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Veolia Environnement S.A.

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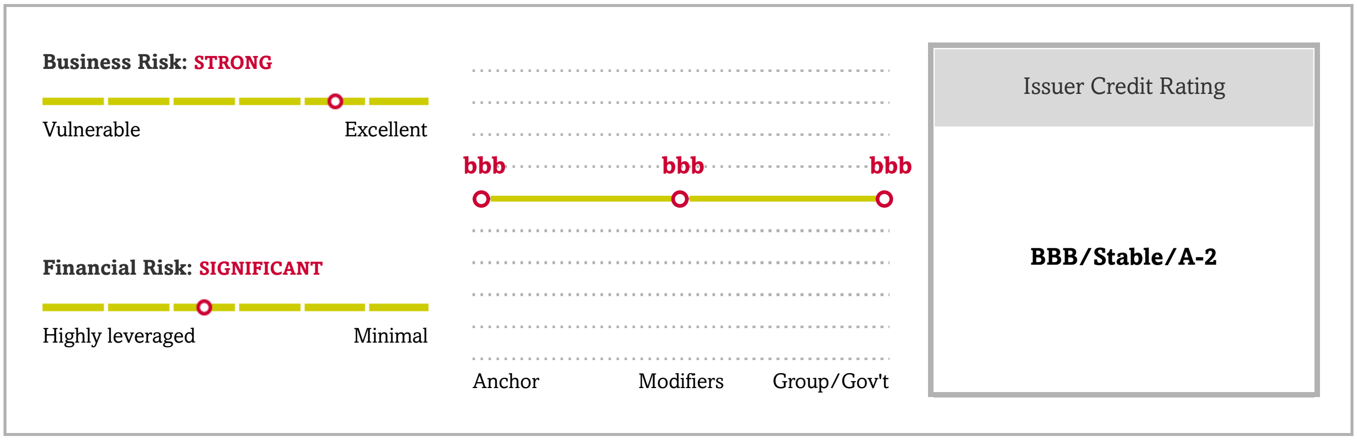
Veolia Environnement S.A.



Credit Highlights

Overview

Key strengths	Key risks
Leading worldwide position in both the water concession (45% of 2020 EBITDA) and waste solution (35%) businesses, which will be strengthened with Suez acquisition.	Pressure on remuneration at contract renewal times, notably on water concessions but also industrial contracts.
Predictable cash flows supported by long-term diversified environmental services, benefiting from positive secular market trends, with Suez adding significant geographical and contract diversity.	Cash flow volatility in the waste solutions business, stemming notably from dependence on industrial output and price volatility of recycled products.
Significant profitability improvement from successful implementation of cost-efficiency measures over 2012-2020, which we expect to continue until 2023 at least, and from Suez's integration.	Exposure to country risk, given presence in emerging markets, which represent about one-third of the group's EBITDA.

The Veolia Environment S.A. (Veolia) -Suez merger now has a clear path ahead, with anti-trust approvals being the key milestone. On April 12, 2021, Veolia and Suez reached an agreement allowing a merger, with a transaction perimeter that was defined on May 14 and made public on June 29 with the filing of the cash tender offer. Veolia and Suez have clearly defined the perimeter of the "new Suez" that will be sold to the financial consortium (notably Meridiam and Global Infrastructure Partners), with €7 billion of revenues that will be sold through a put option for a total amount of between €9.5 billion-€9.8 billion, which is roughly €1.0 billion higher than our initial expectation. Key assets that will be sold include:

- Suez's water and waste operations (excluding hazardous waste) in France;
- Suez's "Smart & Environmental Solutions" business unit;
- Suez's Municipal Water Operations in Italy, Czech Republic, and Africa (where Suez also has waste operations);
- Suez's water and design and construction activities in China; and

We expect Veolia to launch its full takeover offer for Suez in the first quarter of 2022. Veolia will now seek regulatory approval, notably at the European Commission level, which we understand could be provided in fourth-quarter 2021.

Suez will enhance Veolia's scale and revenue diversity. We believe that, overall, Suez's geographic and business mix is less risky than Veolia's ahead of the acquisition, notably thanks to operations in lower-risk markets (including the U.S. and Australia) and a larger share of contracted water and waste activities. We estimate that Suez's inclusion would increase the Veolia group's EBITDA to about €6.3 billion, after planned disposals (that is, by 2023), from about €3.6 billion in 2020. The combined group would also have stronger market positions and increased diversification. In addition, the enlarged group would enjoy greater geographic diversification and increased opportunities to manage portfolio arbitrage and optionality, barring major adverse events.

We expect Veolia to enact strong remedy measures to defend the current rating after the €21.4 billion offer for the remaining 70.1% stake in Suez. Veolia targets a reported net debt to EBITDA ratio of 3.0x after the acquisition, which is equivalent to a S&P Global Ratings-adjusted funds from operations (FFO) to debt above 20%. Remedy measures--expected to offset the €21.4 billion offer for the stake in Suez it does not currently own (including €12.1 billion for the reported net debt of Suez)--are notably the pre-agreed sale of the "new Suez" for an enterprise value between €9.5 billion-€9.8 billion, together with other remedy measures, such as hybrid bonds and capital increase. We also expect Veolia to maintain or refinance the €1.6 billion hybrid bonds of Suez that currently do not meet our criteria conditions for intermediate equity credit. The aforementioned measures, together with a rebound in operating activity expected in 2021, should lead to an adjusted FFO to debt above 20% over 2022-2023.

Strong operating performance in 2021 will be key for the rating. Veolia expects a rebound in operating activity in 2021, with reported EBITDA expected to increase above 4.0 billion after the dip at about €3.6 billion in 2020, together with reported net debt below €12.0 billion, from €13.2 billion in 2020. We expect the EBITDA increase to stem from a normalization of the operating activity in the waste and energy divisions of Veolia in 2021, as already shown with first-quarter 2021 results that were above the 2019 levels.

Outlook: Stable

The stable outlook on French water, waste, and energy group Veolia Environnement SA factors in our expectation that Veolia can offset the proposed cash outlay of about €9.3 billion to purchase the remaining 70.1% stake in Suez. To this amount we add €12.1 billion of Suez's reported net debt, which will be consolidated by Veolia. Moreover, we expect that Veolia will take timely action to restore its balance sheet within 24 months of the takeover offer becoming effective. We expect this could occur in the first quarter of 2022 if Veolia's offer is approved by the anti-trust authorities. This should result in our adjusted FFO to debt metric for Veolia recovering to more than 20% in 2023 following just under 20% in 2022, when the bulk of the cash outflow relating to Suez will likely happen. We note that the competition authorities' review could take up to 15 months, potentially delaying the outcome of the offer further, in which case we would reassess our base-case scenario. We also consider Veolia's track record of improving profitability and restoring its balance sheet after meaningful changes in scope of operations, such as during the 2012-2019 transformational period. In our base case, we assume Veolia's stand-alone operating performance will continue to support the rating.

Downside scenario

We could downgrade Veolia if one or a combination of the following conditions happen, namely if Veolia is unable to:

- Restore its stand-alone operating performance in 2021, notably with adjusted FFO to debt above 20% after 14.9% in 2020.
- Offset (within 24 months at the latest) the approximate €21.4 billion cash payment (including Suez's reported net debt of €12.1 billion) for the 70.1% stake in Suez, and thereby restore its credit metrics to a level commensurate with the current rating.
- Fully control Suez, with an adverse impact on the consolidated entity's operating performance in 2022-2023, including markedly lower cost synergies than expected.

Upside scenario

Although remote, we could consider raising the rating if we forecast an increase of adjusted FFO to debt to more than 25% over the next two years. An upgrade would also depend on Veolia overcoming the operational challenges it faces over the next two years, in particular:

- Formation of the new Suez and related disposals, which need to be executed in a timely manner and on budget.
- Restoring operating performance in 2021 to a level commensurate with the current rating, after a drop in the adjusted EBITDA margin to 11.9% during 2020.
- Limited headroom for a potential upgrade under credit metrics over 2021-2023, following the approximate €9.3 billion investment for Suez's equity.

Our Base-Case Scenario

Assumptions

- Revenue growth in line with EBITDA growth at around 9.0% in 2021, supported by investments in international activities (mainly China's hazardous waste), new contracts with industrial customers, and to a lesser extent more favorable energy prices.
- Reported EBITDA in 2021 of €4.0 billion, the same as in 2019, after about €3.6 billion in 2020.
- Reported EBITDA (after IFRIC 12) almost doubling to about €6.1 billion in 2022, and €6.3 billion in 2023.
- The EBITDA margin after IFRIC 12 and principal payments on operating financial assets stable at about 13%, increasing to about 15% with the consolidation of Suez in 2022.
- Annual cost cuts of €250 million with a 40% retention rate, and Suez's acquisition leading to €500 million of annual cost synergies from 2023.
- Acceleration of capital expenditure (capex) in 2020-2021 to yield a strong EBITDA contribution by the end of the plan, leading to capex of about €5 billion over 2020-2021, and €3 billion per year over 2022-2023.
- Ordinary dividends increasing in line with net income.
- Annual dividends from Suez averaging €100 million-€150 million in 2021.
- Full contribution from Suez as of 2022 (expected closing time of the transaction) with a total cash outflow of €9.3 billion, and an additional €12.1 billion impact on reported net debt stemming from Suez's net debt consolidation. This follows the €3.4 billion cash outflow for the 29.9% stake in Suez in 2020.
- Veolia executing all the necessary measures, including a capital increase, to restore its balance sheet before year-end 2023.

Key Metrics

Veolia Environnement S.A.--Key Metrics

(Bil. €)	2019a	2020a	2021e	2022e	2023e
EBITDA reported (after IFRIC 12)	3.4	2.9	3.5-3.7	6.0-6.3	6.2-6.5
EBITDA*	3.7	3.2	3.9-4.1	6.3-6.5	6.5-6.8
Debt*	13.0	16.2	15.0-16.0	23.0-26.0	23.0-26.0
Capital expenditure*	1.9	1.7	2.2-2.7	3.0-3.5	2.8-3.3
Dividends*	0.7	0.4-0.5	0.7-0.8	1.0-1.3	1.0-1.3
FFO/debt* (%)	22.6	14.9	20.0-22.0	19.5-21.5	19.5-21.5
Debt/EBITDA* (x)	3.5	5.2	3.5-4.0	3.8-4.3	3.6-4.1

*S&P Global Ratings-adjusted figures. FFO--Funds from operations. a--Actual. e--Estimate.

After a challenging 2020, we expect Veolia's financial performance to rebound in 2021. After a challenging performance in 2020, with adjusted FFO to debt declining well below the 20% threshold for the 'BBB' rating at 14.9%, we expect Veolia's operating performance to normalize in 2021 (for more details please refer to "Strong Expected Performance For Veolia In 2021 Should Offset Weaker 2020 Results," published Feb. 25, 2021). In particular, we believe reported EBITDA will increase to above €4.0 billion in 2021, after the dip at €3.6 billion in 2020. Despite our expectation of capex to remain high at above €2.0 billion, we believe reported net debt will decrease to below €12.0 billion in 2021, from €13.2 billion in 2020. Debt reduction will stem from EBITDA growth but also from disposals and asset rotations that were delayed in 2020, notably district heating assets in Prague. We expect reported net debt to EBITDA to decrease to below 3.0x in 2021, from 3.6x in 2020.

Suez is fully consolidated from 2022. In our base-case scenario, we consolidate Suez as a 100% owned subsidiary from 2022. We estimate that Suez's inclusion would increase the Veolia group's EBITDA to about €6.3 billion, after planned disposals (that is, by 2023), from about €3.6 billion in 2020.

Remedy measures will be key to Veolia maintaining the current rating. Veolia has anticipated the need to take significant remedy measures, including disposals, hybrid issuance, and a capital increase to defend the current rating after the €21.4 billion offer for Suez's 70.1% remaining stake (including €12.1 billion for Suez's net debt). Remedy measures will be key to Veolia maintaining adjusted FFO to debt at around 20% in 2022 and 2023. We also expect Veolia to restore its balance sheet through a capital increase. Overall, since the group already pre-agreed the disposal of the New Suez, we now see reduced execution risks on these key measures.

Company Description

Veolia operates worldwide within three main business segments: water services, waste services, and energy. Water services have been the core business since the company's inception in 1853, but Veolia has also increased its waste projects (especially hazardous waste in Asia) since 2003. In 2020, water services represented about 45% of EBITDA, waste about 35%, and energy 20%. Geographically, 60% of revenue came from Europe, 12% from Asia-Pacific, 10% from Americas, 4% from the Middle East, and the remaining 13% from international activities.

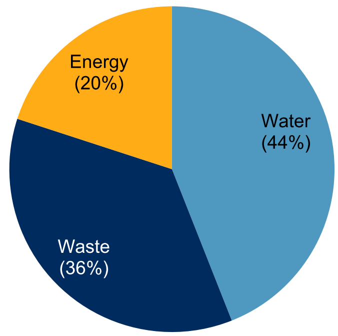
- The water business integrates drinking water and wastewater activities, such as distribution and treatment, industrial process water, and manufacturing of water treatment equipment and technologies.
- The waste solutions business collects, processes, and disposes of household, commercial, and industrial waste. It also includes waste sorting, recycling, and recovery.
- The energy business produces renewable energy, comprising heat and electricity generated primarily from waste.

Additionally, Veolia develops a range of energy-management activities, including heating and cooling networks, thermal, and multi-technical services.

At year-end 2020, Veolia's adjusted revenue totalled €26.4 billion, EBITDA was €3.2 billion, and net debt at €16.2 billion, demonstrating the group's resilience to the COVID-19 pandemic.

Chart 1

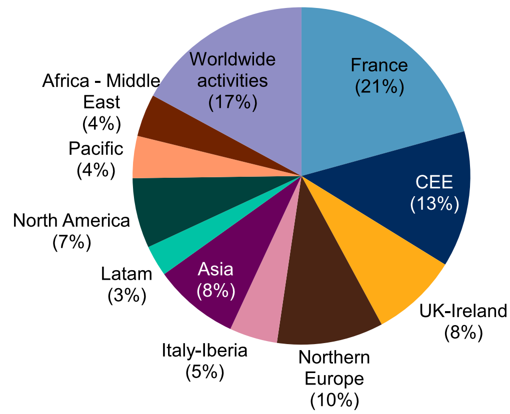
2020 EBITDA Split By Businesses



Source: S&P Global Ratings

Chart 2

2020 Revenue Split By Geography



CEE--Central and Eastern Europe. Source: S&P Global Ratings

Peer Comparison

Table 1

Veolia Environnement S.A.--Peer Comparison

Industry sector: Energy

	Veolia Environnement S.A.	American States Water Co.	A2A SpA	Hera SpA
Ratings as of July 6, 2021	BBB/Stable/A-2	A+/Negative/--	BBB/Stable/A-2	BBB+/Stable/A-2
	--Fiscal year ended Dec. 31, 2020--			
Mil. Mix currencies	€	$	€	€
Revenue	26,373.1	488.2	6,862.0	7,079.0
EBITDA	3,150.2	174.8	1,174.0	1,038.9
Funds from operations (FFO)	2,418.9	140.5	971.0	790.0
Interest expense	426.3	23.5	86.0	103.3
Cash interest paid	451.0	20.6	80.0	64.3
Cash flow from operations	2,736.9	125.8	854.0	929.6
Capital expenditure	1,689.6	131.6	738.0	511.7
Free operating cash flow (FOCF)	1,047.3	(5.8)	116.0	417.9
Discretionary cash flow (DCF)	603.0	(53.0)	-140	199.8
Cash and short-term investments	6,536.4	36.7	1,012.0	987.2
Debt	16,227.8	613.3	4,184.6	3,441.6
Equity	7,321.2	641.7	4,116.0	3,155.3
Adjusted ratios				
EBITDA margin (%)	11.9	35.8	17.1	14.7
Return on capital (%)	4.4	11.2	7.8	9.2
EBITDA interest coverage (x)	7.4	7.4	13.7	10.1

Table 1

Veolia Environnement S.A.--Peer Comparison (cont.)				
Industry sector: Energy				
	Veolia Environnement S.A.	**American States Water Co.**	**A2A SpA**	**Hera SpA**
FFO cash interest coverage (x)	6.4	7.8	13.1	13.3
Debt/EBITDA (x)	5.2	3.5	3.6	3.3
FFO/debt (%)	14.9	22.9	23.2	23.0
Cash flow from operations/debt (%)	16.9	20.5	20.4	27.0
FOCF/debt (%)	6.5	(1.0)	2.8	12.1
DCF/debt (%)	3.7	(8.6)	(3.3)	5.8

Business Risk: Strong

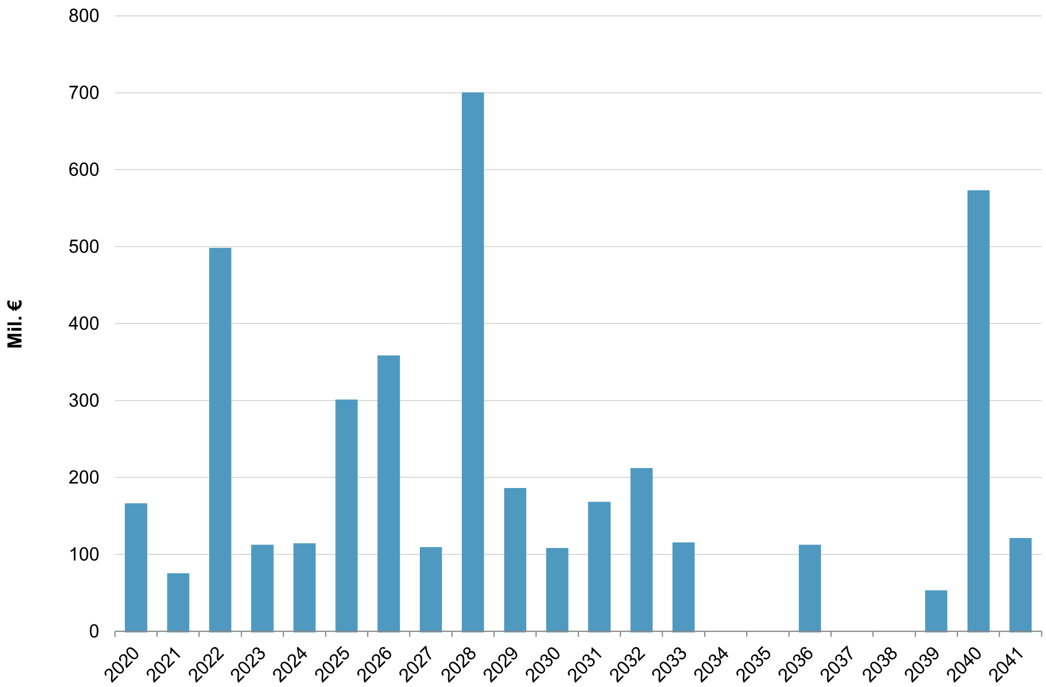
Suez will enhance Veolia's scale and revenue diversity. We believe that, ahead of the acquisition, Suez's geographic and business mix is less risky than Veolia's, notably thanks to operations in lower-risk markets and a larger share of contracted water and waste activities. We estimate that Suez's inclusion would increase the Veolia group's EBITDA to about €6.3 billion, after planned disposals (that is, by 2023), from about €3.6 billion in 2020. The combined group would also have stronger market positions and increased diversification. Both Veolia and Suez are considered global leaders in environmental services, but even combined, represent less than 2% of the fragmented global waste and water market. At a time when macroeconomic trends are becoming more favorable for the sector globally and consolidation is poised to accelerate, joining forces is likely to prove positive. In addition, the enlarged group would enjoy greater geographic diversification and increased opportunities to manage portfolio arbitrage and optionality, barring major adverse events.

Veolia holds leading worldwide positions in water and waste management that will be strengthened with the Suez acquisition. Our assessment of Veolia's business risk profile is supported by its leading worldwide positions in water and waste management, based on its strong franchises in local markets across Europe, the U.S., Latin America, and Asia. The group manages thousands of contracts, with a wide range of customers. Within its strategic plan until 2023, Veolia aims to become the leader in the ecological transition by increasing its circular economy activities, notably in the energy efficiency and waste-to-energy sectors through long-term contracts with industrials. In our view, integrating Suez would reinforce Veolia's already strong business profile as a France-based transnational water, waste, and energy management company, backed by Veolia's strategy to restore its balance sheet if its bid is accepted and the acquisition goes through.

Recurring and stable revenue from long-term contracts. Veolia has a high share of recurrent revenue from long-term contracts with local governments, which results in low volume and performance risk, and confers predictability to group earnings. In its core domestic market, Veolia typically operates under long-term operations and maintenance contracts, whereby it operates assets that are owned and financed by local authorities, and collects a tariff from customers. These contracts typically have a maturity of eight to 20 years for municipalities, depending notably on their capital intensity. For industrials, contracts are generally shorter (three to 10 years). Water consumption and demand are not cyclical, but are secularly and gradually declining (by about 1% per year in France) due to improving consumption efficiencies. Veolia's risks are further mitigated by automatic indexation clauses covering the main variable costs. Moreover, heating networks have little sensitivity to economic cycles and most contracts have pass-through arrangements, albeit with some time lag. In addition, the increasing expertise of local authorities, intense competition, and regulatory changes reducing the maximum duration of contracts have translated into significant tariff cuts in renegotiations of water contracts in France.

Chart 3

Veolia's Reported Contract Renewals



Source: S&P Global Ratings

Financial Risk: Significant

Veolia's credit metrics look set to stay in line with the ratings regardless of the Suez acquisition. Veolia's financial policy is geared toward a solid investment-grade rating ('BBB-' or higher) with reported net debt-to-EBITDA ratios below 3x, which is almost equivalent to the adjusted FFO-to-debt ratio of at least 20% commensurate with the current rating. To maintain such ratios, Veolia has anticipated the need to take significant remedy measures, including disposals, hybrid issuance, capital increases, or a share exchange. We note that, despite the acquisition price now being higher by about €1.5 billion--with the final offer being at 20.5 €/share rather than 18.0€/share initially--Veolia's credit metrics are in line with our previous forecasts, notably with adjusted FFO to debt at about 20% in 2022 and 2023. This is because Veolia will sell more listed activities within Suez that were not contributing to EBITDA compared with our previous base case. We also expect the post-acquisition Veolia group to restore its balance sheet through a capital increase. In addition, in our base-case scenario, we do not assume Veolia will use U.S. tax loss carryforwards equivalent to about €450 million. Overall, we see Veolia as being in a good position to maintain adjusted FFO-to-debt ratios at about 20% until 2023.

The combined group will have a well-spread debt maturity profile, with no structural subordination concerns. Veolia's debt currently comprises senior unsecured debt (mostly bonds) and €2.0 billion of hybrids. If we include Suez's debt in our structural subordination analysis, based on year-end 2020 information (excluding Suez's €1.6 billion hybrid bonds and IFRS 16 leases), the amount of priority debt would represent 45%-50% of total debt. Therefore, once Suez is integrated into the Veolia group, we believe its financial debt would qualify to be rated at the same level as Veolia's current stand-alone financial debt, namely 'BBB'. In our base case, we treat Suez's outstanding €1.6 billion perpetual hybrids (as of Dec. 31, 2020)--with the first call dates seven years after issuance and further call dates every five years afterward--as 100% debt. This is because the step-up margin is a cumulative 100 basis points over 12 years compared with the 25 years stated in our criteria. In our base case, we assume Veolia will find a solution for this hybrid stock in order to receive intermediate equity content.

Financial summary

Table 2

Veolia Environnement S.A.--Financial Summary				
Industry sector: Energy				
	--Fiscal year ended Dec. 31--			
	2020	**2019**	**2018**	**2017**
(Mil. €)				
Revenue	26,373.1	27,526.5	26,203.2	25,437.8
EBITDA	3,150.2	3,697.3	3,486.0	3,298.9
Funds from operations (FFO)	2,418.9	2,950.2	2,701.4	2,467.8
Interest expense	426.3	475.3	548.2	642.1
Cash interest paid	451.0	482.3	572.9	597.6
Cash flow from operations	2,736.9	2,816.8	2,345.9	2,414.3
Capital expenditure	1,689.6	1,887.0	1,603.4	1,610.5
Free operating cash flow (FOCF)	1,047.3	929.8	742.5	803.8
Discretionary cash flow (DCF)	603.0	125.5	140.1	213.3
Cash and short-term investments	6,536.4	5,936.5	4,225.4	5,975.8
Gross available cash	6,547.1	5,936.5	4,418.2	6,150.7
Debt	16,227.8	13,042.6	13,059.2	12,132.9
Equity	7,321.2	7,078.4	7,126.8	7,461.6
Adjusted ratios				
EBITDA margin (%)	11.9	13.4	13.3	13.0
Return on capital (%)	4.4	7.3	7.5	7.3
EBITDA interest coverage (x)	7.4	7.8	6.4	5.1
FFO cash interest coverage (x)	6.4	7.1	5.7	5.1
Debt/EBITDA (x)	5.2	3.5	3.7	3.7
FFO/debt (%)	14.9	22.6	20.7	20.3
Cash flow from operations/debt (%)	16.9	21.6	18.0	19.9
FOCF/debt (%)	6.5	7.1	5.7	6.6
DCF/debt (%)	3.7	1.0	1.1	1.8

Reconciliation

Table 3

Veolia Environnement S.A.--Reconciliation Of Reported Amounts With S&P Global Ratings-Adjusted Amounts (Mil. €)

--Fiscal year ended Dec. 31, 2020--

Veolia Environnement S.A. reported amounts										
	Debt	**Shareholders' equity**	**Revenue**	**EBITDA**	**Operating income**	**Interest expense**	**S&P Global Ratings-adjusted EBITDA**	**Cash flow from operations**	**Dividends**	**expe**
Reported	18,250.7	7,216.2	26,009.9	2,904.6	809.0	363.6	3,150.2	2,737.7	426.0	
S&P Global Ratings' adjustments										
Cash taxes paid	--	--	--	--	--	--	(258.3)	--	--	
Cash interest paid	--	--	--	--	--	--	(437.0)	--	--	
Trade receivables securitizations	686.5	--	--	--	--	--	--	108.5	--	
Reported lease liabilities	1,699.7	--	--	--	--	--	--	--	--	
Intermediate hybrids reported as equity	993.5	(993.5)	--	--	--	--	--	--	--	
Postretirement benefit obligations/deferred compensation	459.5	--	--	(24.2)	(24.2)	6.2	--	--	--	
Accessible cash and liquid investments	(6,547.1)	--	--	--	--	--	--	--	--	
Share-based compensation expense	--	--	--	33.3	--	--	--	--	--	
Dividends received from equity investments	--	--	--	72.5	--	--	--	--	--	
Deconsolidation/consolidation	208.0	--	164.0	164.0	84.0	13.0	(36.0)	133.0	10.0	
Asset-retirement obligations	444.6	--	--	--	--	43.5	--	--	--	
Nonoperating income (expense)	--	--	--	--	113.3	--	--	--	--	
Reclassification of interest and dividend cash flows	--	--	--	--	--	--	--	(441.5)	--	
Noncontrolling interest/minority interest	--	1,098.5	--	--	--	--	--	--	--	
Debt: Guarantees	32.4	--	--	--	--	--	--	--	--	
Revenue: Other	--	--	199.2	199.2	199.2	--	--	--	--	
EBITDA: Other	--	--	--	(199.2)	(199.2)	--	--	--	--	
Depreciation and amortization: Impairment charges/(reversals)	--	--	--	--	104.1	--	--	--	--	
Depreciation and amortization: Other	--	--	--	--	(119.4)	--	--	--	--	
Operating cash flow: Other	--	--	--	--	--	--	--	199.2	--	
Total adjustments	(2,022.9)	105.0	363.2	245.6	157.8	62.7	(731.3)	(0.8)	10.0	
S&P Global Ratings'-djusted amounts										
	Debt	**Equity**	**Revenue**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**	**Dividends paid**	**expe**
Adjusted	16,227.8	7,321.2	26,373.1	3,150.2	966.8	426.3	2,418.9	2,736.9	436.0	

Liquidity: Adequate

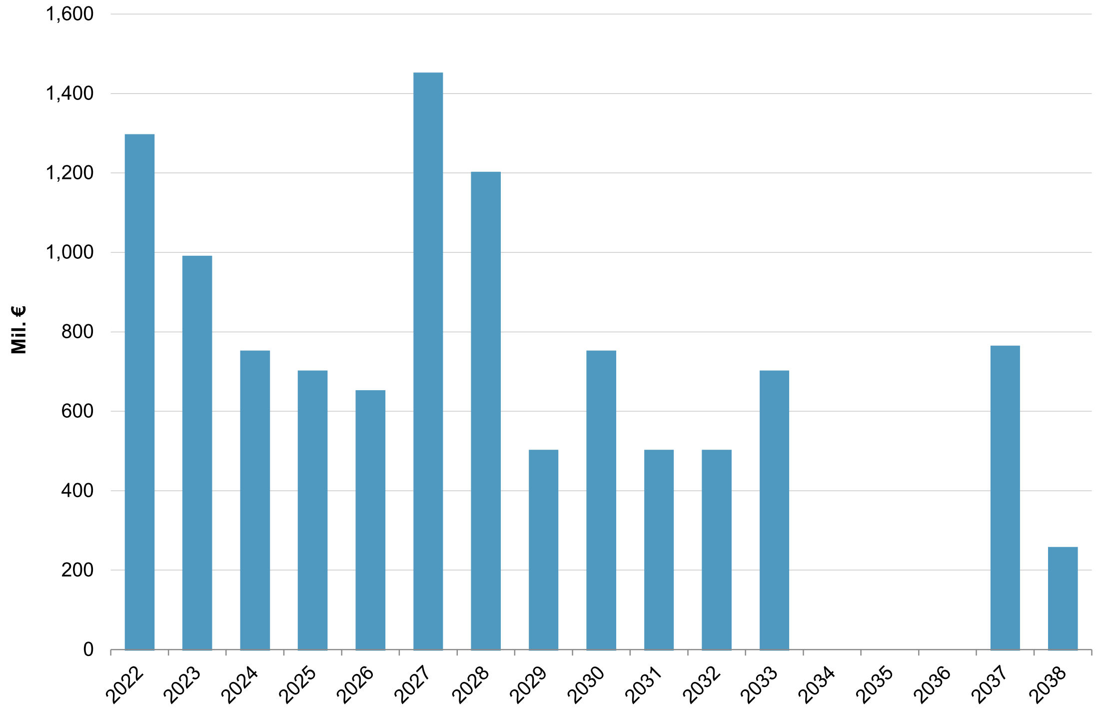
We assess Veolia's liquidity as adequate, since we forecast sources of liquidity will exceed uses by about 1.2x over the next 12 months. In addition, we believe the group's good access to capital markets, proactive liability management, and solid relationships with banks support its liquidity position. The group's debt is not subject to financial covenants.

Principal liquidity sources	Principal liquidity uses
• About €6.4 billion in available cash or highly liquid money market funds as of March 31, 2021; • A bridge loan covering the acquisition of Suez for a total amount of €9.0 billion in two different tranches with maturity in 12 months, with the possibility to extend for an additional 9 to 12 months; • About €4.0 billion of available committed credit lines maturing beyond 12 months, including a €3 billion multicurrency syndicated loan maturing in November 2022; • Planned remedies for the acquisition of Suez contracted at about €10 billion; and • Our forecast of annual cash FFO of about €3.2 billion in the next 12 months (with Suez still accounted for as an affiliate).	• Repayment of about €7.4 billion in debt; • Our estimate of €2.6 billion in annual capex, including expansion capex; • About €9.3 billion for the acquisition of the remaining 70.1% stake in Suez; and • Dividends of about €700 million to be distributed in the next twelve months.

Debt maturities

Chart 4

Veolia Debt Maturities As Of March 31, 2021



Note: One bond repayment of €638 million took place on Jan. 6, 2021. Source S&P Global Ratings.

Environmental, Social, And Governance

Veolia, under its new strategic plan, aims to become the leader in ecological transformation. This ambition will be supported by the Suez acquisition. Through its environmental activities, the group is heavily involved in the development of circular economic activities and waste-to-energy for industrial customers to reduce carbon dioxide intensity, for which it has allocated annual capex of €100 million over 2020-2023.

Water quality and waste management are notably highly scrutinized by consumers and authorities, which could ultimately result in the loss of operating licenses or material fines. Although Veolia has a fairly good track record in managing these risks across its very diverse portfolio, we note the group has faced some litigation in the past.

We also note the significant improvements to internal controls, processes, and reporting achieved by management in recent years, which we believe results in reduced risks for local governance or of mismanagement in Veolia's widely diversified businesses.

The recently announced executive environmental, social, and governance-linked remuneration emphasizes the sustainable focus of the group throughout its businesses. In the context of the Suez-Veolia deal, we revised our management and governance assessment for Veolia to "Fair" from "Satisfactory" previously. This decision came from the initial Suez's management opposition to the full takeover deal with significant operational and legal hurdles expected for Veolia if the transaction was to proceed. Despite this, we now have significantly more visibility on the next steps of the transaction, and we will continue to monitor the execution risk linked to the acquisition, notably in the anti-trust filing process.

Issue Ratings - Subordination Risk Analysis

Capital structure

Veolia's debt currently comprises senior unsecured debt (mostly bonds) and €2.0 billion of hybrids. If we include Suez's debt in our structural subordination analysis based on year-end 2020 information (excluding Suez's €1.6 billion hybrid bonds and IFRS 16 leases), the amount of priority debt would represent about 40% of total debt.

Analytical conclusions

Once Suez is integrated into the Veolia group, we believe its financial debt would qualify to be rated at the same level as Veolia's current stand-alone financial debt, namely 'BBB'.

Ratings Score Snapshot

Issuer Credit Rating

BBB/Stable/A-2

Business risk: Strong

- **Country risk:** Intermediate
- **Industry risk:** Low
- **Competitive position:** Strong

Financial risk: Significant

- **Cash flow/leverage:** Significant

Anchor: bbb

Modifiers

- **Diversification/portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Adequate (no impact)
- **Management and governance:** Fair (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Stand-alone credit profile : bbb

Related Criteria

- 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

Related Research

- SUEZ Water Resources LLC Off CreditWatch, Outlook Is Negative, On Merger Agreement Of Parent With Veolia; Apr. 16, 2021
- French Utility Veolia Affirmed At ‘BBB/A-2’ On Agreed Merger With Suez; Outlook Stable; Apr. 16, 2021
- How Veolia's Bid For Suez May Transform Its Credit Profile, March 18, 2021
- Strong Expected Performance For Veolia In 2021 Should Offset Weaker 2020 Results, Feb. 25, 2021
- French Utility Company Veolia Affirmed At 'BBB/A-2' On Proposed Takeover Of Suez; Outlook Stable, Feb. 22, 2021
- Ratings On Six European Integrated Utilities Affirmed Amid Accelerated Energy Transition; One Outlook Now Negative, Feb. 17, 2021
- The Energy Transition And The Diverging Credit Path For European Utilities, Feb. 16, 2021
- The Energy Transition And What It Means For European Power Prices And Producers: January 2021 Update, Jan. 27, 2021
- France-Based Utility Veolia Environnement's Proposed Junior Subordinated Hybrid Notes Rated 'BB+', Oct. 14, 2020
- 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

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	Intermediate	**Significant**	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	**bbb**	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of July 19, 2021)*

Veolia Environnement S.A.	
Issuer Credit Rating	BBB/Stable/A-2
Commercial Paper	
Local Currency	A-2
Junior Subordinated	BB+
Senior Unsecured	BBB
Short-Term Debt	A-2

Ratings Detail (As Of July 19, 2021)*(cont.)	
Issuer Credit Ratings History	
06-May-2015	BBB/Stable/A-2
15-Nov-2013	BBB/Negative/A-2
10-Oct-2012	BBB+/Negative/A-2

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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