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Bidding for Hertz: Leveraged Buyout

Overview

In late summer 2005, Greg Ledford, managing director and head of automotive and transportation buyouts at the Carlyle Group, found himself examining his BlackBerry atop the Great Wall of China. Though he had planned to be sightseeing with his daughter, his immediate focus was to finalize the terms of the second-largest leveraged buyout in history. The target in question was Hertz, a subsidiary of the Ford Motor Company, which was up for sale. Ledford needed to decide the price he and his co-investors would offer for Hertz as well as assess the potential returns and risks of the deal. Already months of work, many dollars of due diligence, and arrangement of tentative financing had gone into the bid. Complicating matters, he knew he faced tough competition from a rival buyout group, no doubt engaged in a similar process.

The race to win Hertz had been set in motion several months earlier, when William Clay Ford Jr., the chairman and CEO of Ford, announced plans to explore "strategic alternatives" for Hertz in April 2005. That announcement was followed in June 2005 by the filing of an S-1 registration statement setting up a "dual track process" that would result in a Hertz IPO should other sale prospects fail. Ledford, who spoke to senior Ford managers on a regular basis, had gleaned that there was interest on Ford's part for an outright sale of Hertz. He believed a private sale that was competitive with an IPO would be viewed favorably by Ford due to its greater up-front cash proceeds and certainty of execution. When no strategic buyer surfaced, Carlyle, Clayton, Dubilier & Rice (CD&R), and Merrill Lynch Global Private Equity (collectively "Bidding Group") joined forces to bid on Hertz. It faced competition from another buyout consortium that included Texas Pacific Group, Blackstone, Thomas H. Lee Partners LP, and Bain Capital LLC.

Hertz Ownership History

Hertz's ownership history was characterized by a series of sales, public offerings, and leveraged buyouts (**Exhibit 1**).[1] The company was first established in 1918 by 22-year-old Walter L. Jacobs as a car rental operation with a modest inventory of 12 Model T Fords that Jacobs personally had repaired and repainted. The venture was immediately successful, leading Jacobs to expand and generate annual revenues of approximately $1 million within five years. At the $1 million mark, in 1923, Jacobs sold his company to John Hertz, president of Yellow Cab and Yellow Truck and Coach Manufacturing Company, who gave his name to the company, creating "Hertz Drive-Ur-Self System" and a brand name that had endured ever since.

[1] Information on company history was obtained from the company website: www.hertz.com (accessed July 31, 2008).

This case was prepared by Susan Chaplinsky, Professor of Business Administration, Darden Graduate School of Business, and Felicia Marston, Professor, McIntire School of Commerce. It was written as a basis for class discussion rather than to illustrate effective or ineffective handling of an administrative situation. Copyright © 2008 by the University of Virginia Darden School Foundation, Charlottesville, VA. All rights reserved. *To order copies, send an e-mail to sales@dardenbusinesspublishing.com. No part of this publication may be reproduced, stored in a retrieval system, used in a spreadsheet, or transmitted in any form or by any means—electronic, mechanical, photocopying, recording, or otherwise—without the permission of the Darden School Foundation.*

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John Hertz sold his investment three years later to General Motors (GM). In 1953, GM in turn sold the Hertz properties to the Omnibus Corporation, which simplified the company's name to "The Hertz Corporation" in connection with a public stock offering on the New York Stock Exchange (NYSE). In late 1987, together with Hertz management, Ford Motor Company participated in a management buyout of the company. Hertz later became an independent, wholly owned subsidiary of Ford in 1994. Less than three years later, Ford issued a minority stake of shares through a public offering on the NYSE on April 25, 1997. In early 2001, Ford reacquired the outstanding shares of Hertz and the company again became a wholly owned subsidiary of the Ford Motor Company.

Hertz Financial History and Business Segments[2]

The large investor interest in Hertz over time was due in part to the company's proven financial ability. In fact, the company had produced a pretax profit each year since 1967. During the period 1985 to 2005, revenues had grown at a compound annual growth rate of 7.6% with positive year-over-year growth in 18 of those 20 years. Over the past same period, Hertz had emerged as a truly global enterprise; it had car rental operations in 145 countries, and more than 30% of its total revenues were from outside of the United States. Hertz was among the most globally recognized brands and had been listed in *BusinessWeek*'s "100 Most Valuable Global Brands" (limited to public companies) in 2005 and every year since it was eligible for inclusion.

Hertz currently operated in two business segments: car rental ("Hertz Rent A Car" or "RAC") and equipment rental ("Hertz Equipment Rental Company" or "HERC"). In 2005, it was estimated that RAC would comprise 81% of company revenues and HERC 19%. RAC was supported by a network of franchises that together with company-owned facilities operated in more than 7,600 airport and local locations throughout the world. The company led its competition in the airport car rental market in Europe with operations at 69 major airports. Hertz owned and leased cars from more than 30 manufacturers, most of which it had long-term leasing and replacement agreements with. The equipment rental segment offered a wide range of earthmoving, material handling, and electrical equipment; air compressors; generators; and other equipment. Hertz rented equipment through 360 branches in the United States, Canada, France, and Spain and had an extensive network of international licensees outside these markets.

For the year ended December 31, 2005, Hertz was expected to generate revenues of $7,410 million and EBITDA of $2,759 million. Hertz's most recent income statements and balance sheets are shown in **Exhibit 2** and **Exhibit 3**, along with pre-LBO projections for the full year 2005.

The Car Rental Market

U.S. rental car revenues in 2004 totaled approximately $17.4 billion, an improvement of 5.5% over 2003 (**Exhibit 4**). U.S. industry-wide revenues were, in turn, approximately two-thirds of global revenues. Competition within the global car rental industry was keen and highly concentrated among a few companies. In the United States, the top three competitors, Enterprise Rent-A-Car, Hertz, and Avis Rent A Car (owned by Cendant Corp.), captured approximately 68% of the estimated 2006 market revenues and the top six captured almost 94% of the total. Hertz led in the airport rental segment of the industry while Enterprise dominated the nonairport rental segment. In 2005, it was estimated that approximately 79% of the U.S. RAC revenues would be airport-related rentals. Hertz's market-leading share of the airport rental market was

[2] Information on business segments is from Hertz Global Holdings, Inc, 3/30/2007 Form 10-K (Annual Report) (Park Ridge, NJ: Hertz Global Holdings, Inc., 2007).

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attributed in part to its "Hertz #1 Club Gold" program. About 50% of RAC's vehicle rentals came from Club Gold members.

The car rental business was affected by general economic conditions and more particularly by conditions in the travel industry, especially airline traffic. There was a high correlation between airline traffic (number of enplanements) and industry-wide rental revenues. Following the September 11 terrorist attacks on the United States, there was a sharp downturn in enplanements, but they finally seemed to be rebounding in 2004. The U.S. Department of Transportation predicted enplanements would grow at an annual rate of 3.7% from 2004 to 2010.[3]

Partially due to 9/11, off-airport rentals, which consisted primarily of insurance replacement (rentals provided by insurance companies while the policyowner's automobile was out of service), local business travel, and leisure travel, had recently grown at a faster pace than had airport rentals.

The Equipment Rental Market

As of August 2005, the size of the North American equipment rental market in revenues was believed to be $25 billion, while that of France and Spain were approximately $4 billion and $2 billion, respectively. But because HERC only offered certain types of equipment, Hertz's applicable market was somewhat smaller.

The equipment rental market was more variable than the car rental market and depended mostly on industrial productivity, particularly commercial and residential construction. Over the past 15 years, the best estimates of growth suggested the market had grown at an annual rate of approximately 9.7%. During this time, there was a trend toward companies in need of equipment renting rather than owning it, which was expected to continue. The market had experienced rapid growth in the 1990s but had slowed considerably between 2000 and 2003 with the decline in the economy. The equipment rental market had recently started to rebound from the 2000–03 levels, a rebound which was expected to continue.

Unlike the car rental market, the U.S. equipment rental industry was highly fragmented with few national competitors. Other major national scale operators like Hertz included United Rentals, Inc., and RSC Equipment Rentals, a division of the Atlas Copco Group. The equipment rental business was highly competitive, and rental prices had started declining in 2001 and did not improve in North America until 2004. Prices in France and Spain had yet to stop declining.[4]

Instead of a concentrated source of revenues (U.S. airports), customers of the equipment rental industry were widely scattered throughout the country. This complicated the distribution of equipment and reduced the opportunity to achieve scale in operations, encouraging local players to compete with large businesses. Nonetheless, Hertz was a top player in the industry, ranking third based on 2005 revenues. Hertz's diverse customer base also helped to alleviate some of the risks of cyclicality and seasonality present in the industry.

Tough Times at Ford

Ford's acquisition of Hertz in January 2001 reflected the strategy of its then CEO and president, Jacques A. Nasser. Nasser had been promoted from president of Ford's worldwide automotive operations to become CEO in December 1998.[5] At the same time, Bill Ford Jr., a great-grandson of Henry Ford, assumed the role

[3] U.S. Department of Transportation.
[4] Consortium internal documentation on Hertz LBO.
[5] Keith Bradsher, "The Top Spot at Ford is Returning to a Ford," *New York Times*, September 12, 1998.

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of company chairman. Nasser's strategy was to turn Ford into something, anything, other than a traditional car company. He attempted to shrink Ford's mainstream automotive divisions and remake it into a leading consumer company in automotive products and services. Known for his abrasive style, Nasser frenetically pursued his strategy, jetting around the world and working 20-hour days. He acquired Volvo, Land Rover, Hertz, and spent billions pursuing noncore operations. During Nasser's three-year tenure, Ford's once-impressive $15 billion cash reserve dwindled to less than $1 billion by 2001.[6]

In November 2001, Bill Ford Jr. assumed the CEO role at Ford replacing Nasser. After the turbulent years of Nasser, Bill Ford's ascension to CEO was greeted enthusiastically.[7] But Ford inherited a company that had lost $5.5 billion the previous year and whose future held great uncertainty. While Ford had a strong line of trucks, its passenger car line was lagging. By mid-2002, Ford was losing $190 per vehicle because of its bloated cost structure and intense pricing pressure from competitors.

Although Ford proposed several restructuring plans that would reduce costs and reenergize its passenger car line, his plans were not enough to stem the company's decline. By the time he announced the company's intentions to explore strategic options for Hertz in April 2005, Ford's stock price had fallen to less than $10 per share. The company continued to lose money, especially in its North American operations.[8] Rumored to be facing a potential downgrade in its bond rating, Hertz looked to be a viable candidate for Ford to raise some much-needed cash to shore up its bond rating and attempt to return its car operations to profitability.

Hertz as an LBO candidate

Although Ford owned 100% of Hertz, Hertz had operated largely without oversight by or obligation to Ford.[9] Members of the Bidding Group had individually evaluated Hertz and believed it to be an attractive leveraged buyout candidate.

Operating Synergies

Hertz's two business segments presented large opportunities for operational improvement. The key drivers of the rental car business included the number of transactions, the length of each rental, revenue per rental day, and fleet utilization. Transaction volume, which was a good indicator of market demand, typically followed growth in the general economy and enplanements. Rental length was largely dependent on customer and end-product mix. Leisure and insurance renters generally rented cars for longer periods than business travelers. Another major driver of revenues was price, or revenue per rental day. Utilization of the fleet also played an important role in determining profitability and return on assets.

Improvement in any of these drivers had the potential to yield substantial increases in revenue. With travel finally beginning to rebound after the events of 9/11, the near-term market trends appeared favorable, and management had projected transaction volume to grow 6.9% in 2005. With respect to price, the Hertz brand was exceptionally strong and recognized worldwide. Hertz had shown an ability to sustain a premium pricing strategy, which was in part due to its loyal customer base. Although Hertz was the price leader in the market, it could not impose higher rates if competitors chose not to follow.

[6] Kathleen Kerwin, "Ford's Long, Hard Road," *BusinessWeek* (October 7, 2002).
[7] Tim Burt and Nikki Tait, "The King of Detroit: Man in the News: Bill Ford," *Financial Times*, November 3, 2001.
[8] Bernard Simon, "Ford Hit by Falling North American Sales," *Financial Times*, July 19, 2005.
[9] In January 2001 when Nasser repurchased Hertz outstanding shares, Ford paid $710 million for the 18.5% of the company it did not already own. It paid $35.50 per share or an 18% premium for Hertz's shares. The acquisition implied a value of approximately $3.8 billion for Hertz equity at the time.

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Hertz was one of the largest private-sector purchasers of new cars in the world. In 2004, the company operated a peak fleet of 300,000 cars in the United States and approximately 169,000 in its international operations. Fleet usage was highly seasonal—it peaked in the second and third quarters of the year and declined in the first and fourth quarters as leisure travel waned. Significant cost savings could arise from right sizing the fleet (purchasing and disposing of cars) to match seasonal demand. Historically, Hertz had purchased the majority of its cars from Ford, but in recent years, it had moved to decrease its reliance on Ford vehicles. In part, this was in response to U.S. auto manufacturers' decision to reduce fleet sales to bolster their own profitability. This had two effects on Hertz and its competitors. First, it increased vehicles costs and second, it increased the proportion of "at risk" vehicles potentially subject to declining residual values.[10] An increase in vehicle costs in 2006 was expected to increase Hertz's acquisition costs and hence fleet capital spending by proportionately more than the previous year.

The Bidding Group compared Hertz with peer firms and with its own historical results to identify the following operational savings.[11]

1. Current adjusted EBITDA margins were approximately 400 basis points (bps) below 2000 levels and were 100 to 200 bps below those of Avis.
2. From 2002 to 2005E nonfleet-related operating expenses had increased by 38% and had outpaced revenue growth by 6%.
3. Hertz's off-airport growth strategy had resulted in significant losses. The Bidding Group would look to rationalize this strategy.
4. U.S. RAC's nonfleet capital expenditures (CAPEX) as a percentage of sales were considerably higher than Avis's long-term CAPEX levels.
5. Europe RAC's SG&A as a percentage of sales and on a per-day basis were three times higher than those in the United States.
6. HERC's return on assets lagged that of competitors, reflecting an inefficient use of capital. In 2005, HERC's rental revenue on fleet assets was projected to be 70.5%. By comparison, the returns for RSC and United Rentals were expected to be 85% and 116%, respectively.

All told, the Bidding Group believed that an amount between $400 million and $600 million in annual EBITDA savings (relative to 2005 levels) was attainable by 2009. These estimates of operational improvements were confirmed by external industry advisors who had been hired as part of due diligence.

The Bidding Group had also carefully evaluated Hertz's management team. The current management team had considerable industry experience but, partially as a result of Ford's hands-off management style, they operated in an insular manner and had not been pressured to excel. The existing compensation structure was based on market share, and new incentive plans were planned that would target cash flow and capital usage metrics. If removal of the current CEO, Craig Koch, proved necessary, an experienced manager, George Tamke, had been identified to step in. Tamke, who was currently a partner at CD&R, was formerly vice chair and co-CEO of Emerson Electric, and had successfully led CD&R's Kinko's transaction.

[10] During 2004, Hertz purchased 85% of its U.S. and 74% of its international cars under fleet-repurchase programs with automobile manufacturers. Under these programs, automobile manufacturers agreed to repurchase the cars at a specified price subject to certain car conditions and mileage requirements. The repurchase programs limited the residual risk that Hertz bore on "program cars." The average holding period for a new car was 11 months in the United States and 8 months in its international operations.

[11] Consortium internal documentation for Hertz LBO.

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Financial Synergies

In addition to operational savings, the Bidding Group had identified several sources of financing value, most notably debt that could be backed by Hertz's fleet of rental cars (asset-backed securitized debt). By contrast, Ford had opted to rely mainly on more expensive unsecured financing.

Asset-backed securitized (ABS) debt was a form of financing commonly used by financial institutions to remove illiquid assets from their balance sheets (such as mortgages or credit card receivables) and raise cash from them. ABS financing required the creation of a special purpose vehicle (SPV) to facilitate its issuance. An SPV was set up to achieve legal isolation of the assets from the original holder of the assets or "originator." The originator conveyed the assets to the SPV (or trust), which transferred ownership of the assets from the originator to the trust. The SPV would then issue securities backed by the assets of the trust. The interest and principal on the securities were paid from the receipt of cash flows that arose from the trust assets. Because the debt issued by the trust was nonrecourse to the originator, an important benefit of ABS was that the credit rating on the debt was based on the trust assets rather than the originator's assets. The proceeds raised from the sale of asset-backed securities to investors were returned to the originator, thereby enabling illiquid assets of the originator to be turned into cash. Although ABS financings were commonplace, this form of financing had never been used in a buyout before Hertz.

In Hertz's case an SPV ("RAC Fleet") would be set up to retain legal ownership of the rental car fleet and its associated debt. Hertz would make payments in the amount of the fleet depreciation and interest to RAC Fleet, such that it effectively sold the fleet to the SPV and then leased it back (i.e., the depreciation and interest payments effectively represented the operating lease payments). Furthermore, as Hertz acquired (deposed of) cars, it had agreements to increase (decrease) the ABS debt. Investors who purchased ABS debt would be paid through the lease payments Hertz remitted to RAC Fleet. Through a combination of these payments and credit enhancement (including the purchase of insurance for the ABS assets), Hertz hoped to be able to raise $6.1 billion in secured debt at an AAA rating, which was considerably higher than Hertz's current rating of BBB−. The ABS debt carried a low interest rate for LBO-type financing, estimated at about 4.5%.[12]

The Bidding Group believed it held a distinct advantage with respect to financing. Early in the process, it had entered into a financing arrangement with Lehman Brothers and Deutsche Bank to provide ABS debt financing for the transaction. Lehman Brothers and Deutsche Bank held a 90% market share in the ABS market for rental car financing. Not only was the ABS debt less expensive but it also provided a more flexible financing arrangement that allowed for the debt to increase and decrease with fleet size.

Deal Structure

Given the large deal size, the ABS debt was not the only source of financing needed to finance the buyout. **Exhibit 5** shows the proposed financing for the transaction. Although $1,400 million of existing debt would roll over, for the most part, Carlyle and the consortium members planned to raise new debt to finance the deal. In total, the nonequity funding for the transaction was approximately $12.5 billion.[13]

[12] Although the ABS debt was floating rate, there were swap agreements to hedge interest-rate risk such that a good portion of the interest payments would be at a fixed rate rather than a floating rate. The case assumes fixed-rate payments. The international ABS debt was estimated to have a higher interest rate of 4.9%.

[13] There were several iterations of the estimated financing for the transaction. The financing shown in **Exhibit 5** is closer to the actual financing used. Flexibility was built into the financing through the term loan facility and a fleet financing facility (which was unfunded at close).

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In the summer of 2005, the debt and LBO market had recovered from the lows following the 2001 slowdown. Senior debt, which had fallen to 2.38× EBITDA in 2002, had since recovered to 3.24× EBITDA in 2004. Further relaxation of lending standards had occurred over the course of 2005 and senior debt multiples were expected to close above 4× EBITDA by year end 2005. Deal valuation had followed suit—purchase-price multiples, which had fallen to around 6× EBITDA in 2001, had expanded to more than 8× EBITDA in 2005. **Exhibit 6** shows the recent history of debt and purchase price multiples.

Valuation of Hertz

The Bidding Group planned to set up both RAC and HERC as separate legal entities within a holding company named "Hertz Corporation" or "HertzCo"—in part due to the decision to use ABS financing, and because later it might facilitate separate disposals of the properties. HertzCo consisted of the two business segments: RAC and HERC. RAC was made up of RAC Operating Company (OpCo), which held claim to the cash flows and nonfleet assets of the car rental company, and RAC Fleet, the subsidiary which housed the rental car fleet. HERC held claim to the cash flows and assets of the equipment rental business. This structure was key to valuing HertzCo—the value of RAC and HERC could be determined separately and then added together to determine the total enterprise value of HertzCo. The value of equity in turn could be determined by subtracting the total operating company and fleet debt from enterprise value. See **Exhibit 7** for a detailed representation.

RAC could be valued by applying an appropriate multiple to RAC OpCo's operating flows and then adding the net book value of the fleet.[14] Due to its relatively short life, the fleet had a fairly transparent market value, which was well approximated by its book value. Because of the ABS debt, the operating company's flows had to be adjusted to reflect the depreciation and interest payments made to RAC Fleet. In essence, the service obligations on the fleet had to be met before the providers of LBO financing were paid. RAC Adjusted EBITDA was therefore RAC Gross EBITDA less fleet depreciation and fleet interest. HERC could be valued by applying an appropriate multiple to HERC Gross EBITDA (Revenues less Direct Operating and SG&A Expenses).[15] HERC did not utilize ABS debt because the market value of equipment rentals was less transparent (due to longer lives and diverse usages).

Exhibits 8 and **9** contain a base-case pro forma income statement and balance sheet with projections for 2006–10. Given projected enplanements, car-rental growth was estimated to slow to 4.5% by 2009 and stabilize at that level. Though the equipment rental market had started to rebound from a cyclical slowdown, equipment rental growth at Hertz had been much more variable, and it was eventually expected to decline over time and to stabilize at 3% by 2010. The base-case estimates build in the low end of $400 million in operational savings over time and incorporate the segment revenue growth rates noted above. RAC fleet expenditures (and ABS debt) were expected to increase as a percentage of sales due to higher vehicle costs, leading to corresponding increases in RAC depreciation.[16]

Exhibit 10 combines the operating cash flows of the two divisions and provides cash-flow projections for 2006–10. Although it was not possible to directly estimate a beta for Hertz, comparable company equity betas were around 1.5, which, when de-levered, yielded unlevered betas of approximately 0.60. But there was

[14] It was common industry practice to value the rental fleet separately from the operating company.

[15] Purchase price and other deal metrics were based on Hertz Corporate EBITDA, which was the total of the operating flows of its two business units (i.e., the sum of RAC Adjusted EBITDA + HERC Gross EBITDA).

[16] Working capital (net of cash) was assumed to be maintained at 2005 percentages for the most part, though receivables arising from repurchases of cars by manufacturers were projected to decline as a percentage of sales. Necessary cash (cash and cash equivalents line item) was set at 2% of sales. The projections also built in a small increase in HERC equipment efficiency. PPE, net (nonfleet PPE), was expected to decline more significantly as a percentage of sales.

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a wide range to these estimates. Interest rates as of August 2005 and market multiples are shown in **Exhibit 11**.

The Decision

Any bid put forth by the Bidding Group for Hertz would have to satisfy three critical tests. First, it would have to provide adequate returns to the sponsors' limited partners. Second, it would have to be higher than Ford could receive from an IPO. Third, the bid would have to best that of the rival bidding group.

Time was drawing to a close, and Carlyle and its partners needed to finalize their bid. Ledford knew that his investment committee would not only be keenly interested in the possible returns they could expect from Hertz, but also in his views on the risks of the deal and bidding strategy. Although much work had been done, much more lay ahead. It was not turning out to be the vacation he planned.

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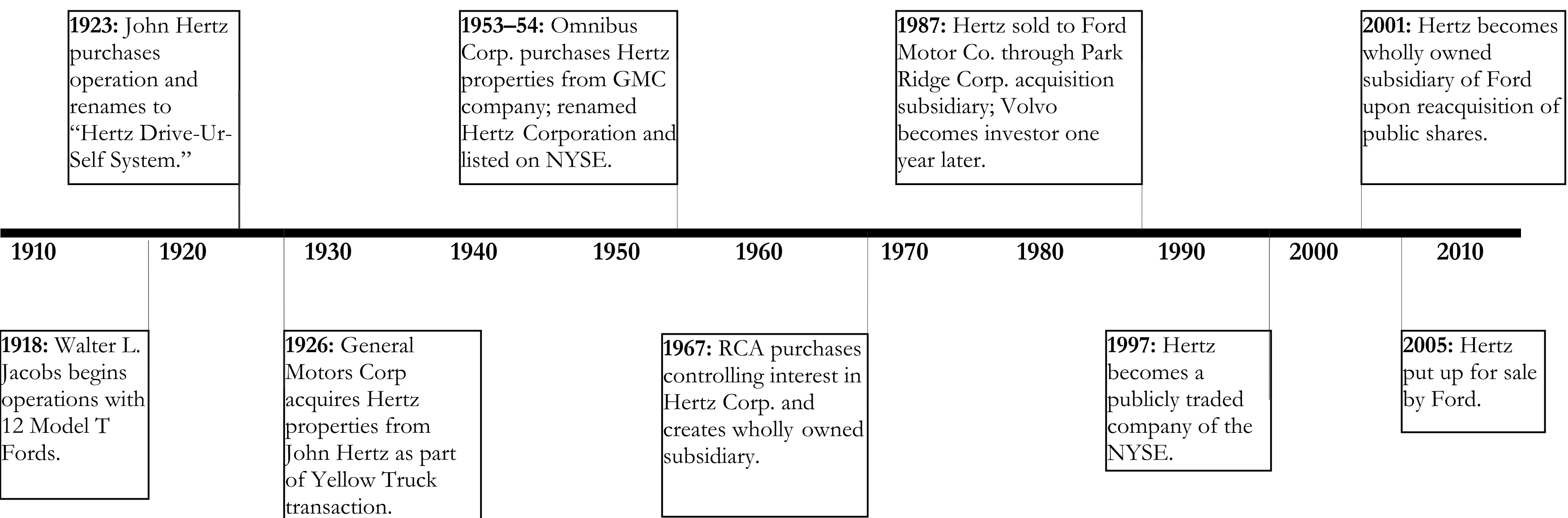
Exhibit 1

Bidding for Hertz: Leveraged Buyout

Hertz Ownership History



Source: Hertz Corporation.

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Exhibit 2

Bidding for Hertz: Leveraged Buyout

Hertz Historical Consolidated Income Statement
($ millions)

	2002	2003	2004	2005E [1]
RAC				
Revenue	$4,542.7	$4,852.2	$5,490.1	$6,051.7
Direct Op Ex & SG&A	2,676.3	2,943.9	3,393.9	3,845.2
Gross EBITDA	1,866.4	1,908.3	2,096.2	2,206.5
Fleet Depreciation	1,216.7	1,256.4	1,231.9	1,362.2
Fleet Interest	270.9	276.2	310.2	380.1
Adjusted EBITDA	378.8	375.7	554.1	464.2
HERC				
Revenue	1,095.7	1,081.5	1,185.9	1,358.0
Direct Op Ex & SG&A	722.2	717.9	749.6	805.1
Gross EBITDA	373.5	363.6	436.3	552.9
Fleet Depreciation	282.8	267.0	231.4	228.0
Fleet Interest	95.4	78.9	74.3	96.6
Adjusted EBITDA	-4.7	17.7	130.6	228.3
Total Adjusted EBITDA	374.1	393.4	684.7	692.5
Non-Fleet Depreciation	157.6	156.0	182.7	184.7
Operating Company Interest Expense	0.0	0.0	0.0	0.0
Pretax Income	216.5	237.4	502.0	507.8
Book Taxes	77.9	85.5	180.7	182.9
Minority Interest	0.0	0.0	3.2	9.7
Net Income	**$138.6**	**$151.9**	**$321.3**	**$324.9**

[1] Reflects pre-LBO estimated net income for 2005.

Data source: Consortium internal documentation.

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Exhibit 3

Bidding for Hertz: Leveraged Buyout

Hertz Historical Consolidated Balance Sheet
($ millions)

	2002	2003	2004	2005E [1]
Assets				
Cash and Equivalents	601.3	1,110.1	1,237.9	1,102.9
Fleet Cash Enhancement	0.0	0.0	0.0	0.0
Accounts Receivable	799.1	1,308.2	1,225.1	1,004.2
Manufacturer Receivables	473.8	511.9	600.1	629.7
Inventories	71.8	73.4	83.3	92.7
Prepaid Expenses	83.8	90.3	100.1	113.1
Other Assets	42.3	45.6	44.1	36.5
Total Current Assets	2,072.1	3,139.5	3,290.6	2,979.1
Fleet, Net	7,425.8	7,793.3	9,122.9	9,767.3
PP&E Net	1,111.8	1,169.8	1,236.2	1,354.6
Existing Goodwill & Intangibles	519.0	536.9	544.4	534.6
New Goodwill & Intangibles	0.0	0.0	0.0	0.0
Total Assets	11,128.7	12,639.5	14,194.1	14,635.6
Liabilities & Stockholders' Equity				
Accounts Payable	506.2	757.9	786.0	758.0
Accrued Liabilities	789.4	736.4	835.7	819.7
Accrued Taxes	52.8	111.4	130.1	129.3
Total Current Liabilities	1,348.4	1,605.7	1,751.8	1,707.0
Total Long-Term Debt	7,043.2	7,627.9	8,428.0	9,180.3
Public Liability & Property Damage	353.5	398.8	391.7	374.3
Deferred Taxes	462.1	721.2	849.7	636.0
Commitments & Contingencies	0.0	0.0	0.0	0.0
Minority Interest	0.0	0.0	4.9	12.7
Total Liabilities	9,207.2	10,353.6	11,426.1	11,910.3
Total Equity	1,921.8	2,285.8	2,767.9	2,725.9
Total Liabilities & Equity	11,129.0	12,639.4	14,194.0	14,636.2

[1] Reflects pre-LBO estimated balance sheet for 2005. Small differences in historical total assets and total liabilities and equity in 2002–04 are due to rounding.

Data source: Consortium internal documentation.

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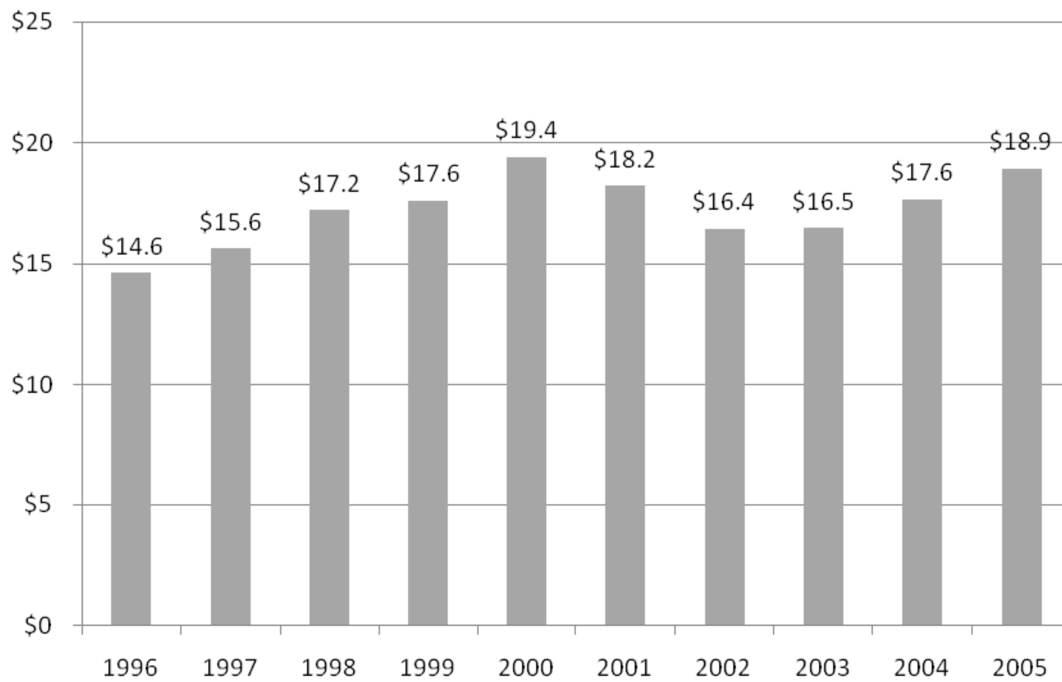
Exhibit 4

Bidding for Hertz: Leveraged Buyout

U.S. Rental Car Market Revenues (1996–2005)
($ billions)



Data source: *Auto Rental News,* 2006.

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Exhibit 5

Bidding for Hertz: Leveraged Buyout

Proposed Financing for the Hertz Buyout

Amount ($ millions)	Type of Security	Rate	Terms
$4,300	U.S. ABS secured notes	4.50%	Could increase with new car purchases, subject to fleet equity requirement[1]
$1,800	International ABS secured notes	4.90%	Could increase with new car purchases, subject to fleet equity requirement[1]
$ 600	Existing ABS debt	4.00%	
$6,700	Total Estimated RAC Fleet/ABS debt		
$1,800	Term Loan Facility	8.00%	Estimated (floating) rate; 7-year term; repay or refinance in 7 years
$ 400	Senior ABL Facility	7.00%	Estimated (floating) rate
$ 200	Senior Euro notes	7.88%	Bullet amortization, due in 2014
$2,000	Senior Unsecured notes	8.875%	Bullet amortization, due in 2014
$ 800	Existing Senior Notes	7.0%	Varying maturities to 2028
$ 600	Senior Subordinated notes	10.50%	Bullet amortization, due in 2016
$12,500	Total Debt		
Other Sources			
$2,300	Sponsor equity		
$14,800	Total payment for assets[2]		

[1] There was a 10% to 20% fleet equity requirement, dependent on the financial strength of the vehicle supplier. The fleet equity requirement was assumed to average 13% of the book value of the fleet.

[2] The expected transaction fees approximated the amount of estimated excess cash and hence both net to zero and are ignored for simplicity in the case.

Source: Consortium documentation, Hertz Global Holdings, Inc. form S-1 A, 11/13/2006, and author estimates.

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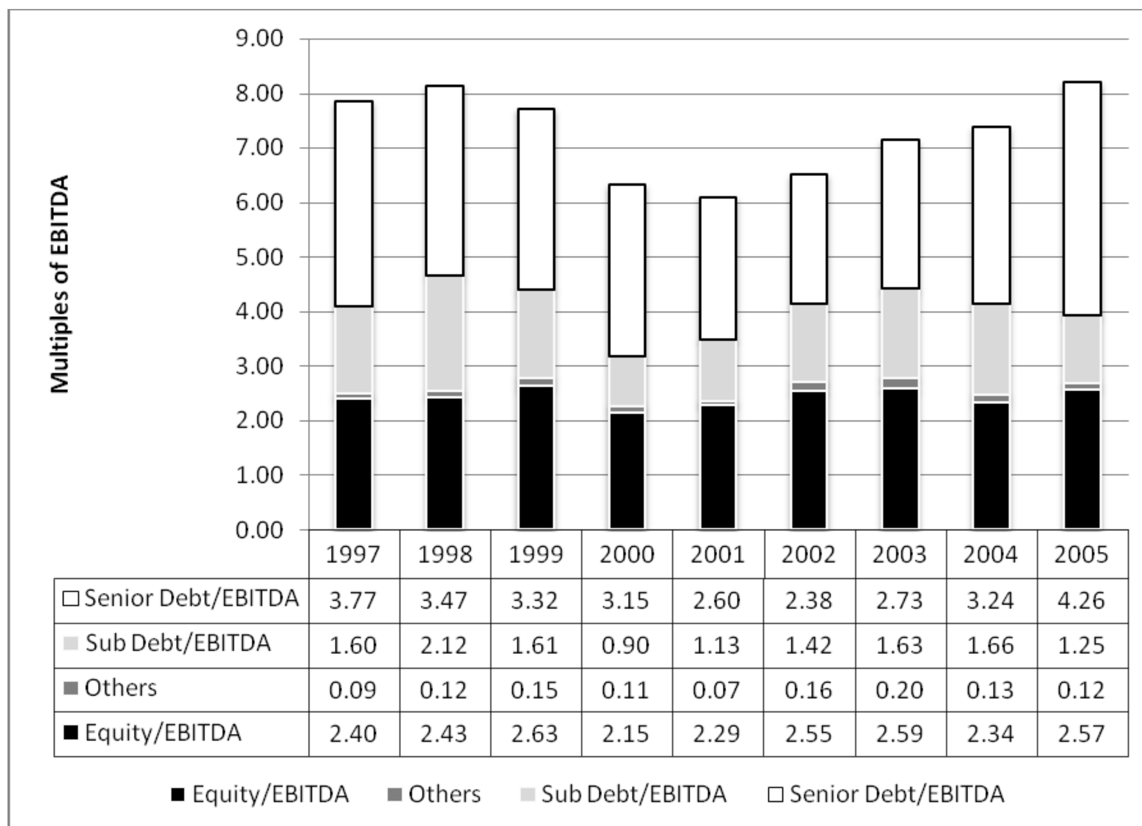
Exhibit 6

Bidding for Hertz: Leveraged Buyout

Debt and Purchase-Price Multiples for Leveraged Buyouts Greater than $50 Million[1]



	1997	1998	1999	2000	2001	2002	2003	2004	2005
Senior Debt/EBITDA	3.77	3.47	3.32	3.15	2.60	2.38	2.73	3.24	4.26
Sub Debt/EBITDA	1.60	2.12	1.61	0.90	1.13	1.42	1.63	1.66	1.25
Others	0.09	0.12	0.15	0.11	0.07	0.16	0.20	0.13	0.12
Equity/EBITDA	2.40	2.43	2.63	2.15	2.29	2.55	2.59	2.34	2.57

[1] Purchase Price Multiple equals the sum of Senior, Sub Debt, Others, and Equity multiples.

Data source: Standard & Poor's, a division of the McGraw-Hill Companies, Inc.

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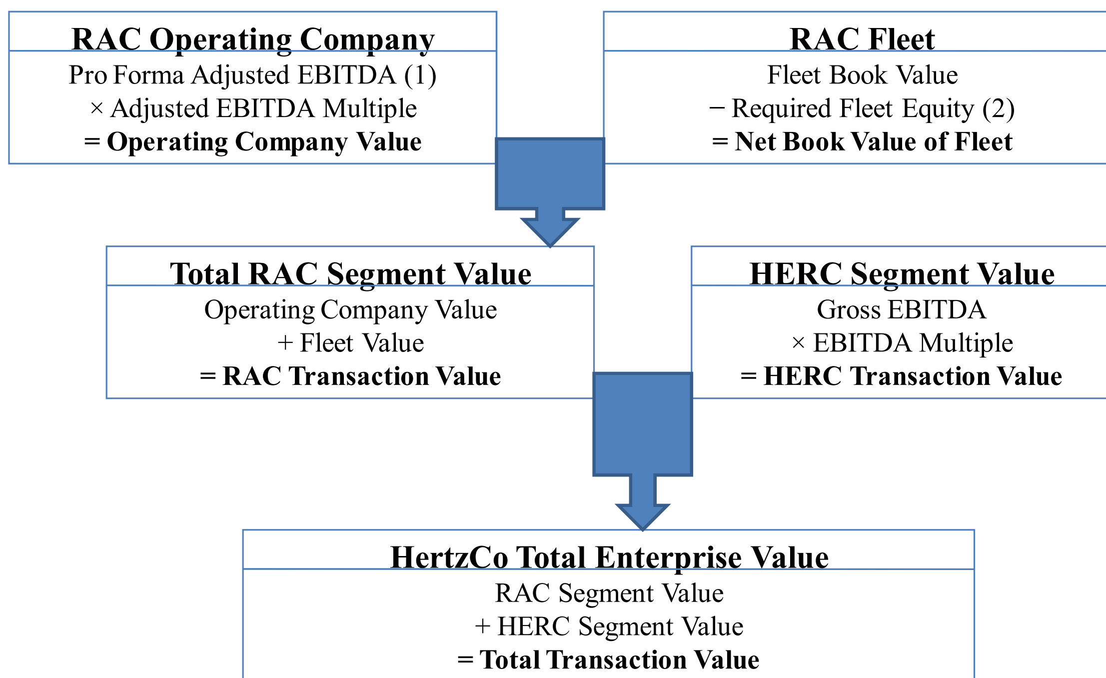
Exhibit 7

Bidding for Hertz: Leveraged Buyout

Valuation Schematic for Hertz Transaction



(1) Pro Forma Adjusted EBITDA = Gross EBITDA – Fleet Depreciation and Fleet Interest

(2) There was a 10% to 20% fleet equity requirement, dependent on the terms of the vehicle supplier. The fleet equity requirement was assumed to average 13% of the book value of the fleet.

Source: Consortium internal documentation, adapted by author.

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Exhibit 8

Bidding for Hertz: Leveraged Buyout

Projected Income Statement
($ millions)

	2005 PF[1]	2006	2007	2008	2009	2010
Business Segments:						
RAC						
Revenue	6,051.7	6,535.8	6,993.3	7,412.9	7,783.6	8,133.9
Direct Op Ex & SG&A	3,845.2	4,025.3	4,231.0	4,455.1	4,605.6	4,828.2
Gross EBITDA	2,206.5	2,510.5	2,762.3	2,957.8	3,178.0	3,305.7
Fleet Depreciation	1,362.2	1,544.7	1,652.9	1,752.0	1,839.6	1,922.4
Fleet Interest	366	408.1	449.5	479.0	505.6	529.9
Adjusted EBITDA	478.3	557.7	660.0	726.8	832.7	853.4
HERC						
Revenue	1,358.0	1,493.8	1,613.3	1,710.1	1,787.1	1,840.7
Direct Op Ex & SG&A	805.1	863.1	919.0	968.8	999.5	1,031.3
Gross EBITDA	552.9	630.7	694.3	741.3	787.6	809.4
Fleet Depreciation	228.0	249.5	269.5	285.7	298.5	307.5
Fleet Interest[2]	0.0	0.0	0.0	0.0	0.0	0.0
Adjusted EBITDA	324.9	381.1	424.8	455.6	489.1	501.9
Hertz Corporation (HertzCo)						
Total Adjusted EBITDA	803.2	938.8	1,084.8	1,182.3	1,321.8	1,355.3
RAC Non-Fleet Depreciation	145.9	154.4	159.0	161.0	163.0	165.0
HERC Non-Fleet Depreciation	38.8	41.8	43.0	45.0	46.0	47.0
Operating Company (total) EBIT	618.5	742.6	882.8	976.3	1,112.8	1,143.3
Op Co Interest Expense:						
Term Loan facility (RAC), 8.0%		144.0	148.1	149.7	141.8	125.0
Senior ABL facility, 7%		28.0	28.0	28.0	28.0	28.0
Euro notes, 7.88%		15.8	15.8	15.8	15.8	15.8
Senior unsecured notes, 8.875%		177.5	177.5	177.5	177.5	177.5
Existing senior notes, 7.00%		56.0	56.0	56.0	56.0	56.0
Senior subordinated notes, 10.5%		63.0	63.0	63.0	63.0	63.0
Total Op Co interest expense	460.8	484.3	488.4	490.0	482.1	465.2
Pretax Income	157.7	258.3	394.4	486.4	630.7	678.1
Book Taxes (36%)	56.8	93.0	142.0	175.1	227.0	244.1
Net Income	100.9	165.3	252.4	311.3	403.6	434.0
Corporate EBITDA[3]	1,031.2	1,188.4	1,354.3	1,468.0	1,620.3	1,662.8

[1] Reflects 2005PF income statement in **Exhibit 2** adjusted for LBO capital structure (and associated increase in total interest expense). Transaction costs are excluded for simplicity.

[2] Fleet interest exceeds the interest rate times the average year-end balances on the fleet debt due to additional ABS debt incurred intra-year to meet seasonal peaks in automobile rentals.

[3] Sum of RAC Adjusted EBITDA and HERC Gross EBITDA.

Source: Author estimates from consortium documents and Hertz Global Holdings, Inc. form S-1 A, 11/13/2006.

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Exhibit 9

Bidding for Hertz: Leveraged Buyout

Projected Balance Sheet [1]
($ millions)

	2005 PF [2]	2006	2007	2008	2009	2010
Assets						
Cash and Equivalents	300	161	172	182	191	199
Fleet Cash Enhancement	317	342	366	388	407	426
Accounts Receivable	1,004	1,088	1,166	1,236	1,297	1,352
Manufacturer Receivables	630	666	713	756	794	829
Inventories	93	100	108	114	120	125
Prepaid Expenses	113	123	131	139	146	152
Other Assets	37	40	42	45	47	49
Total Current Assets	2,493	2,520	2,699	2,861	3,002	3,132
Fleet	9,767	10,960	11,750	12,455	13,065	13,613
RAC Fleet	7,701	8,733	9,344	9,905	10,400	10,868
HERC Fleet	2,066	2,227	2,405	2,550	2,665	2,745
PP&E, Net	1,355	1,445	1,463	1,460	1,474	1,516
Goodwill & Intangibles	3,915	3,915	3,915	3,915	3,915	3,915
Total Assets	17,530	18,841	19,827	20,691	21,456	22,177
Liabilities & Stockholders' Equity						
Accounts Payable	758	821	880	933	979	1,020
Accrued Liabilities	820	888	952	1,009	1,059	1,103
Accrued Taxes	129	140	150	159	167	174
Total Current Liabilities	1,707	1,850	1,983	2,102	2,205	2,298
Long-term Debt:						
Term Loan facility (RAC), 8.0%	1,800	1,852	1,871	1,773	1,562	1,314
U.S. ABS notes, 4.5% [3]	4,300	4,902	5,258	5,585	5,873	6,146
International ABS notes, 4.9% [3]	1,800	2,096	2,272	2,433	2,575	2,709
Existing ABS debt, 4.0%	600	600	600	600	600	600
Fleet (ABS) financing facilty	0	0	0	0	0	0
Senior ABL Facility, 7.0%	400	400	400	400	400	400
Senior Euro notes, 7.88%	200	200	200	200	200	200
Senior unsecured notes, 8.875%	2,000	2,000	2,000	2,000	2,000	2,000
Existing senior subordinated notes, 7.0%	800	800	800	800	800	800
Senior subordinated notes, 10.5%	600	600	600	600	600	600
Total Long-Term Debt	12,500	13,449	14,001	14,390	14,610	14,769
Public Liability & Property Damage	374	374	374	374	374	374
Deferred Taxes	636	689	739	783	821	856
Minority Interest	13	13	13	13	13	13
Total Liabilities	15,230	16,375	17,110	17,662	18,024	18,310
Total Equity	2,300	2,465	2,718	3,029	3,433	3,867
Total Liabilities & Equity	17,530	18,841	19,827	20,691	21,456	22,177

[1] Small differences in the totals and the sum of individual line items are due to rounding.

[2] Reflects 2005 balance sheet in **Exhibit 3** adjusted for LBO capital structure.

[3] ABS debt balances increase over time due to increases in RAC fleet from growth and rising vehicle costs.

Source: Author estimates from consortium documents and Hertz Global Holdings, Inc. form S-1 A, 11/13/2006.

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Exhibit 10

Bidding for Hertz: Leveraged Buyout

Projected Cash Flows to Operating Company[(1)]
($ millions)

	2006	2007	2008	2009	2010
Net Income	165.3	252.4	311.3	403.6	434.0
Add: increase in deferred taxes	53.2	49.5	44.3	38.4	34.7
Add: HERC fleet depreciation	249.5	269.5	285.7	298.5	307.5
Add: total non-fleet depreciation	196.2	202.0	206.0	209.0	212.0
Less: HERC fleet CAP EX	410.7	447.7	430.0	413.3	387.4
Less: total non-fleet CAP EX	287.0	219.8	202.6	223.2	254.2
Less: increase in NWC	-115.8	46.3	43.0	38.3	37.0
Less: net fleet equity requirement	134.2	79.5	72.9	64.4	60.8
Cash Flow available to pay down debt[(2)]	-51.7	-19.8	98.8	210.4	248.6
Add: operating company interest after tax	309.9	312.6	313.6	308.5	297.7
Free Cash Flow to Capital (unlevered)	258.3	292.8	412.4	518.9	546.3

[(1)] Depreciation and capital expenditures associated with RAC fleet are not added back/subtracted from projections because the RAC fleet is valued separately from the operating company.

[(2)] The sponsors would use the available cash flow to pay off the 8% term loan facility.

Source: Author estimates from consortium documents and Hertz Global Holdings, Inc. form S-1 A, 11/13/2006.

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Exhibit 11

Bidding for Hertz: Leveraged Buyout

Comparable Company Analysis
($ millions)

Company[1]	Stock Price (8/15/05)	Equity Value	Enterprise Value (EV)[2]	LTM Financials			Price Earnings		Enterprise Value/LTM	
				Revenue	EBITDA	EBITDA Margin	2005E	2006E	Revenue	EBITDA
Car Rental										
Amerco	$58.01	$1,236	$1,929	$2,047	$298	14.60%	19.1	15.7	0.94	6.47
Cendant	$20.54	$22,117	$26,417	$20,454	$3,119	15.20%	14.6	12.3	1.29	8.47
Dollar-Thrifty	$32.30	$846	$661	$1,481	$107	7.20%	15	13.7	0.45	6.18
Equipment Rental										
United Rentals	$18.49	$1,440	$4,212	$3,013	$785	26.10%	10.8	8.7	1.4	5.37
Ashtead Group	$2.04	$675	$1,567	$1,144	$246	21.50%	16.9	11.8	1.37	6.37
Atlas Copco	$18.02	$10,942	$11,823	$6,270	$1,495	23.80%	16.8	15.2	1.89	7.91

(1) Cendant held Avis and other travel-related businesses. RSC Equipment Rentals was a division of Atlas Copco.

(2) Enterprise Value for car and truck rental represents the value of the operating company, such that the associated multiples represent the multiples for the operating company. Similarly, EBITDA for car rental represents adjusted EBITDA. Dollar Thrifty Automotive Group, Inc.'s enterprise value is less than equity value because all of its debt is fleet-based (there is no operating company debt) and because Dollar Thrifty has $185 million in excess cash.

Source: Consortium internal documentation on LBO.

Treasury and Corporate Rates—August 2005

3-month T-bill	3.44%
5-year Treasury Bond	4.12%
10-year Treasury Bond	4.26%
Corporate BBB Bonds	5.98%

Source: http://research.stlouisfed.org/fred2/ (accessed October 30, 2008).

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