada Technology Group and Thorn UK's Radio Rentals. The Boxclever Group comprises Boxclever, the UK's leading home entertainment and domestic appliance rental company, with more than two million customers; and Endeva, the UK's leading service provider for brown and white goods.
www.boxclever.co.uk

On 20 June 2002, Boxclever completed an £868m refinancing of bridge facilities put in place at the time of its leveraged buyout two years earlier. This involved a securitisation, combined with a mezzanine term loan and working capital facility. The £748m asset securitisation cleverly blended classical asset securitisation analysis with whole business securitisation technology and, unusually, was supplemented by a £120m mezzanine debt layer. The whole shebang should save Boxclever in excess of £15m per annum in interest charges and is the largest and most complex financing completed in its class to date.

CHERRY PICKING. Andrew Gardner, Executive Director at WestLB, explains: "With whole business securitisations, the debt is typically restricted to the securitisation programme and tight covenants are put in place to restrict the business by, for example, prohibiting further borrowings. The Boxclever refinancing captured the higher leverage associated with asset securitisation of the group's core rental business, while permitting the flexibility to borrow outside of the securitisation structure.

FIGURE 1
SIMPLIFIED STRUCTURE OF THE SECURITISATION.



"To do this, it was critical to satisfy the rating agencies and investors that in the event of a default by Boxclever as servicer, third parties could be brought in to take on this key role. This approach took substantially more work and resource but ultimately achieved a better result for the company. The more efficient way of funding reached longer tenors and enabled incremental leverage from the mezzanine and bank markets."

The securitisation structure cherry picks the best of traditional asset securitisation and "whole business technology".

NON CONTRACTUAL CASHFLOW. Boxclever securitised the income stream from lease agreements, hire-purchase agreements, warranty agreements and insurance commissions, and proceeds from second-hand equipment sales from television, video and other electronic consumer goods. At closing, the collateral comprised 2.44 million lease contracts split 52% for TVs, 25% for VCRs, 10% for white goods and 13% for others. The weighted average contract age was 45 months and the equipment age 58 months. A typical TV rental contract will impose a minimum hire period of 18 months and can be terminated at any time thereafter, leaving only the residual value of the sets. But the deal managed to go beyond this and securitised non-contractual cashflows over a rolling nine-year period in a business that is generally recognised as being in long-term decline.

Nearly a billion data points were analysed from 15 years of historic rental streams to establish the longevity of the rental contracts and project customer contract mortality rates to garner the life expectancy of the existing pool of contracts. The income, from this business at risk from technological change, proved surprisingly robust with little volatility and demonstrated the predictability of future cashflows. This allowed Boxclever to get more leverage out of the assets at an investment grade rating level. Consequently, less sub-investment grade residual financing was needed from more expensive mezzanine sources, ultimately bringing down the blended cost of capital. Roger Mavity, Chief Executive of Boxclever, said: "Most people think they understand their own business quite well, but the rating process forces you into a level of thinking and depth of trend analysis that you end up educating yourself to learn more about your own business than you thought possible."

WestLB initially funded the leveraged buyout and being close to Boxclever structured and managed the refinancing in its capacity as arranger and joint lead manager for the £748m securitised bond issue. CIBC World Markets, which privately placed two smaller securitisation packages for Thorn a few years previously, was brought in to joint lead. This gave investors confidence that the two arrangers closest to the company and the underlying asset class paid more than lip service to the banner deal.

TWO TIERS. The securitisation issue was split in to two classes (A and B), with a legal maturity of 15 years (see *Table 1*.) The largest class A raised proceeds of £660,173,000 and was initially sold into commercial paper funded conduits sponsored by WestLB and CIBC. The notes were priced to yield 85bp over each conduits' cost of funds. Both classes have a five-year revolving period that allows the issuer to substitute new assets and repay and redraw amounts of principal.

The expected maturity is seven to eight years and after nine years a deterrent margin of 200bp kicks in. The bond amortises with reference to the cash in hand and present value of stress tested future cashflows, updated monthly according to the future performance of the rental business. At issue, £300m of the bond was forecast to be amortised within four to five years, bringing the weighted average life of the bond to roughly 5.8 years.

Tranche A was not formally rated, but structured as to the maximum issue size and security package that could sustain the short-term ratings criteria of A-1+/P1 of the initial conduit investors – WestLB's Compass Securitisation and CIBC's Superior Funding Capital Corp. This was achieved with the full understanding of the nature of the cashflows, the strength of the operating lease revenues from contracts made to a highly diversified pool of obligors, key risks and credit enhancement.

The key risks were identified as technological risk, VAT risk and the reliability of the rented goods and the ability of Boxclever or potentially third parties to service and repair to ensure continuity of cashflow. Making rating agencies and investors comfortable with the capacity of other servicers to take on the rental asset portfolio was key in ensuring that the transaction was viewed as a traditional asset-backed transaction rather than a 'whole business' deal. Credit enhancement to the B notes took the form of 20% over-collateralisation of expected future cashflows in the first instance. The B notes further cushion the A note investors by an additional 10% of the collateral value.

The second tier B notes were structured to achieve the public ratings of BBB/Baa2 from Standard & Poor's and Moody's, respectively. At £88,070,000, it was the first public securitisation of UK consumer rental goods and was sold to institutional investors. This class enjoys the same security package as class A on a subordinated basis and has the additional benefit of a liquidity reserve of around £7.5m to cover any temporary shortfall in the payment of interest, sized at 12 months' class B interest.

THE STRUCTURE. The securitised assets were structured through Boxclever's bankruptcy remote, special purpose vehicle (SPV), Home Technology Receivables No 1 plc (HTR), which issued the class A and B bonds and entered into a series of interest rate swap transactions, to hedge its floating interest obligations, and security arrangements with the Security Trustee (JPMorgan Chase). (See *Figure 1*). The bond proceeds were on lent on a secured basis to Home Technology Finance Ltd (HTFL), which although not bankruptcy remote is ring-fenced to enable the transaction to survive its insolvency. HTFL used these funds to repay Boxclever Finance and ultimately WestLB for a substantial portion of the original acquisition debt. HTFL is also the recipient of the rental stream and other payments from the obligors and uses these proceeds to discharge its principal and fixed rate interest obligations to the issuer, HTR.

The use of the secured loan structure provided the issuer with effective security over the securitised asset pool, without requiring the transfer of the assets into the issuer that would have required a cumbersome exercise and probably created a few logistical headaches.

THE SMALL PRINT. As you might expect, the layering of the different facilities creates some interesting inter-creditor arrangements. The security for the bonds comprises fixed and floating charges over the assets of HTFL and HTR and class A ranks ahead of class B. The small print provides that the revolving substitution period will be suspended and no further advances permitted upon the occurrence of a substitution termination event – that is:

- where the default ratio exceeds 0.60%;
- the delinquency ratio exceeds 12%;
- the dilution ratio exceeds 0.75%; or
- the first level debt service coverage ratio is less than 102% –110% at various predetermined dates.

New assets may be introduced to the portfolio to remedy a breach.

TABLE 1

BOXCLEVER REFINANCING.

	Size (£m)	Weighted average life (years)	Margin	Expected maturity
Securitisation (A)	660.17	5.8	0.85%(1)	2010(2)
Securitisation (B)	88.07	5.8	3.00%	2010(2)
Mezzanine bank debt	120.00	4.5	4.50%(3)	2007
Total term debt	868.24			
Working capital facility	40.00	2.8	2.00%	2005
Structured interest rate swap program	748.24	5.8	–	2010(2)

1 *Over conduits cost of funds – Libor and stepping to 2% per annum from June 2010*
2 *Legal maturity of 15 years*
3 *Stepping up to 6.50% during life of the facility*

The facility also defines PoP's – the borrower's Priorities of Payments, in three distinct stages and all being well only the first will be applicable.

The first are the Pre-Rapid Amortisation PoP's that remain in force until a Rapid Amortisation Event occurs, ie when the Debt Service Coverage Ratio reduces below 100% or the borrow has insufficient funds to meet the next monthly payment. The Rapid Amortisation PoP's would then come into force which provide another layer of credit enhancement in the form of a cash trapping reserve account. Finally, the Post Enforcement PoP's trigger early amortisation of principal.

MEZZANINE AND WORKING CAPITAL LAYER. In addition to the two classes of securitisation notes, Boxclever borrowed a further £120m from WestLB under a mezzanine facility and secured additional liquidity of £40m through a committed working capital facility (see *Table 1*). Both facilities are serviced from cashflows arising within the securitisation programme and from non-securitised assets. The mezzanine facility is scheduled to amortise after five years – before the 'senior' ranking securitisation notes.

The initial coupon of the mezzanine facility is 450bp, increasing to 500bp after 18 months and further to 650bp in the last six months up to the final maturity in June 2007. This mezzanine facility was secured on the Boxclever group's other assets, principally Endeva, the third-party servicing operator regarded as a growth business.

The lenders to both bank facilities have security over certain of the securitised assets by way of lower priority charges. The flexibility of the structure allowed Boxclever to maximise the proceeds level from its core rental assets, while retaining the flexibility to raise debt from non-securitised businesses, not typical of traditional whole business securitisation deals.

THE DEAL HEDGE. The financing package would not be complete without intricate hedging arrangements and fortunately Boxclever did not have to contend with cross currencies as well. As part of the credit enhancement package Boxclever entered into a series of swaps to hedge the floating rate interest exposure in the aggregate sum of £748.24m. Gardner explains: "The swap carries the same profile as the securitisation deal – that is, amortising out to final legal maturity of 15 years. The swap is 'structured' in that the principal amount of the swap changes every month so it exactly matches the outstanding profile of the aggregate A and B notes.

There is also a further swap between WestLB and Boxclever that passes this risk back to the Boxclever group, but which has to be fronted by WestLB since Boxclever does not have the requisite rating. You could probably write a whole article on the deal hedge alone!"

The proceeds from the securitisation and the mezzanine facility together paid off the £860m senior and subordinated bridge facilities provided by WestLB at the time of the formation of Boxclever in June 2000, but early repayment options pave the way for the next round of funding, perhaps when the shareholders exit the business for good or when the initial debt quantum has been reduced by way of a leveraged re-capitalisation of the business.

ROGER MAVITY'S TRANSACTION HIGHLIGHTS.

- The dawning that this transaction was extraordinarily complex, even by the standards of people who do it all the time.
- Being mind-boggled by the sheer scale of it, the amount of legal documentation and level of assurance the rating agencies needed.
- At the end of the day, the excitement of being associated with something so ground breaking.