Gaining credit

HENRYK WUPPERMANN, HEAD OF CAPITAL MARKETS AT BAYER AG, TALKS TO **JULIA BERRIS.**

PHOTOGRAPHER: ROGER HARRIS

Henryk Wuppermann joined the diversified international Bayer in 2001 and is now the Head of Capital Markets within Bayer's corporate finance division. Working across a broad range of areas, Wuppermann deals with a wide range of the group's debt and equity-related transactions, including structuring syndicated loans, and structuring and placing hybrid bonds, for which Bayer won the emerging trend category in the ACT's Deals of the Year for 2005.

Before joining Bayer, Wuppermann worked in the banking sector at EastMerchant and West Merchant Bank. Favouring a more varied career, he decided to move to the corporate environment and became Head of Structured Finance at Bayer before taking up his current position.

"Working in banking means that you are very specialised in what you do," he says. "There are several different departments that deal with various things.

"I wanted to gain experience in a variety of areas. A corporate offers you this. If, like me, you have eight years' experience in banking, you still can't move easily to another department in the bank. At Bayer I have done leveraged leases, securitisations, syndicated loans, bonds and ratings, among others. As an individual I have had the opportunity to see all of these different product areas within just a few years."

Bayer is an innovation-driven company with core competencies in the fields of healthcare, crop science and material science. To support these subgroups, Bayer created three service companies: Bayer Business Services, Bayer Technology Services and Bayer Industry Services. All six entities operate under the umbrella of the holding company, Bayer.

Wuppermann's job is to raise funds for the entire group on an international scale.

"We have a centralised finance department which covers all subgroups in every country in the world. We have centralised finance functions because it is to the benefit of the whole group," he says.

A large part of his work is focused on funding the group. That means he deals with all types of debt and equity-related instruments, and works closely with rating agencies. The funding is then distributed via inter-company loans to the various parts of Bayer.

"I think a big challenge in my position is to maintain good and effective contact with the credit rating agencies," he says. "This is pretty much building the fundamentals on which you work. I don't mean just having an annual review meeting, but keeping the contact going regularly so the agencies are well informed on an ongoing basis."

Bayer adopts a different approach from the majority of other corporates in Germany and other countries in continental Europe by choosing not to use a credit rating adviser to facilitate between Bayer and the agencies.

"We much prefer having direct contact," he says. "It makes the job

Tax-deductible equity

Those who have studied hybrid financial instruments are convinced there are major benefits for corporates. And indeed those like Henryk Wuppermann, whose company Bayer has gone down the hybrid route, are pleased with the result. But the British market seems unconvinced so far. A breakfast seminar, organised by the ACT and sponsored by JPMorgan Cazenove, brought together a panel of experts, including Wuppermann, to see if hybrids were a realistic way forward.

The key issues for corporates concern tax and credit ratings. Hybrids are old news in the financial sector, where banks and insurance companies use them extensively for regulatory capital purposes. They became of more interest to non-financial companies when Moody's changed its approach, and credit agencies are now more willing to give credit for the equity characteristics of a hybrid issued by a non-financial company. The precise equity credit awarded by rating agencies will depend on the terms of the bond.

Peter Elwin, Head of Accounting and Valuation Research at Cazenove, says that for equity investors there are a number of theoretical benefits of hybrid capital. He says that it gives companies additional financial headroom with the equity characteristics carrying benefits. "If a corporate gears up and then blows up, the coupon on that debt is contractual," he says. "Hybrid can break that link and gives companies more wriggle room. That ought to be to the benefit of everyone bar restructuring lawyers."

Elwin's research among equity analysts suggests that the market remains largely ignorant about hybrids and, in some instances, worse than ignorance is the misinterpretation.

Hybrids are accounted for under IAS 32 *Financial Instruments: Disclosure and Presentation* and whether it is debt or equity depends on the small print in the bond agreement. As for tax, the bond terms need to be carefully drafted so that interest payments are tax-deductible and thus significantly cheaper for the company and shareholders than the equivalent dividend on an equity instrument.

Nicholas Mourant, Group Treasurer of Tesco Stores, admits that "UK corporates are nervous" about hybrids. He points out that the credit cycle in 2004/2005 meant that for UK plc the funding need was not there. A determining factor will be institutional appetite. But the weighted average cost of capital argument may really start to ring bells for treasurers.

Paul Gibbs, Managing Director of JPMorgan Cazenove, who works on mergers and acquisition valuations, describes hybrids as "an equity component at a debt cost. The cost of capital and market valuation arguments are pretty attractive even if the market doesn't understand it". Whether the British market gets the message in 2006 remains to be seen.

Peter Williams

more interesting and more meaningful because otherwise you are going via several people. The message is far clearer when you are speaking directly to the credit rating analysts."

Bayer has had a successful year with all three subgroups in the company performing well. This was helped by the performance of the consumer health business that it acquired from Roche in the first quarter of 2005.

Along with strong profits in the first nine months there was the successful completion of the deal to spin off global chemical company Lanxess in January 2005. Wuppermann supported the transaction by helping to set up a syndicated loan, which was vital for Lanxess.

In May 2005, Wuppermann concentrated on structuring the hybrid bond which won the hybrid category of the ACT's Deals of the Year awards (see page 41). He explains that Bayer's reasoning for using the hybrid was two-fold.

"When we bought Aventis Crop Science in 2002 we issued a €5bn Eurobond," he explains. "We had a €3bn bond due in 2007 and another €2bn in 2012. The €3bn is a big amount for our company and the simultaneous tender offer clearly improved the maturity profile of the company.

"We put the two things together – tendering existing bonds, and financing that via the issuance of the hybrid. The aim of the hybrid was to improve our credit metric with the agencies."

Wuppermann argues that the Bayer and the Vattenfall deals are both worthy of featuring in this category because they both achieved notable success in this relatively new area of hybrid bonds. Considering the development of hybrid capital across the globe, Wuppermann believes that companies in more countries should embrace this form of bond.

"The varying tax schemes in different countries do have an impact on how hybrids are done," he says. "But, apart from the tax issue, hybrids are pretty much the same.

"In Germany there are no clear guidelines about whether the interest is tax-deductible. This depends on whether the interest payment obligation is related to the net result of the company."

Continental Europe has indeed acted as a guinea pig for the UK in terms of hybrid bonds. However, many companies still appear to be sceptical and could be waiting for a UK-based company to take the plunge before diving in themselves.

"If you believe something will be positive and work for your company, you should just do it and not wait and see how it affects other companies in a country," says Wuppermann. "With Bayer's hybrid bond, we had some luck in terms of the Vattenfall hybrid. They were before us, so our pricing benefited from that. But I don't think you need to have a wait and see approach to hybrid bonds."

Wuppermann says he is hoping to contribute to another successful year for Bayer in 2006. Given the recognition among his peers and the wider financial community for what Bayer has achieved with the hybrid deal, it is a tough benchmark he has set himself.

"MAINTAINING GOOD AND EFFECTIVE CONTACT WITH THE CREDIT RATING AGENCIES IS PRETTY MUCH BUILDING THE FUNDAMENTALS ON WHICH YOU WORK. I DON'T MEAN JUST HAVING AN ANNUAL REVIEW, BUT KEEPING THE CONTACT GOING REGULARLY SO THE AGENCIES ARE INFORMED ON AN ONGOING BASIS."

From birth to behemoth

Bayer is a global enterprise operating in the fields of health care, nutrition and high-tech materials. Founded in 1863 by Friedrich Bayer and Friedrich Weskott, the company has its headquarters in the German city of Leverkusen, which sits on the east bank of the River Rhine between Cologne and Dusseldorf.

Bayer started life selling synthetic dyestuffs during the height of the textile industry in the 1800s. Since 1881 the company has branched out into other areas and become a successful chemical company with international operations.

The company most famous for creating Aspirin now has a presence in 150 countries and 113,000 employees.

Over the years Bayer has made several key acquisitions. Acquiring the Toronto-based Polysar Rubber Corporation in 1990 made it the biggest supplier for raw materials in the rubber industry.

In 2001 Bayer acquired Aventis Crop Science for €7.25bn – the largest acquisition it has ever made. Bayer's activities are concentrated in three subgroups: Bayer Healthcare, Bayer Crop Science and Bayer Material Science. These groups are supported by three service companies: Bayer Business Services, Bayer Technology Services and Bayer industry services. They all operate under the umbrella of the holding company, Bayer.