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# DUE CREDIT TO E.ON

THE DEVELOPMENT OF THE EURO CAPITAL MARKETS HAS OPENED NEW DOORS FOR EU COMPANIES SEEKING OPTIMUM FUNDING SOLUTIONS. **HANS-GISBERT ULMKE**, FINANCE DIRECTOR OF GERMAN ENERGY GIANT E.ON, ASSESSES THE IMPACTS.

**E**.ON is the world's largest private sector energy company, with a market capitalisation of some €30bn. In Germany, E.ON is the largest provider of electricity and the third largest supplier of gas and, in the UK, the group commands a substantial share of the energy market through its Powergen subsidiary. E.ON's strategy is to build on its integrated energy business model in its core energy markets and to further expand into certain other European countries and, longer term, in the mid-West region of the United States. E.ON believes that this planned programme of growth will be achieved through a continued focus on core businesses, where we shall 'sweat the assets' we already have by leveraging best practices across energy markets, whilst new acquisitions will have to meet rigorous financial targets.

Prudent financial and treasury management strategies play a key role in realising E.ON's strategic objectives. Not only do cash management and working capital initiatives contribute to the streamlining of processes and the reduction of costs, but, in addition, the finance (treasury) function adds value by ensuring that cost-effective funding is in place for both ongoing operations and for acquisitions. In this respect, the finance function at E.ON has already shown an appetite for exploring new territory in the search for funds in the size, tenor and spreads required by the group's strategy.



## 'THE POTENTIAL OF THE WIDER EURO CAPITAL MARKET IS NOW SUCH THAT IN MANY INSTANCES, IT RIVALS THE US, WITH PRICING AGAINST SWAPS OFTEN PROVING MORE COMPETITIVE'

**A CHANGING WORLD.** Before the advent of the single currency, German corporates traditionally relied heavily on bank lending as their main external funding source. This was in part due to an historic structural position whereby banks and companies often had significant cross holdings in place and corporates cultivated very close, long-term relationships with their bankers. However, a lack of depth in the domestic capital markets also played a part. Low demand for debt capital markets issuance, particularly at the long-end, was often attributed to factors such as the fragmentation of demand from European investors across national borders and currencies, and the continental 'pay-as-you-go' frameworks for pension provision which reduced the level of related institutional investment. With the introduction of the euro, an opportunity was presented for the establishment of a pan-European capital market of a scale and depth to potentially address such issues, not only for German companies but for corporates across the euro zone and beyond.

**NEW START.** On the launch of the single currency, the euro capital markets, of course, did not fully develop overnight. In 1999, Powergen which is now part of our group, issued a 10-year €500m Eurobond. At that time, this was on the envelope of what the market could bear. However, since these early days, the euro markets have continued to expand and deepen.

E.ON has always prided itself in being in close touch with this market development and in being ready to seize optimum funding opportunities as they arise. As early as July 1995, a medium term note programme was in place to facilitate such opportunistic issuance. However, it was not until the early summer of 2002 that we felt we were in a position to derive maximum benefit from the advantages which the group could achieve in a European capital markets environment. These advantages include economies of scale, which minimise the 'per unit' impact of issuance costs, impressive name recognition and a superior credit rating for the sector. When we moved to launch our inaugural bond issue in May 2002, our long term rating was Aa2 (stable) from Moody's and AA- (stable) from S&P's.

**SIZE MATTERS.** It was a clear reflection of the new-found importance and maturity of the euro capital markets that E.ON was able to get away over €5bn of euro-denominated Eurobonds in just one day in tenors of 7 (€4.25bn) and 15 years (€0.9bn). This was coupled with sterling issues of £0.5bn and £0.85bn in 10- and 30-year maturities respectively. Just three weeks later, on 7 June 2002, capacity still existed for us to issue a further £125m in the 30-year tenor. This market capacity showed the depth of demand which it is now possible for companies such as E.ON to tap on a pan-European basis. This E.ON Eurobond issue, coupled with other large euro deals

over the past couple of years, is testament to the fact that the euro capital markets now represent a realistic medium for significantly diversifying a debt investor base (whilst maintaining a desirable level of pricing). What was perhaps all the more important for our own growth strategy was that E.ON was able to get these funds on board without committing the company to financial covenants which might constrain our ability to manage our business either now or in the future.

**FUTURE GROWTH.** Since 2002, we have witnessed still further developments in the euro bond markets, most notably the emergence of liquidity at the long-end, with Deutsche Telekom and others executing in 30-year maturities (see *The Treasurer*, March 2003, p39). There has also been a material expansion of the euro-denominated euro commercial paper (ECP) market, along the US model. This summer, E.ON has had almost €7bn of paper outstanding under its €10bn ECP programme under its short-term ratings of P-1 and A-1+.

The potential of the wider euro capital market is now such that in many instances, it rivals the US, with pricing against swaps often proving more competitive. In addition, the regulatory and reporting requirements for Eurobonds are less onerous than those in the US, especially since the introduction of new corporate governance rulings such as the Sarbanes-Oxley Act 2002. The growing importance of the euro market is also highlighted by the investment which the European and US banks have clearly made in developing specialist, high-quality advisory teams to lead euro issues. All these factors have combined to create a growing trend toward dis-intermediation across the euro zone over the past five years, with more and more corporates exploring the capital markets funding route.

**BANKING ON RELATIONSHIPS.** E.ON is not a frequent visitor to the debt capital markets but is also keen to stress that its issuance programmes form only one part of its integrated funding strategy. We continue to maintain excellent relations with our corporate bankers as witnessed by our finely priced and oversubscribed syndicated loan financing in December 2002. This was for a €15bn revolving credit facility (split between a €10bn 364-day and a €5bn five-year tranche which includes a €2.5bn swingline) and was syndicated through lead arrangers Barclays Capital, Citibank/SSSB, Deutsche Bank, Dresdner Kleinwort Wasserstein, HSBC and JPMorgan.

**CREDIT WHERE IT'S DUE.** Whilst E.ON has no intention of relying solely on capital markets for all its future funding needs, the group does however recognise the increasing importance of the fixed income investor community to the ongoing success and stability of our business. Between them, E.ON's debt capital markets investors hold the equivalent of €11bn in our paper. In some companies, communication with equity investors has traditionally taken precedence over interactions with bondholders and E.ON will devote significant time and effort to recognising more fully the valued support which the group enjoys from its debt investors as part of the specific focus on communications to capital markets announced in August. Accordingly, the group is now taking a proactive approach to developing a constructive and participative relationship with our fixed income investors. This strategy has become all the more crucial following the well-publicised credit collapses in the US energy sector where many other corporate bondholders suffered significant losses. It is a cornerstone of our credit strategy to differentiate our prudent, sustainable and cash generative proposition from other higher risk, trading-focused energy plays.

E.ON's finance function is working alongside the group's investor relations team to deliver the information flow which investors require to make qualitative as well as quantitative investment decisions. The first step in our structured plan for achieving this goal is to carry out a thorough analysis of the debt investor base. This has included not only collating contact details for as many existing investors as possible, but also looking at specific target investors and the criteria they are currently utilising to select credits for investment.

**THE PROFESSIONALS.** We are also targeting the bank credit analysts who regularly publish credit research on our group. It is hoped that by encouraging openness and by fostering understanding of our business and our strategy amongst this increasingly high-profile community, we can encourage better understanding of the E.ON credit across a much broader spectrum of investors.

We have attempted to maintain a regular and open information flow to the credit rating agencies. This is one of the factors which has contributed to E.ON continuing to maintain strong long-term ratings against the backdrop of considerable volatility in energy and utility credits globally. In August 2003, our long-term rating with S&P is at AA- (negative), whilst Moody's regards us as A1 (stable).

**COMMUNICATION SKILLS.** After building our investor relations database, E.ON is striving to encourage regular and responsive

communication between the company and fixed income investors. We have greatly expanded the range of investor relations materials which are available through our website at [www.eon-ag.com](http://www.eon-ag.com) and have also instigated regular investor mailings.

E.ON arranges a rolling programme of 'non-deal roadshows' held locally to allow Investors to meet E.ON management and we shall couple this with one-on-one meetings with our larger investors. Conference calls are held after significant announcements or credit events to facilitate the resolution of any queries or issues which investors and analysts might have. We shall also organise larger 'Capital Market Days' in Germany.

At E.ON, the finance functions appreciate that the opportunities represented by the diversification of our funding sources go hand in hand with new obligations to our debt investors. The development of the euro capital market has allowed us to reach out to investors across the EU and to introduce them to E.ON and investment opportunities within our group. The challenge is now to establish the long-term symbiotic relationships with these new investors which we have for so long enjoyed with our closest banking partners and equity investors.

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Hans-Gisbert Ulmke is Executive Vice President, Finance, E.ON AG.  
[www.eon-ag.com](http://www.eon-ag.com)  
[www.powergen.co.uk](http://www.powergen.co.uk)