S&P Global
Ratings

RatingsDirect®

Research Update:

French Utility Veolia 'BBB' Rating Affirmed On Successful Integration Of Suez; Outlook Stable

February 1, 2022

Rating Action Overview

- As part of its merger with Suez, Veolia Environnement SA (Veolia) has sold assets excluded from the merger perimeter (called "New Suez") to a consortium of financial investors for about €10.4 billion, which is above our initial expectation. This marks a key milestone in the merger and should allow Veolia to sustain its balance sheet despite the €22.7 billion acquisition of Suez over 2020-2022.
- We expect the acquisition will improve Veolia's business risk profile within our strong category, given Suez's highly complementary portfolio in terms of geographies and businesses. The consolidation will also boost Veolia's scale, with reported EBITDA for the combined entity increasing to €6.3 billion by 2023 according to our estimates from about €3.6 billion reported in 2020.
- We affirmed our 'BBB/A-2' long- and short-term issuer credit ratings on Veolia.
- The stable outlook indicates our expectation that Veolia will successfully integrate Suez while maintaining sufficient rating headroom, with notably adjusted funds from operations (FFO) to debt expected at above 20% over the next two years. We will closely monitor the integration process for operational or financial setbacks.

PRIMARY CREDIT ANALYST

Massimo Schiavo
Paris
+ 33 14 420 6718
Massimo.Schiavo
@spglobal.com

SECONDARY CONTACTS

Claire Mauduit-Le Clercq
Paris
+ 33 14 420 7201
claire.mauduit
@spglobal.com

Pierre Georges
Paris
+ 33 14 420 6735
pierre.georges
@spglobal.com

Emeline Vinot
Paris
+ 33 014 075 2569
emeline.vinot
@spglobal.com

Rating Action Rationale

Veolia's sale of "new Suez" to a consortium of financial investors for about €10.4 billion is a major step forward in the group's merger with Suez. On Jan. 31, 2022, Veolia announced the sale of "new Suez" to a consortium of financial investors (notably Meridiam and Global Infrastructure Partners) for about €10.4 billion. Veolia will thus retain and consolidate €10.0 billion of Suez's revenue while selling about €7.0 billion of revenue with activities that include the group's:

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

operations); and

- Water and design and construction activities in China.

This sale is key in restoring Veolia's balance sheet considering the €22.7 billion acquisition spending on Suez over 2020-2022. Veolia should cash out €9.3 billion for the 70.1% stake in Suez that it did not own at year-end 2021. This is in line with the cash tender offer made public in June 2021.

On Jan. 27, 2022, Veolia achieved a stake in Suez of 95.95%, and is therefore able to squeeze out the minority investors in the company and to de-list Suez before end of February 2022. It has received 17 out of 18 anti-trust approvals, including from the European Commission, as well as the Australian and the U.S. regulators. The only remaining regulatory hurdle is the approval in the U.K., which we expect Veolia will achieve before the end of the summer 2022.

The acquisition of Suez will strengthen Veolia's business risk positioning, given the increased scale and highly complementary business portfolios. 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 group's EBITDA to about €6.3 billion by 2023, 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.

Strong expected 2021 results for Veolia highlight robust operating performance ahead of the Suez's integration. We believe Veolia will see a strong rebound in its operational performance in 2021 thanks to the recovery in waste and energy activities that should lead to reported EBITDA increasing to about €4.1 billion, after the dip to about €3.6 billion in 2020. The rebound in operating performance in the two aforementioned business units was linked to economic recovery and activity as COVID-19-related restrictions were eased. For 2022, we expect Veolia will sustain its operating performance on a stand-alone basis, thanks to the supportive performance of contracted water activities and continued expected growth in the waste and energy activities. Specifically, we expect reported net debt of below €10.0 billion, in line with company's expectations, which should translate in S&P Global Ratings' adjusted FFO to debt above 23%, with a strong rebound from the 14.9% posted in 2020.

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 €2.5 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 International Financial Reporting Standard [IFRS] 16 leases), the amount of priority debt would represent 45%-50% of total debt. Therefore, once Suez is integrated into the 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 €1.1 billion perpetual hybrids (as of today, assuming Suez will call back its hybrid bond with a reset date in April 2022)--with the first call dates seven years after issuance and further call dates every five years thereafter--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 to receive intermediate equity content.

Outlook

The stable outlook indicates our expectation that Veolia will successfully integrate Suez while maintaining sufficient rating headroom, with notably adjusted funds from operations (FFO) to debt above 20% over the next two years. This is based on our expectation that Veolia will:

- Successfully complete all its remedy measures in 2022 for a total expected amount of about €12 billion, with the disposal of the "new Suez" for about €10.4 billion completed on Jan. 31, 2022;
- Receive the pending anti-trust approval in the U.K. before end-2022;
- Successfully refinance the hybrid bonds and senior unsecured bonds of Suez; and
- Face no operational, financial, or organizational setbacks in the first months of joint operations.

Downside scenario

We would lower our rating on Veolia if we expect the group will not be able to sustain adjusted FFO to debt above 20% over the next two years. This could notably stem from:

- Remedy measures' amount being lower than expected in 2022; or
- Veolia suffering major operational setbacks in the Suez integration in 2022.

Upside scenario

Upside potential will depend on our assessment of Veolia's business following a few months of joint operations without major setbacks in 2022. We would also require:

- More visibility on the strategy of the joint entity;
- Successful refinancing of Suez's debt; and
- A strong operational track record of the joint entity.

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 €16.2 billion.

Our Base-Case Scenario

Assumptions

- Reported EBITDA in 2021 of about €4.1 billion, the same as in 2019, after about €3.6 billion in 2020.
- Reported EBITDA (after IFRIC 12) almost doubling to about €6.2 billion in 2022, and €6.5 billion in 2023 following the integration of Suez.
- 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.
- Capital expenditures (capex) of about €1.7 billion in 2021 and €3.0 billion-€3.5 billion following the integration of Suez.
- Ordinary dividends increasing in line with net income.
- Full contribution from Suez as of 2022 with a total cash acquisition of €9.3 billion, and an additional €10 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 completing additional anti-trust measures as planned before the end of first-half 2022, after the disposal of "new Suez" on Jan. 31, 2022.
- €1.1 billion of hybrid bonds from Suez meeting our criteria for intermediate equity content.
- Veolia successfully refinancing the senior unsecured bonds of Suez before year-end 2022.

Key metrics

(Bil. €)	2019a	2020a	2021e	2022e	2023e
EBITDA reported (after IFRIC 12)	3.4	2.9	3.2-3.5	5.8-6.0	6.1-6.3
EBITDA*	3.7	3.2	3.6-3.8	6.1-6.3	6.4-6.6
Debt*	13	16.2	13.0-14.0	23.0-25.0	23.0-25.0
Capital expenditure*	1.9	1.7	1.6-1.8	3.0-3.5	2.8-3.3
Dividends*	0.7	0.4	0.5-0.7	1.0-1.3	1.0-1.3
FFO/debt* (%)	22.6	14.9	21.5-23.5	19.5-21.5	19.5-21.5
Debt/EBITDA* (x)	3.5	5.2	3.5-4.0	3.6-4.1	3.5-4.0

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

Liquidity

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

We estimate that principal liquidity sources for the 12 months from Sept. 30, 2021, include:

- About €6.4 billion in available cash or highly liquid money market funds;
- Nearly €4.0 billion of available committed credit lines maturing beyond 12 months, including a €3 billion multicurrency syndicated loan maturing in May 2024;
- Our forecast of annual cash flow from operations of about €4.4 billion; and
- About €12 billion of remedy disposals following the acquisition of Suez.

For the same period, we estimate that principal liquidity uses include:

- Debt repayment of about €2.3 billion and commercial paper standing at about €5.7 billion;
- Our estimate of €2.8 billion in annual capex, including expansion capex;
- About €9.3 billion of committed acquisitions in 2021-2022 for 70.1% stake in Suez; and
- Dividends of about €0.6 billion-€0.7 billion.

Environmental, Social, And Governance

ESG credit indicators: E-2, S-2, G-2

ESG factors are an overall neutral consideration in our credit rating analysis of Veolia. The group is the global leader in environmental services, benefitting from megatrends such as the circular economy. We factor in the successful progress on the takeover offer for Suez that started in August 2020 and Veolia's management ability to successfully turnaround the company before the launch of the full takeover offer for Suez.

Issue Ratings - Subordination Risk Analysis

Capital structure

Veolia's debt currently comprises senior unsecured debt (mostly bonds) and €2.5 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 38% 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 (standard volatility table)

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: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, 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

- Industry Top Trends 2022: EMEA Utilities, Jan. 26, 2022
- ESG Credit Indicator Report Card: Regulated Utility Networks, Nov. 18, 2021
- France-Based Utility Veolia Environnement S.A.'s Proposed Junior Subordinated Hybrid Security Rated 'BB+', Nov. 8, 2021
- French Utility Veolia's €2.5 Billion Capital Increase For Suez Acquisition Reduces Execution Risk And Increases Headroom, Sept. 21, 2021
- Veolia Environnement S.A., July 19, 2021
- How Veolia's Bid For Suez May Transform Its Credit Profile, March 18, 2021
- French Utility Veolia Affirmed At ‘BBB/A-2’ On Agreed Merger With Suez; Outlook Stable, April 16, 2021

Ratings List

Ratings Affirmed	
Veolia Environnement S.A.	
Issuer Credit Rating	BBB/Stable/A-2
Senior Unsecured	BBB
Junior Subordinated	BB+
Commercial Paper	A-2