Energy and synergy

RECESSION-PROOF? E.ON'S FINANCE TEAM VERENA VOLPERT AND HENRYK WUPPERMANN TELL **GRAHAM BUCK** HOW THE ENERGY GIANT IS RESPONDING TO THE CHALLENGE.

German energy utility E.ON is a formidable force. It has 26 million customers in 30 countries, and is a familiar name in the UK following its £5bn acquisition of Powergen 10 years ago. The group was formed in 2000 from the merger of two energy conglomerates, VEBA and VIAG. Within two years E.ON had added Powergen. Other major acquisitions included Sweden's Sydkraft and Russia's OGK-4, although a lengthy bid to gain Spain's Endesa, launched in February 2006, was ultimately thwarted.

E.ON's senior vice president of finance, Verena Volpert, joined the group just as it was readying to launch the Endesa bid. "I was left with very little time to carry out a thorough review of the capital structure as I immediately had to conduct a practical analysis – for example, whether the acquisition was affordable and its effect on E.ON's rating," she says.

Volpert arrived at the utility after nearly 18 years with multinational media group Bertelsmann. While her position at Bertelsmann as executive vice president of corporate finance was similar to her current post at E.ON, there were several major differences. "Bertelsmann was and still is privately owned through a family and a foundation, and was more international, with around 80% of its revenues from outside Germany and significant activities in the US," she explains. "E.ON has some US exposure, but generally has been more focused on Europe.

"The group's general corporate culture was also different. Media companies tend to be relatively decentralised, giving their people the creative freedom they need. 'Entrepreneur' was the buzzword – they were regarded as essential. Utilities are generally more centralised and this helps to create synergies and optimise the business."

CENTRALISED FINANCE One feature common to both businesses is a centralised finance department, which Volpert describes as "the group's face to the financial markets". Bertelsmann also carried out a significant amount of fundraising, although a typical bond issue would be for €500m – a comparatively modest amount by E.ON's standards. "E.ON's needs are more diverse and utilities must also take longer-term decisions, covering periods of 30, 40 or even 50 years," she explains.

Volpert says she enjoyed her work at Bertelsmann but had started to feel the restrictions of a private company after nearly two decades. It had been widely expected that the group would launch an IPO during 2006 or 2007, but the plan was shelved. "My boss also departed, so it felt like time for a change. E.ON was seeking a head for its finance department and offered interesting challenges: it had zero net financial debt and lacked a clear financial strategy – shareholders were demanding to know where the group was heading."

The group had at least taken action to focus on its core business as a power supplier. The 2000 merger had left it with a number of peripheral activities in areas such as property and mobile phones, so acquisitions during the early years were accompanied by the selling off of non-core divisions. "There was a total switch of the portfolio and the transition to a core utility was mostly completed by 2003," says Volpert. "Today E.ON is a strictly focused energy company, but it took several years for all its diverse parts to be assimilated."

WUPPERMANN ON BOARD In October 2008 Volpert was joined in Dusseldorf by Henryk Wuppermann as vice president of corporate finance. Profiled in The Treasurer (Jan|Feb, 2006) when he was Bayer's head of capital markets, Wuppermann has given sterling service on the ACT's Deals of the Year Awards judging panel over the years. "I moved to E.ON a week after the demise of Lehmann," he says, "and just as the group was seeking to raise funding of €9bn over 12 months to cover maturing bonds and fund a €60bn investment programme."

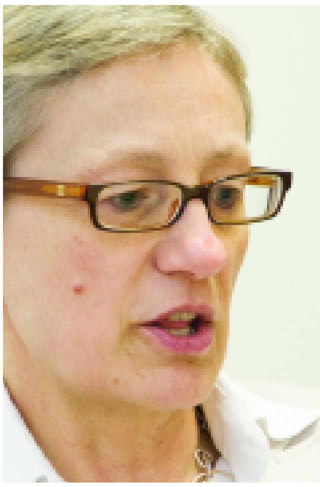
Despite the sudden downturn, windows of opportunity still opened for utilities in the fourth quarter of 2008 as other sectors saw them slam shut. "E.ON managed to agree on the extension of a €7.5bn 364-day facility as part of an overall €12.5bn syndicated facility, and to issue bonds in late November, as a result of good debt investor relations," says Wuppermann.

The funding programme restarted with full vigour in the first quarter of 2009, but during the second half of 2009 both the business and regulatory environments began to deteriorate. Since then they have worsened further.

"As our EBITDA did not grow at the same speed as our leverage, it implied we couldn't continue to carry such a high level of indebtedness as planned," says Wuppermann. "We therefore initiated a divestment programme and have disposed of more than €21bn in assets over the past three years."

At the same time E.ON's cash pile was steadily increasing. "This obviously wasn't a bad position to be in," he says, "but it was becoming steadily more difficult to invest the money – interest rates were unattractive and banks were increasingly regarded as a counterparty risk."

After conducting a structural analysis for the five years to 2015, the finance department concluded that pre-credit crunch conditions




were unlikely to return and E.ON's funding needs would continue to be sharply lower. Full management backing was secured for a debt reduction and balance sheet derisking programme, a keystone of which was retiring liabilities ahead of schedule.

A debt repurchase deal concluded last February raised over €1.8bn, via a two-stage tender offer across six series of notes with maturity dates from October 2012 to January 2014. Hailed as the largest debt buyback by an EMEA corporate issuer since the financial crisis began, its success gained E.ON The Treasurer's Deals of the Year Award 2011 in the liability management category.

More recently, the group has pledged to shave €1.5bn from its annual controllable costs to a maximum of €9.5bn within the next three years. This move is in response to overcapacity in Europe's energy markets, technological change and increased political pressures. The group suffered a €1.5bn financial hit last March when Germany decided to shut down its nuclear plants after the Fukushima reactor disaster in Japan, and the country's total exit from nuclear power was brought forward from 2034 to 2022.

SYNERGIES ESSENTIAL The cost-cutting programme could shrink E.ON's global workforce of 80,000 by 11,000. In January the group reached agreement with unions for 4,000 German jobs to go over four years, largely at managerial level. "There is evidence that the group can operate more effectively," says Wuppermann. "To make acquisitions pay off, synergies need to be raised."

The group's strategy will also focus on lessening dependence on its European core market. E.ON already runs very successful businesses in North America and Russia. This year it has already agreed to purchase a 10% stake in Brazil's MPX Energia for €350m and ultimately aims to be involved in building new plants in Latin America through 50-50 joint ventures.

E.ON might seem to be massive and complex, but Volpert believes that it is much leaner and efficient now. "Various companies, each with a proud history, were put together to form the group, but some potential synergies weren't realised at the time of the mergers," she says. "It now has a clear vision and and we think that an improved performance culture can be achieved. It has been a challenge to make people recognise the benefits of a centralised finance function, but we have developed clear financial guidelines and good lines of communication."

E.ON is a major user of over-the-counter (OTC) derivatives and Volpert has in the past expressed concerns about a possible clampdown by EU regulators. Have these fears receded?

"Discussions are continuing over the proposed regulations, but we're certainly in a much better position than a couple of years ago," she suggests. "Initially, politicians didn't recognise that meeting corporate needs involves using derivatives for hedging. The aim is risk mitigation, so making the rules more complicated or restrictive merely increases risk because corporates will do less hedging. The agreement between the European Parliament and Council provides an exemption from the proposed regulation for non-financial institutions that employ hedging. Not all details have been decided, but politicians have listened and there is now a much better understanding."

Quick-fire quotes from Verena Volpert

WORDS YOU MOST OFTEN SAY TO YOUR CFO: "Mind the impact on our debt capacity!"

WORDS YOU MOST OFTEN SAY TO YOUR TEAM: "We are one team: make use of synergies among team members!"

RECESSION OR GROWTH AHEAD? Certainly more volatility.

DEBT OR EQUITY? Debt, unless there is a very good reason to raise equity, such as a transforming M&A event.

FIXED OR FLOATING RATE? Depends on the company. Our long investment cycles and relatively recession-proof cashflows mean fixed rates for E.ON.

YOUR BIGGEST SUCCESS? Successfully executing a €30bn funding programme in the midst of the financial crisis.

DEAL YOU ARE MOST PROUD OF? Monetisation of major parts of Bertelsmann's stake in AOL Europe in 2001/02.

MOST VALUABLE PART OF THE ACT QUALIFICATIONS? It's a well-defined education path for corporate treasurers – something which is missing here in Germany.

REASON FOR ATTENDING ACT CONFERENCE/EVENTS? Networking with international peers.

EVER PRESENT GADGET? Still a Blackberry, but not always.

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