



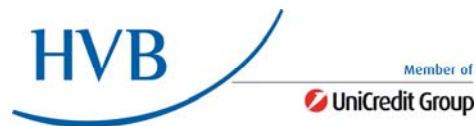
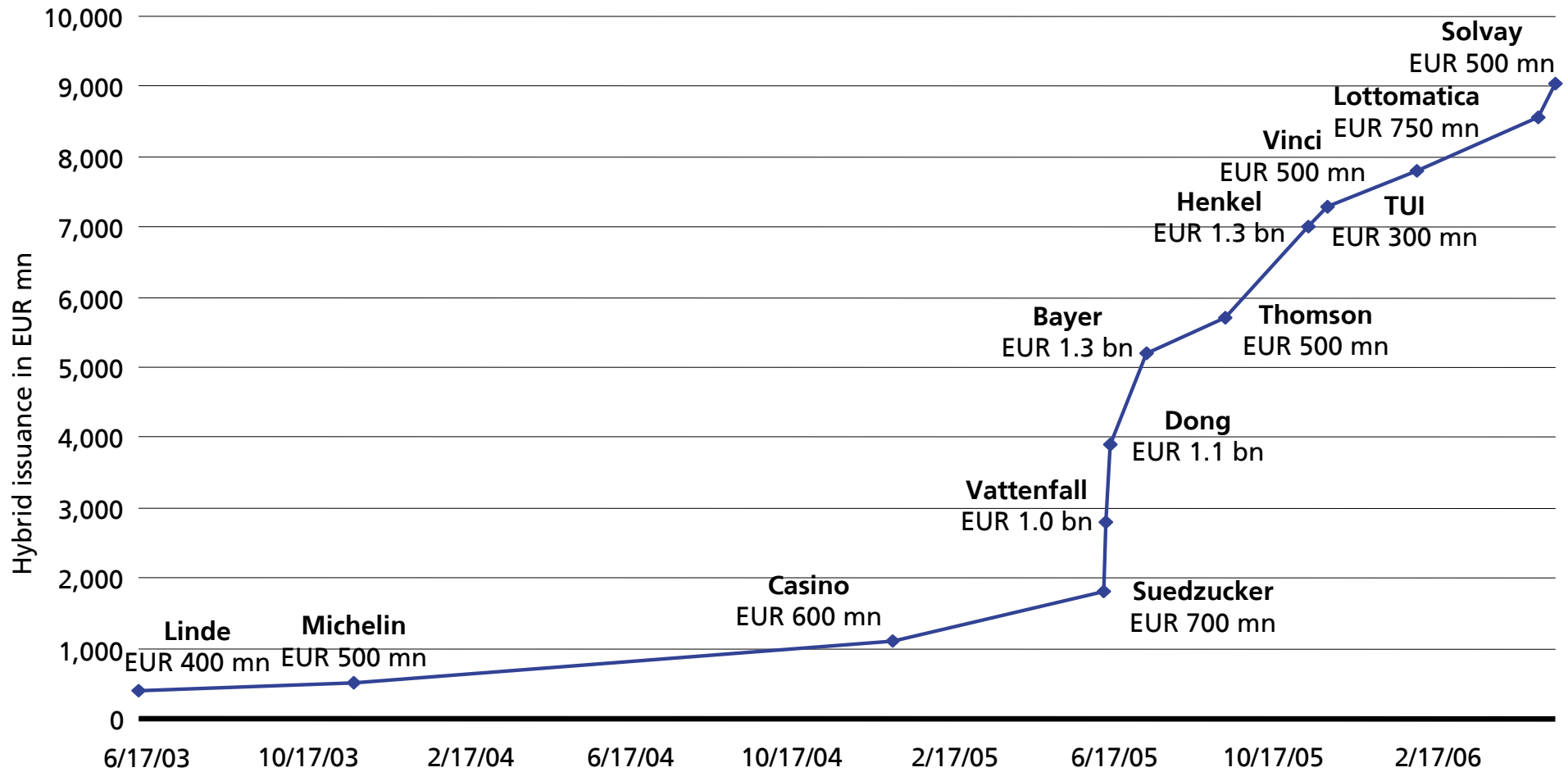
Corporate Hybrid Debt

Perspectives for a new asset class

Introduction

- Hybrid securities have developed into a new asset class in Europe
- While European financial institutions routinely issue subordinated bonds treated as part-equity by rating agencies, corporates have been avoiding them
- Prior to 2005, the market only saw little hybrid issuance activity, with the hybrids issued posting weak equity content only (i.e. Linde, Michelin)
- Following the changes in rating agencies' views on hybrids at the beginning of 2005, a European market for corporate hybrids emerged, with EUR 8+bn in 11 deals
- As a new asset class hybrid capital offers the possibility to diversify the investor base. It thereby helps to increase financial flexibility for the issuer and has been used as part of acquisition financing when issuers were interested in maintaining their rating
- Among the main reasons for issuing hybrid securities: to avoid dilution for equity holders, to obtain equity credit with rating agencies, to provide long term funding for pensions

A New Asset Class Develops



Corporate Hybrid Characteristics

- Since June 2005, the market has seen a rush of corporate hybrid security issuance, with Bayer, Dong, Henkel, Porsche, Suedzucker, Thomson, TUI, Vattenfall and Vinci issuing hybrids
- There is no standard hybrid structure in place. However, there are some basic requirements for debt to be treated as equity-like "corporate hybrid"
 - Debt ranking: most junior; subordinated to all other debt
 - Senior/equal ranking to share capital only
 - Maturity: ultra-long dated with ability to call, mostly after 10 years
 - Coupon: fixed-to-floating structure with interest deferral features
 - Replacement language
- Issue rating typically up to 3 notches below senior debt rating – depending on subordination features and coupon deferral language

"The major story in the market is the issuance of hybrids. Following the subordinated 01/10 perpetual issue from Casino in January 2005, also Vattenfall, Suedzucker and Dong issued or plan to issue hybrids, including a fix-to-float and/or a call feature.

From the companies' viewpoint, the equity-like characteristics (perpetual, interest deferral feature) have a favorable balance sheet effect given the partial accountability as equity. This has a positive impact on the issuer's rating.

In the current low yield environment, investors are still searching for carry and hybrids offer an attractive spread from a relative value perspective."

Source: HVB Daily Credit Briefing, June 17, 2005

Key Structure Elements

1 **Coupon step up:**
In order to incentivise the issuer to call the hybrid at the 1st call date the coupon steps up by 100-200 bps after 7-10 years (max. ½ of coupon)

2 **Coupon deferral:**
The issuer has the option to defer coupon payments. These deferrals are related to dividend payments or credit ratios. They can be mandatory or non-mandatory, cumulative or non-cumulative, cash pay or PIK

3 **Replacement:**
If the issuer of a hybrid calls the security, the hybrid should be replaced by issuing another similar hybrid or equity of the same size

4 **Change of control:**
Investors seek a significant coupon step up in case of a change of control in order to hedge the risk of a worsening of the credit (max. 500bps)

Issue Rationale

"... Hybrid capital is a way of rebalancing a company's capital structure without having to issue shares or run the risk of being downgraded by issuing senior debt, and thereby considerably reduces the implied equity cost.

This means that hybrid debt is expensive debt but at the same time it's cheap equity. Interest is fully tax deductible as part of expenditure on the balance sheet, whereas share dividends have to be paid after tax and therefore are taxable."

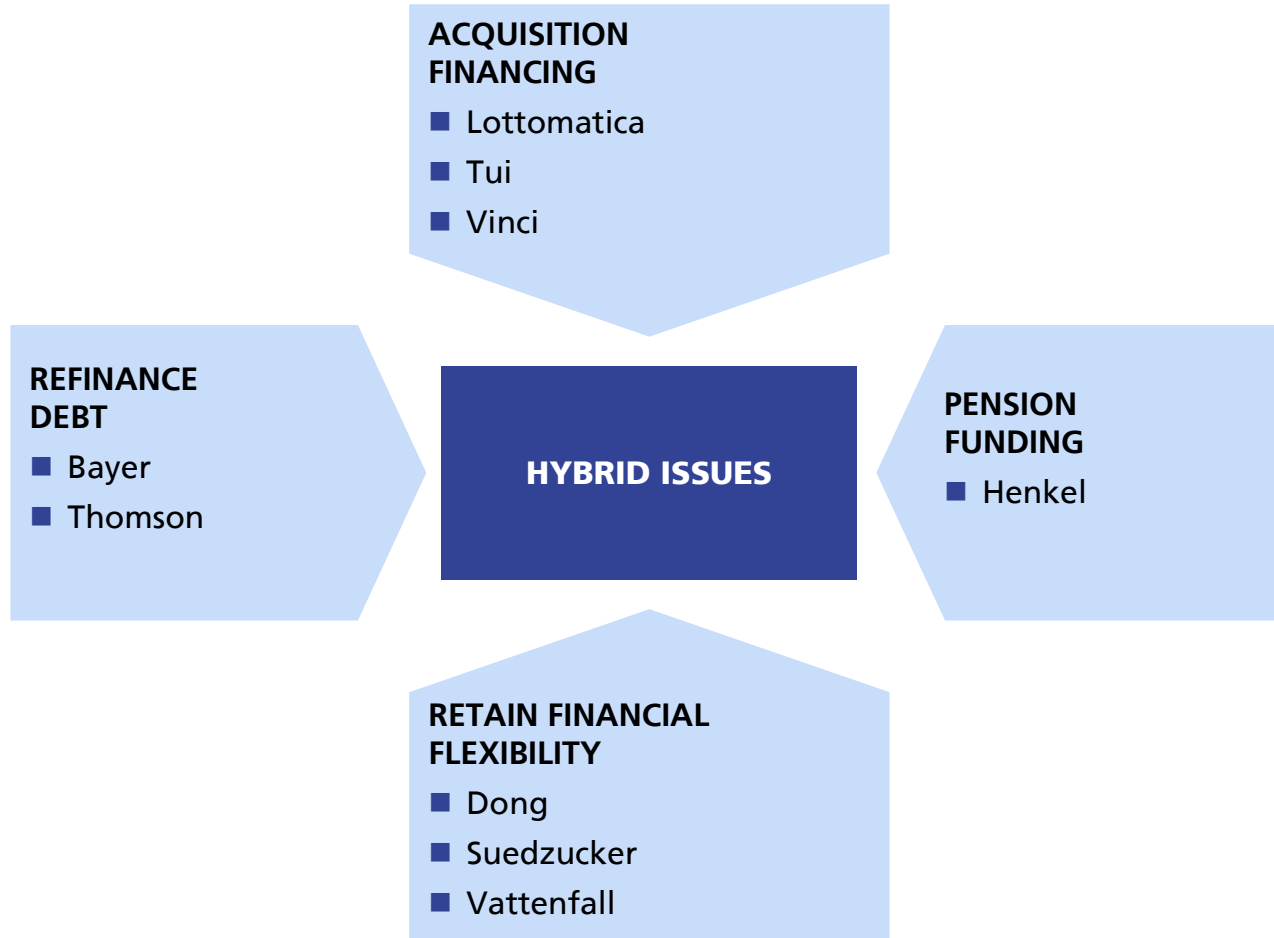
Source: Bondrumours, June 16, 2005

"...The attraction of hybrid capital is that, as perpetual debt, it looks like equity on the balance sheet, with a muted or even benign effect on ratings. As debt, it is non-dilutive and cheaper to raise than equity capital, while coupon payments, unlike dividend payments, remain tax-deductible. ..."

Source: The Banker, August 16, 2005

- Strengthens the company's capital structure and equity base without a dilution of shareholders' stakes
- Supports rating and improves credit matrix
- Quality of the capital profile improves, thus supporting the quality of other debt securities in place
- Extends debt capacity as well as diversification of investor base
- Compared to "real" equity or mezzanine, hybrid capital is cheap leading to a reduction of implied equity cost
- Can account for 100% equity under IFRS and receives equity credit from rating agencies according to structure
- Unlike dividends, interest is fully tax-deductible
- Helps to retain financial flexibility

Main Reasons for Hybrid Issuance



Investors' View – Attraction for Investors

- Hybrid Securities have become an accepted asset class by European institutional investors and have attracted great interest on the retail side
- Hybrids offer relative value through a spread pick-up versus senior notes. The pick-up accounts for the subordination versus the senior and the lack of covenants in case of non-investment grade issues
- New asset class ("corporate debt with equity features of the coupon") which can be used for portfolio diversification
- The latest Hybrid Securities transactions from Vinci, Vattenfall, TUI, Südzucker, Dong and Bayer have been well received by the market

Investors' View – Preferred Characteristics

INDUSTRY, RECOGNITION AND RATING

- Industries with stable, predictable cash flows are preferred while cyclical industries are more difficult
- Issuers with a "history" in the bond market are favored simplifying valuation
- LBO candidates are viewed as problematic due to the adverse effect on credit ratios following a leveraged buy out
- Household names issues also attract demand from retail side
- Companies expecting an upgrade from agencies offer investors significant upside potential

USE OF PROCEEDS AND STRUCTURE

- Investors want to see a story (e.g. support for rating, strengthening credit ratios, etc.). Getting "cheap equity" only is not regarded as adequate issue rationale
- Substitution for new equity in order to avoid dilution of existing shareholders is clearly accepted
- Coupon deferral: optional and cumulative preferred
- Structure should be as plain and easy as possible

Rating Agencies' View

Moody's classification

- Moody's assesses hybrid capital by using five baskets on the debt-equity continuum
- Each basket will set out the level of equity credit afforded, with the remainder being treated as debt
- Hybrids that are considered debt for ratio purposes may still be viewed as providing qualitative benefit in terms of the financial flexibility offered

Basket	Equity Credit	Requirements
A	0%	Perpetual subordinated debt and traditional preferred shares without replacement language
B	25%	Perpetual subordinated debt and traditional preferred shares with replacement language
C	50%	Perpetual subordinated debt with replacement- and deferral language
D	75%	Perpetual subordinated debt required with mandatory coupon deferral and replacement language
E	100%	Mandatory converts (3 year conversion period) with accelerated conversion under stress scenarios

- Moody's ranks certain hybrid characteristics along three dimensions of equity:

	Weak	Moderate	Strong
No maturity	Cash call	Cash call + replacement language	No call or call + legally binding replacement language
Loss absorption	subordinated debt with rights	Subordinated debt, no rights	Preferred securities, most junior subordinated debt
No ongoing payments	Contingent optional deferral	Pure optional deferral (non-cum; ACSM)	Mandatory deferral (non-cum; ACSM)

Rating Agencies' View

S&P's classification

- S&P is less transparent than Moody's in their publications: "Each issuer's situation would require a unique analysis, making standardization impossible"
- Since June 2005, hybrids are divided into three categories
 - hybrids with equity content of 10 – 30% i.e. "minimal equity content"
 - hybrids with equity content of 40 – 60% i.e. "intermediate equity content"
 - hybrids with equity content of 70 – 90% i.e. "high equity content"
- Like Moody's, S&P assigns equity credit alongside the hybrid characteristics maturity, deferral mechanism and subordination
- Being subordinated, securities receive a one-notch differential, if there is an optional coupon deferral it receives another and an additional for mandatory coupon deferral
- Equity credit is limited by S&P to a maximum of 15% of the issuer's total capital

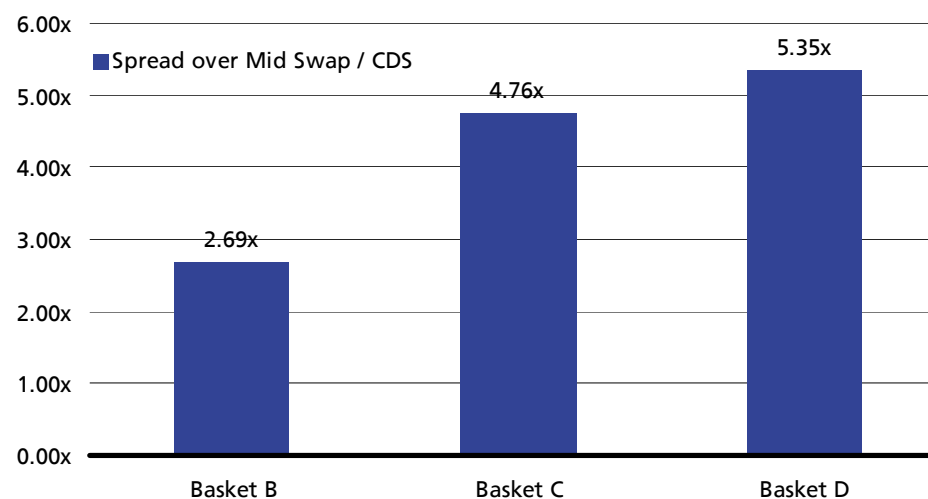
Selected Hybrid Issues

Issuer	Bayer	Dong	Henkel	Lottomatica	Porsche	Solvay	Südzucker	Thomson	TUI	Vattenfall	Vinci
Senior Rating	A3/A	Baa1/BBB+	A2/A-	(p) Ba1/BBB (neg.)	not rated	A2/A	A3/A-	Baa1/BBB+	Ba2/BB+	A2/A-	na/A (neg)
Issue Rating	Baa2/BBB	Baa3/BBB-	Baa1/BBB-	(p) Ba3/BB+ (neg)	not rated	Baa1/BBB+	Baa2/BBB-	Baa3/BBB-	B1/B+	Baa1/BBB-	Baa3/BBB-
Issue Size	EUR 1.3 bn	EUR 1.1 bn	EUR 1.3 bn	EUR 750 mn	USD 1.0 bn	EUR 500 mn	EUR 700 mn	EUR 500 mn	EUR 300 mn	EUR 1 bn	EUR 500 mn
Maturity	2104 (100yrs)	3005 (1000yrs)	2104	2066	Perpetual	2104	Perpetual	Perpetual	Perpetual	Perpetual	Perpetual
First Call Date	Jul-15	Jun-10	Nov-15	Mar-16	Jan-11	Jun-16	Jun-15	Sep-15	Jan-13	Jun-15	Nov-15
Step-up	100bp from Year 10	100bp from year 10 to year 49, 200bp from year 50 onwards	100bp from year 10	100bp from year 7	no step up	100bp from year 10	100bp from year 10	100bp from year 10	200bp from year 7	100bp from year 10	100bp from year 10
Replacement Language	Yes	Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes
Subordination	Senior only to equity	Senior only to equity	Senior only to equity	Senior only to equity	Senior only to equity	Senior only to equity	Senior only to equity	Senior only to equity	Senior only to equity	Senior only to equity	Senior only to equity
Optional Coupon Deferral	Yes, cumulative for a maximum of 10 years. Interest not payable on deferred payments	Yes cumulative. Interest payable on deferred payments	Yes, cumulative for a maximum of 5 years but no interest payable on deferred payments	Yes, cumulative for a maximum of 5 years. Interest not payable on deferred interest	Yes, cumulative. Interest not payable on deferred interest	Yes, cumulative for a maximum of 5 years and compounding	Yes, cumulative. Interest not payable on deferred payments	Yes, non-cumulative	Yes, cumulative. Interest not payable on deferred interest	Yes, cumulative. Interest not payable on deferred interest	Yes, non-cumulative
Mandatory Coupon Deferral	Yes, non-cumulative, coupons can be paid at issuer's option through ACSM, though must be paid if dividend is paid within 6 months	No	Yes, cumulative for a maximum of 5 years but no interest payable on deferred payments. Coupons can be made up via ACSM or PIK. If ACSM or PIK fails, deferred interest obligation is cancelled	Yes, cumulative for a maximum of 10 years. Deferred interest does not bear interest	No	No	Yes, non-cumulative, coupons can be paid at issuer's option through ACSM	No	No	Yes, non-cumulative	No
Mandatory Event Trigger	Cash flow < 7% of Sales	Not applicable	Cash flow < 15% Net Debt	Interest Coverage Ratio < 1.35x	Not applicable	Not applicable	Cash flow < 5% of Sales	Not applicable	Not applicable	Interest cover ratio greater or equal to 2.5:1	Not applicable
ACSM Feature	Yes, applicable to mandatory coupon deferral	Yes, applicable to optional coupon deferral	Yes, applicable to mandatory coupon deferral	Yes, applicable to mandatory deferral	No	Yes, applicable to optional coupon deferral	Yes, applicable to mandatory coupon deferral	No	Yes, applicable to optional coupon deferral	No	No
Moody's Equity Credit	75% (Basket D)	50% (Basket C)	75% (Basket D)	75% (basket D)	Undisclosed	50% (Basket C)	75% (Basket D)	50% (Basket C)	25% (Basket B)	75% (Basket D)	50% (Basket C)

Market Snapshot

- Hybrid issues currently trade c. @ 1.8 – 7.0x CDS levels, with companies showing higher CDS levels trading relatively tighter
- Over the last week, we saw a significant widening of hybrid trading, which was in line with most recent nervous developments in the equity markets
- While straight bond markets have been stable for the most part, it seems that investors tend to value hybrids more along equity principles
- We expect the European hybrid market to stay volatile as long as equity markets remain as nervous as currently

RELATIVE HYBRID-UNIVERSE TRADING

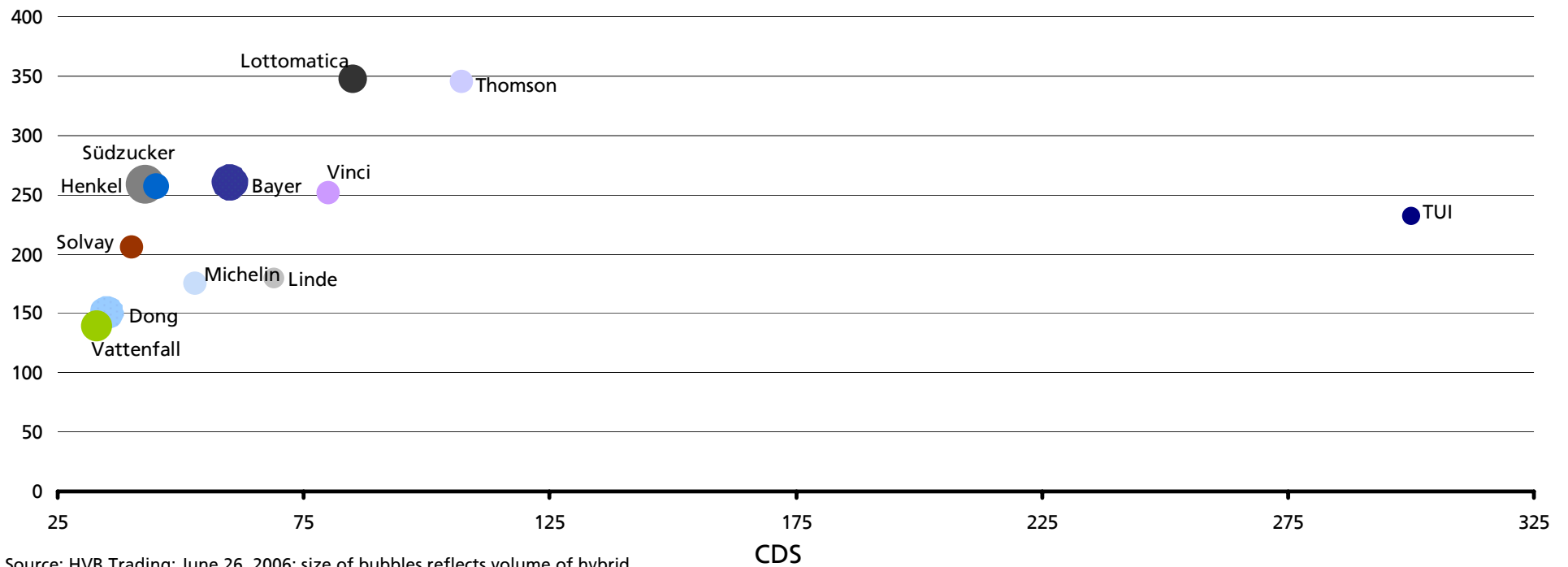


CURRENT HYBRID TRADING

Security	Moody's	S&P	Next Call	Basket	CDS	Spread over Mid Swap	Spread over Mid Swap / CDS (X)
Bayer	Baa2	BBB	07 / 2015	D	60	321	5.4x
Dong	Baa3	BBB	06 / 2015	C	35	185	5.3x
Henkel	Baa1	BBB-	11 / 2015	D	43	301	7.0x
Linde	Baa1	BBB-	07 / 2013	B	69	249	3.6x
Lottomatica	Ba3	BB-	03 / 2016	D	85	433	5.1x
Michelin	Baa3	BBB-	12 / 2013	n.a.	53	229	4.3x
Solvay	Baa1	BBB+	06 / 2016	C	40	246	6.2x
Südzucker	Baa2	BBB-	06 / 2015	D	45	302	6.7x
Thomson	Ba1	BB+	09 / 2015	C	107	453	4.2x
TUI	B1	B+	01 / 2013	B	300	532	1.8x
Vattenfall	Baa1	BBB-	06 / 2015	D	33	173	5.2x
Vinci	Baa3	BBB-	11 / 2015	C	80	332	4.2x

Hybrid Pricing Matrix

PICK UP SPREAD OVER MS VS CDS



Case Study Corporate Hybrid: TUI



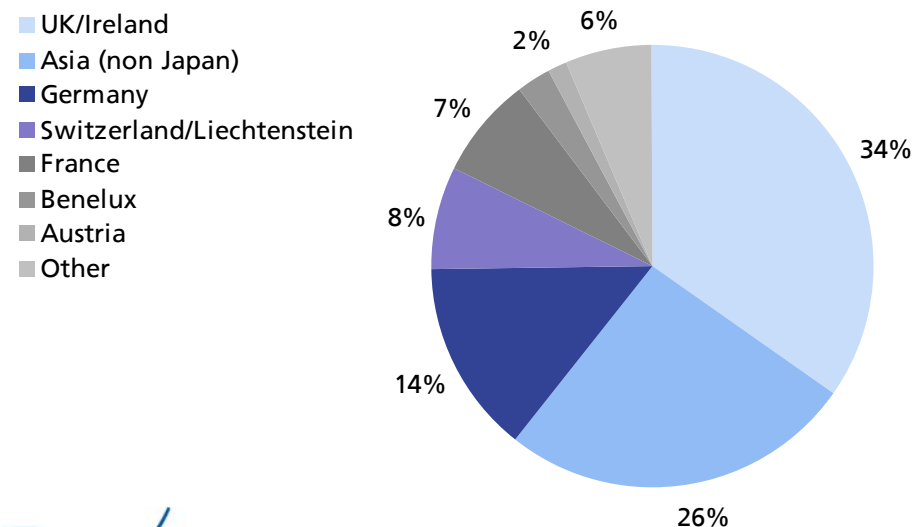
ISSUE OVERVIEW

Issuer	TUI AG
Issuer Rating (Senior)	Ba2 stable by Moody's/BB+ positive by S&P
Debt Status	Deeply subordinated, unsecured
Issue Rating (Sub)	B1 stable by Moody's/B+ positive by S&P
Issue Size	EUR 300 mn
Launch & Pricing	December 2, 2005
Equity Credits	S&P: 40 – 60% ("intermediate equity content") Moody's: 25% ("Basket B")
Coupon Structure	Fixed-to-floating
Maturity	Perpetual NC7
Re-offer Spread	530 bp over 7 year Midswap
Coupon	8.625% fixed to 01/2013, thereafter 3m-Euribor + 730 bp (200 bp step-up)
Documentation	Stand-alone
Listing	Dublin
Orderbook	EUR 1.6 bn
Bookrunner	HVB, Citi, DB, RBS

TRANSACTION HIGHLIGHTS

- TUI successfully priced EUR 300 mn of Hybrid Capital Securities on December 2, 2005.
- TUI was the first company from the non-investment grade universe to issue a hybrid.
- Following a 5-day roadshow in Europe and Asia, with a final order book in excess of EUR 1.5 bn, it priced at mid-swaps + 530 bp, firmly within the initial price guidance.

INVESTOR DISTRIBUTION BY REGION



Case Study Corporate Hybrid: TUI (cont'd.)



HYBRID LANGUAGE

Optional Deferral	TUI may suspend payments of interest if it does not declare any dividends. Interest payments so deferred will be cumulative but not interest bearing themselves and have to be paid following the next dividend payment via ACSM only
Optional Redemption	Redeemable at par plus accrued interest, if any, on January 30, 2013 and any interest payment date thereafter
Alternative Coupon Settlement Mechanism (ACSM)	TUI makes up for arrears of interest via ACSM through raising the funds by either issuing new shares, selling treasury shares or by issuance of new hybrid securities (in an aggregate principal amount of not more than 25% of the initial amount)
Change of Control Provision	Upon the occurrence of a change of control resulting in a downgrade the interest rate will increase by 500 bp and the Issuer will have the right to call the Securities at par plus accrued interest, if any
Purchase with Squeeze-out Provision	TUI can always purchase the securities at any price. If TUI purchases 80% or more of the initial amount, the company has the right to call the bond at the greater amount of the principal amount of the bonds and the make whole amount of the securities plus accrued interest

STRUCTURAL HIGHLIGHTS

- In order to achieve equity credit (Moody's: "Basket B" = 25%, S&P: "intermediate" = 40 – 60%), the following features were included in the structure: deep subordination, perpetual tenor, cumulative optional interest deferral, replacement language.
- Very strong change of control language with 500 bps step up in the case of a downgrade in the course of a change of control.
- Tax and accounting treatment: Interest payments are deductible by TUI for corporate tax purposes and the Capital Securities will be accounted for as equity under IFRS.

Conclusion

- Hybrid securities have become an accepted asset class by European institutional investors and have attracted great demand on the retail side
- The attraction of hybrids for issuers is that, as perpetual debt, it looks like equity on the balance sheet, with a benign effect on rating
- Existing shareholders are not diluted and coupon payments remain tax-deductible
- For investors, hybrids offer relative value through a significant spread pick-up versus senior notes
- The latest transactions from Vattenfall, Vinci, TUI, Südzucker, Porsche, Dong or Bayer have been very well received by the market
- It is key to structure the hybrid balanced in order to both achieve appropriate equity credit from agencies and to be well received by investors
- Going forward we expect further hybrid structures to come to market, benefiting from the current low interest and spread environment

Contacts

Hybrid Capital Markets

Dr. Mathias Külpmann, CFA

Head of High Yield and Hybrid Capital Markets

Director

Telephone: +49 89 378-17573

E-mail: mathias.kuelpmann@hvb.de

Hans Niethammer

Vice President

Telephone: +49 89 378-15924

E-mail: hans.niethammer@hvb.de

Sebastian Schwartz

Vice President

Telephone: +49 89 378-11820

E-mail: sebastian.schwartz@hvb.de



Disclaimer

The information in this publication is based on carefully selected sources believed to be reliable but we do not make any representation as to its accuracy or completeness. Any opinions herein reflect our judgement at this date and are subject to change without notice. The investments discussed or recommended in this report may be unsuitable for investors depending on their specific investment objectives and financial position. This report is provided for general information purposes only and cannot be a substitute for obtaining independent financial advice. Private investors should obtain the advice of their banker/broker about the investments concerned prior to making them. Nothing in this publication is intended to create contractual obligations on Bayerische Hypo- und Vereinsbank AG.

Note to UK residents:

This report is intended for clients of Bayerische Hypo- und Vereinsbank AG who are market counterparties or intermediate customers (both as defined by the Financial Services Authority – "FSA") and is not intended for use by any other person, in particular, private customers as defined by the rules of FSA. This report does not constitute a solicitation to buy or an offer to sell any securities. The information in this publication is based on carefully selected sources believed to be reliable but we do not make any representation as to its accuracy or completeness. Any opinions herein reflect our judgement at this date and are subject to change without notice. We and/or members of Bayerische Hypo- und Vereinsbank Group may take a long or short position and buy or sell securities mentioned in this publication. We and/or members of Bayerische Hypo- und Vereinsbank Group may act as investment bankers and/or commercial bankers for issuers of securities mentioned, be represented on the board of such issuers and/or engage in "market making" of such securities. We and/or members of Bayerische Hypo- und Vereinsbank Group may also, from time to time, have a consulting relationship with a company being reported upon. The investments discussed or recommended in this report may be unsuitable for investors depending on their specific investment objectives and financial position. This report is provided for general information purposes only and cannot be a substitute for obtaining independent financial advice. Private investors should obtain the advice of their banker/broker about the investments concerned prior to making them. Nothing in this publication is intended to create contractual obligations on Bayerische Hypo- und Vereinsbank AG. Regulated by FSA for the conduct of investment business in the UK.

Note to U.S. residents:

The information contained in this report is intended solely for institutional clients of Bayerische Hypo- und Vereinsbank AG, New York Branch and HVB Capital Markets, Inc. (together "HVB") in the United States, and may not be used or relied upon by any other person for any purpose. It does not constitute a solicitation to buy or an offer to sell any securities under the Securities Act of 1933, as amended, or under any other US federal or state securities laws, rules or regulations. Investments in securities discussed herein may be unsuitable for investors, depending on their specific investment objectives, risk tolerance and financial position. In jurisdictions where HVB is not registered or licensed to trade in securities, commodities or other financial products, any transaction may be effected only in accordance with applicable laws and legislation, which may vary from jurisdiction to jurisdiction and may require that a transaction be made in accordance with applicable exemptions from registration or licensing requirements. All information contained herein is based on carefully selected sources believed to be reliable, but HVB makes no representations as to its accuracy or completeness. Any opinions contained herein reflect HVB's judgement as of the original date of publication, without regard to the date on which you may receive such information, and are subject to change without notice. HVB may have issued other reports that are inconsistent with, and reach different conclusions from, the information presented in this report. Those reports reflect the different assumptions, views and analytical methods of the analysts who prepared them. Past performance should not be taken as an indication or guarantee of further performance, and no representation or warranty, express or implied, is made regarding future performance.

HVB and any HVB affiliate may, with respect to any securities discussed herein: a) take a long or short position and buy or sell such securities; b) act as investment and/or commercial bankers for issuers of such securities; c) engage in market-making for such securities; d) serve on the board of any issuer of such securities; and e) act as a paid consultant or adviser to any issuer. The information contained in this report may include forward-looking statements within the meaning of US federal securities laws that are subject to risks and uncertainties. Factors that could cause a company's actual results and financial condition to differ from its expectations include, without limitation: political uncertainty, changes in economic conditions that adversely affect the level of demand for the company's products or services, changes in foreign exchange markets, changes in international and domestic financial markets, competitive environments and other factors relating to the foregoing. All forward-looking statements contained in this report are qualified in their entirety by this cautionary statement.