France-Based Utility Veolia Environnement's Proposed Junior Subordinated Hybrid Notes Rated 'BB+'

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- Veolia Environnement S.A. plans to issue junior subordinated perpetual hybrid securities to partially finance the €3.4 billion acquisition of ENGIE's 29.9% share in Suez Environnement S.A.
- We assess the proposed securities as having intermediate equity content, underpinned by the structural features of the instrument and the group's supportive financial policy.
- We are assigning our 'BB+' issue rating to the proposed securities to reflect their subordination and optional deferability.

PARIS (S&P Global Ratings) Oct. 14, 2020--S&P Global Ratings today assigned its 'BB+' long-term issue rating to the proposed, undated, optionally deferrable, and deeply subordinated hybrid capital securities to be issued by France-based vertically integrated utility Veolia Environnement S.A. (BBB/Stable/A-2).

We consider the proposed securities to have intermediate equity content until their first call dates (5.5 years and 8.5 years after issuance), because they meet our hybrid capital criteria in terms of their subordination, permanence, and optional deferability during this period.

We arrive at our 'BB+' issue rating on the proposed securities by notching down from our 'BBB' long-term issuer credit rating (ICR) on Veolia. The two-notch differential between the issue rating and the ICR reflects our notching methodology, which calls for:

- A one-notch deduction for subordination because the ICR on Veolia is investment grade (that is, 'BBB-' or above); and
- An additional one-notch deduction for payment flexibility to reflect the fact that the deferral of interest is optional and that the ICR is investment grade.

The notching of the proposed securities reflects our view that there is a relatively low likelihood that Veolia will defer interest. Should our view change, we may significantly increase the number of downward notches that we apply to the issue rating, and more quickly than we might take a rating action on the ICR.

In addition, in view of what we see as the intermediate equity content of the proposed securities, we allocate 50% of the related payments on these securities as a fixed charge and 50% as equivalent to a common dividend, in line with our hybrid capital criteria. The 50% treatment (of principal and accrued interest) also applies to our adjustment of debt. We note hybrids represent about 10% of Veolia's total capital today, and it would be lower should Veolia launch a full takeover offer on Suez.

Although the securities are perpetual, they can be called at any time for tax, gross-up, rating, or accounting events. Furthermore, Veolia can redeem them for cash as of the first call dates, and every five years thereafter. If any of these events occur, the company intends to replace the instrument, although it is not obliged to do so. As per its statement of intent, we understand that Veolia's capital strategy is to strengthen its balance sheet following the announced acquisition and that hybrids play a key role in this financial policy (see "French Utility Veolia To Offset €3.4 Billion Stake Purchase In Suez With Remedy Measures," published Oct. 6, 2020, on RatingsDirect). We note that Veolia redeemed hybrids in the past without replacing them and currently does not have any hybrids. We believe that financial policy has evolved since then though, notably in the context of the acquisition of the 29.9% stake in Suez, which we consider a material development for the group. Should we perceive a change in the commitment to the hybrids, we would consider the proposed securities to have no equity content compared with intermediate equity content currently.

The interest to be paid on the proposed securities will increase by 25 basis points (bps) from 2026 for the 5.5 year tranche and from 2029 for the 8.5 year tranche with a further 75-basis-point increase five years later. We consider the cumulative 100 bps as a material step-up, which is currently unmitigated by any commitment to replace the instrument at that time. This step-up provides an incentive for Veolia to redeem the instrument on the call date.

KEY FACTORS IN OUR ASSESSMENT OF THE INSTRUMENT'S DEFERABILITY

In our view, Veolia's option to defer payment of interest on the proposed securities is discretionary. This means that Veolia may elect not to pay accrued interest on an interest payment date because it has no obligation to do so. However, any outstanding deferred interest payment would have to be settled in cash if Veolia declares or pays an equity dividend or interest on equal-ranking securities, and/or if Veolia or its subsidiaries redeem or repurchase shares or equal-ranking securities. We see this as a negative factor in our assessment of equity content. That said, this condition remains in line with our rating methodology because once the issuer has settled the deferred amount, it can choose to defer payment on the next interest payment date.

Veolia retains the option to defer coupons throughout the instrument's life. The deferred interest on the proposed securities is cash-cumulative, and will ultimately be settled in cash.

KEY FACTORS IN OUR ASSESSMENT OF THE INSTRUMENT'S SUBORDINATION

The proposed securities (and coupons) are intended to constitute direct, unsecured, and deeply subordinated obligations of Veolia. The proposed securities rank junior to all unsubordinated obligations, ordinary subordinated obligations, and prêts participatifs, and are only senior to common and preferred shares. As per our criteria, however, we only notch the proposed notes down by one notch despite their deep subordination.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017

- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Related Research

- French Utility Veolia To Offset €3.4 Billion Stake Purchase In Suez With Remedy Measures, Oct. 6, 2020
- French Utility Veolia Environnement 'BBB' Rating Affirmed After €2.9 Billion Bid For 29.9% Stake In Suez; Otlk Stable, Sept. 1, 2020
- Veolia Environnement S.A., June 10, 2020
- French Utility Veolia Environnement S.A. Affirmed At 'BBB' Despite COVID-19 Operating Uncertainty; Outlook Stable, March 27, 2020