MOODY'S
INVESTORS SERVICE

CREDIT OPINION
5 December 2017

Update

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RATINGS

**Veolia Environnement S.A.**

| | |
|---|---|
| Domicile | Paris, France |
| Long Term Rating | Baa1 |
| Type | LT Issuer Rating |
| Outlook | Stable |

*Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.*


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# Veolia Environnement S.A.

## Semi-annual update to credit analysis

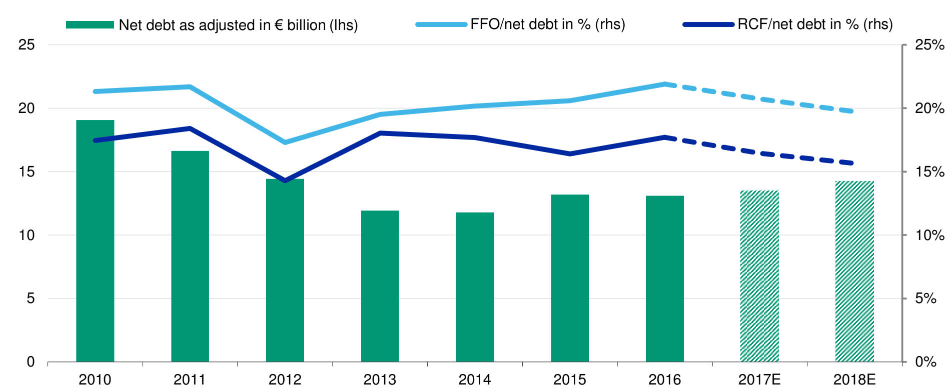

## Summary

The credit profile of Veolia Environnement S.A. (Veolia, Baa1/P-2 stable) is underpinned by (1) its size and position as one of the two largest groups active globally in environmental services, which benefit from positive structural dynamics; (2) the diversity of its revenue base by business, contract type and geography; and (3) the relatively low-risk profile of its water business, which accounts for 44% of revenues and is characterized by low volume volatility. These factors are balanced by (1) Veolia's exposure to the macroeconomic cycle through its waste business, which accounts for 37% of revenues; and (2) the increasing proportion of shorter-term contracts with industrial clients in its revenue mix.

From the financial risk perspective, we expect that the group will continue to demonstrate funds from operations (FFO)/net debt around 20% and retained cash flow (RCF)/net debt in the mid teens in percentage terms. This is mostly predicated upon the continued successful execution of the group's cost-saving programme, which should more than offset the pressures stemming from weak price indexation in the European water business (see exhibit 1 below).


Exhibit 1

**Financial profile expected to remain resilient**




Note: the 2017 and 2018 estimates represent Moody's forward view; not the view of the issuer, and assume that the hybrids are refinanced with senior debt in 2018.
*Source: Veolia, Moody's Investors Service*

## Credit strengths

» Scale and diversification support cash flow stability

» Supportive long-term industry dynamics

» Low-risk water activities, albeit currently impacted in Europe (and notably in France) by weak indexation stemming from the low inflation environment

» Improving financial profile primarily driven by cost saving programme

## Credit challenges

» Exposure of waste business to cyclical macroeconomic environment in Europe

» Increasing share of the industrial sector in the company's client mix

» Growing presence outside Western Europe, albeit mitigated by a balanced approach to capital deployment

## Rating outlook

The stable outlook reflects our expectation that Veolia's financial profile will remain aligned with our guidance for the Baa1 rating, which includes FFO/net debt around 20%, RCF/net debt at least in the mid-teens in percentage terms and FFO interest cover above 4x. It also factors in that any potential deterioration in the company's business risk profile as a result of an increased exposure to industrial clients could be offset by a further improvement in credit metrics.

## Factors that could lead to an upgrade

Upward pressure on the ratings could develop over the medium term depending if Veolia were to achieve RCF/net debt approaching 20% on a sustainable basis. In this scenario, we would take into account management's future financial policy and use of the financial flexibility that could be developed in the medium term.

## Factors that could lead to a downgrade

Negative pressure on ratings could arise if metrics were to fall short of our guidance due to weaker-than-expected operating performance or increased investments.

## Key indicators

Exhibit 2

**Veolia's key adjusted indicators**

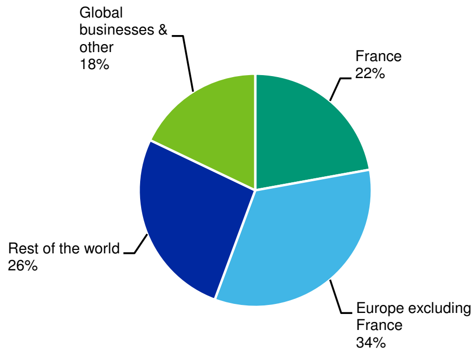
| Veolia Environnement S.A. [1][2] | LTM 30/06/2017 | 31/12/2016 | 31/12/2015 | 31/12/2014 | 31/12/2013 | 31/12/2012 |
|---|---|---|---|---|---|---|
| (FFO + Interest Expense) / Interest Expense | 5.9x | 6.0x | 5.5x | 4.6x | 4.2x | 3.9x |
| FFO / Net Debt | 20.8% | 21.9% | 20.6% | 20.2% | 19.5% | 17.3% |
| RCF / Net Debt | 16.5% | 17.7% | 16.4% | 17.7% | 18.0% | 14.3% |
| FCF / Net Debt | 0.1% | 0.7% | 0.3% | -1.3% | -2.1% | -6.4% |

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
[2] The 2015, 2016 and LTM key indicators are adjusted for IFRIC 12
For definitions of Moody's most common ratio terms please see the accompanying User's Guide.
*Source: Moody's Investors Service*

## Profile

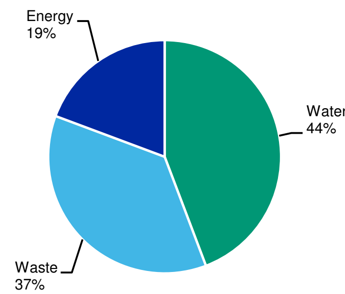
Headquartered in Aubervilliers, France, Veolia is one of the world's largest provider of environmental services, with revenues of €24.2 billion in the last 12 months to September 2017. It provides drinking water to 100 million people, wastewater treatment to 61 million people and waste management services to 40 million people. Veolia is listed on the Paris stock exchange with a market capitalisation of around €11.5 billion.

Exhibit 3
**Split of 9M17 revenue by geography**




*Source: Veolia*

Exhibit 4
**Split of 9M17 revenue by activity**




*Source: Veolia*

## Detailed credit considerations

### Scale and diversification support cash flow stability

Veolia's credit profile is underpinned by its scale and diversity which have contributed to leading market positions in many different geographies across its three businesses of water, environmental and energy services. The diversity of its revenue base by business, contract type and geography (see exhibits 3 and 4 above) helps mitigate the negative effect on earnings from deterioration in any one activity or region and supports the relative stability of its cash flows.

### Increasing share of industrial clients in revenue mix

Veolia's revenues are derived from a portfolio of thousands of multi-year contracts, which range from long-term concessions with low-risk counterparties in the public sector to shorter-term contracts with industrial and commercial (I&C) customers. Contracts vary by market and can either be capital intensive, requiring the group to invest in infrastructure in exchange for the right to provide services on a long-term basis, or structured as operating and maintenance or management contracts requiring little investment.

Public authorities currently account for 55% of Veolia's turnover and I&C customers for the remaining 45%, a proportion which we expect will continue to grow as the group's commercial pipeline includes a greater share of projects in the I&C sector. Veolia has identified six growth areas where it sees increasing demand from industrial clients to meet growing efficiency, environmental or regulatory requirements. This shift in client mix may over time raise Veolia's business risk profile as it entails greater reliance on shorter term, asset light contracts.

### Supportive long-term industry dynamics, albeit in an increasingly competitive environment

Veolia operates within sectors that benefit from positive long-term underlying dynamics globally, although they are not immune from short-term economic pressures. These include population growth, the trend to urbanisation and industrialisation, and an expectation of rising living standards in emerging economies.

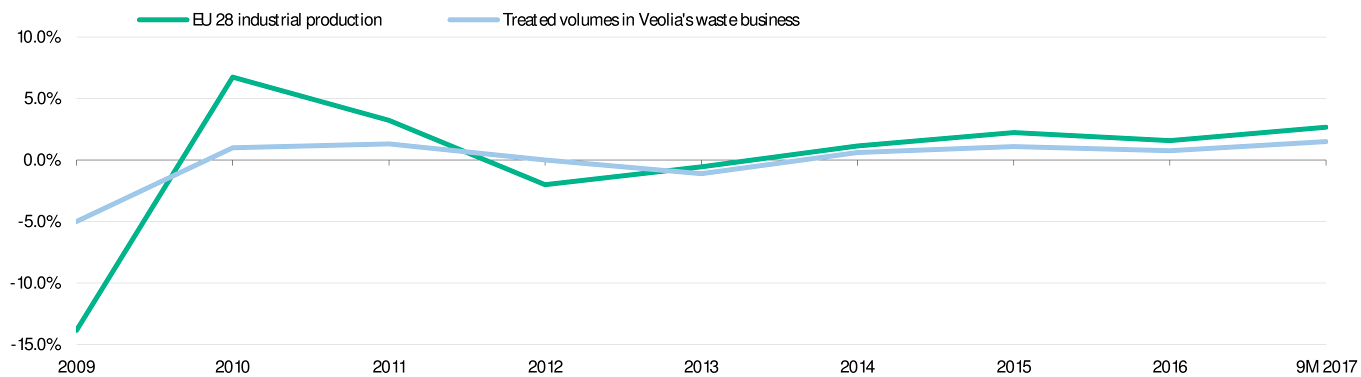
Together with public concern over the impact of climate change on scarce resources and increasingly stricter environmental regulation, these positive underlying factors are combining (1) to increase demand for existing technologies for the provision of water, wastewater and waste management services; and (2) to extend demand into new services and technologies that, for example, facilitate water preservation, or the ongoing shift towards waste recovery. Against this backdrop, competition - notably from Asian players - is fierce, especially in the lower part of the value chain.

### Low-risk water activities but exposure of waste business to cyclical macro-economic conditions

Veolia benefits from the low risk profile of its water business, which provides essential water and wastewater services to individuals and businesses, often on behalf of local municipalities under long-term concession agreements. Although demand for water continues to experience a slow ongoing structural decline in advanced economies, especially in Europe because of a more "resource-aware" population, variations in water consumption are mainly driven by weather. Typical renewal rates of around 90% in the municipal sector provide revenue visibility and stability.

The waste business is more exposed to cyclical macroeconomic conditions, reflecting (1) the higher proportion of I&C customers, (2) contract terms often linked to volumes collected or processed, which are in turn linked to industrial production (see exhibit 5 below), and (3) the modest and residual exposure to paper and scrap metal prices of the recycling business. With barriers to entry low in the collecting and elimination of non-hazardous waste, Veolia continues to invest in higher value-added activities, which can include sorting, hazardous materials and recovery, which will in turn raise the group's exposure to materials and energy price fluctuations.

Exhibit 5
**Veolia's waste business is exposed to the macroeconomic cycle**
**(growth rate in %)**




Note: in 2010, waste volumes are from industrial clients only.
*Source: Veolia, Moody's Investors Service*

In Veolia's energy business, around two thirds of revenues come from the management of district heating and cooling networks, which is supported by long-term contracts that include indexation and pass-through clauses covering variations in energy prices, although these can be subject to some regulatory risk. These features ensure relatively predictable cash flows, although this activity remains exposed to weather conditions, which drive seasonal demand for heating and cooling. In addition to networks, the group acts as a subcontractor for public and private customers to manage or maintain various energy installations, including decentralised electricity generation, such as biomass and CHP, which in turn can expose it to energy prices.

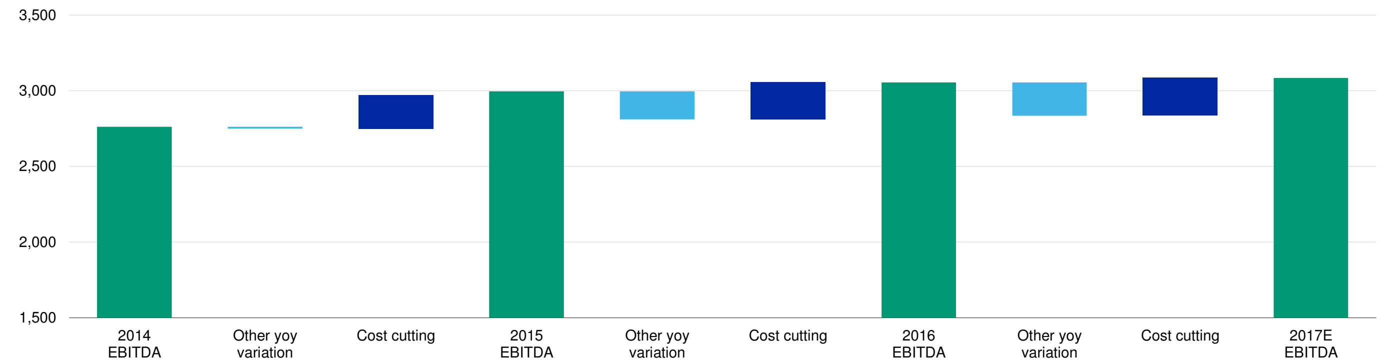
### Growing presence outside Europe mitigated by a balanced approach to capital deployment

Veolia's strategy to shift progressively from mature economies to growth markets outside Europe implies incremental risks; thus, we expect that the group will remain cautious in its approach to capital deployment so as to limit the scale of the investment it takes on in any individual country.

### Cost reduction programme supports financial leverage

Given our expectation of broadly stable net debt given neutral free cash flows for Veolia, the group's ability to maintain leverage (expressed as FFO/net debt) constant stems from the evolution of its operating cash flows. The group's profitability is mostly predicated upon the continued successful execution of its cost-saving programme, which has in prior years more than offset the pressures stemming from weak price indexation and subdued industrial production in Europe (see exhibit 6 below). The execution of this programme was the main driver behind the 1.7% EBITDA growth (at constant FX) reported in the first nine months of 2017.

Exhibit 6
**EBITDA growth has been so far primarily driven by cost savings**
**(in € million)**




Note: EBITDA excluding IFRIC 12 impact.
*Source: Veolia, Moody's Investors Service*

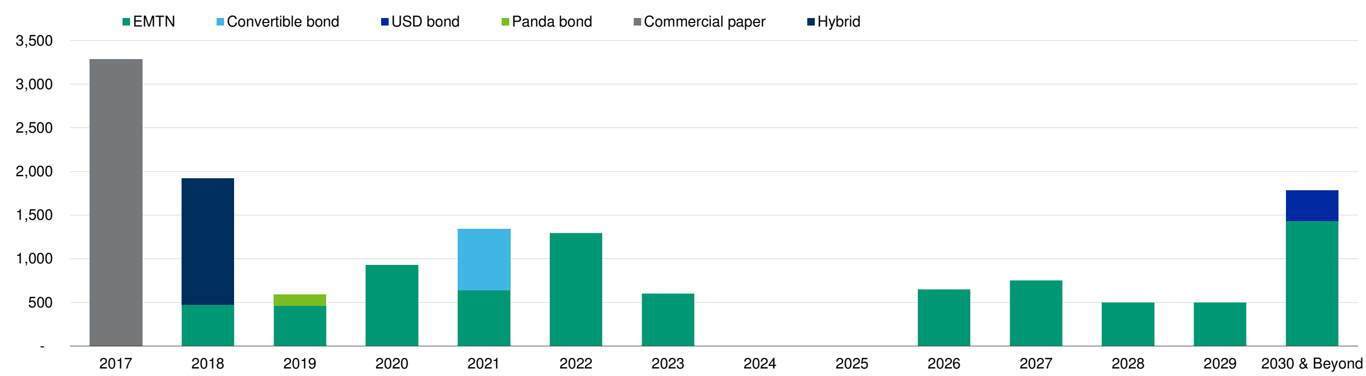
For 2018, Veolia targets another €300 million of cumulative gross cost savings vs. an aggregate of close to €500 million achieved in 2016 and 2017. This, combined with an expected acceleration of revenue growth in 2018 and 2019 driven by new contracts and a stronger outlook for industrial production, should in turn underpin the group's credit metrics in the medium term.

## Liquidity analysis

Veolia's liquidity profile is sound. We expect that the group will be broadly free cash flow neutral after dividend payment over the next 12 months. The group's funding needs as of June 2017 thus mostly comprise €4.7 billion of short term debt maturities and bank overdrafts. These funding needs are covered by (1) €4.9 billion of cash and cash equivalents (excluding restricted cash) on balance sheet and (2) undrawn credit lines of €3.9 billion in aggregate as of June 2017.

These credit lines mainly consist of (1) a syndicated facility of €3 billion maturing in 2021; and (2) undrawn bilateral facilities of €925 million maturing between 2018 and 2020. These facilities contain no triggers, covenants, material adverse changes or general restrictions. The group's average debt maturity was 9.0 years (excluding hybrids) as of June 2017.

Exhibit 7
**Veolia's debt maturity profile as of November 2017**
**(in € million)**




Note: hybrids' maturity dates are shown as of the next call date.
*Source: Veolia, Moody's Investors Service*

## Rating methodology

There is no single rating methodology for Veolia given the group's mix of businesses. We assess the water business in accordance with the rating methodology for Regulated Water Utilities published in December 2015, while we assess the waste activities in accordance with the rating methodology for Environmental Services and Waste Management Companies published in June 2014.

## Ratings

Exhibit 8

| Category | Moody's Rating |
|---|---|
| **VEOLIA ENVIRONNEMENT S.A.** | |
| Outlook | Stable |
| Issuer Rating | Baa1 |
| Senior Unsecured | Baa1 |
| Jr Subordinate | Baa3 |
| Commercial Paper | P-2 |

*Source: Moody's Investors Service*

## Appendix

Exhibit 9

### Veolia's Selected Historic Moody's Adjusted Financial Data

| EUR million | FY 2012 | FY 2013 | FY 2014 | FY 2015 | FY 2016 |
|---|---|---|---|---|---|
| **Income Statement** | | | | | |
| Revenue | 23,420 | 23,022 | 24,011 | 25,138 | 24,591 |
| EBITDA | 3,330 | 3,136 | 3,749 | 3,572 | 3,608 |
| EBIT | 1,301 | 1,060 | 1,718 | 1,408 | 1,413 |
| Interest Expense | 847 | 733 | 662 | 609 | 578 |
| **Balance Sheet** | | | | | |
| Cash & Cash Equivalents | 4,998 | 4,125 | 2,963 | 3,922 | 5,314 |
| Gross Debt | 15,382 | 12,705 | 14,307 | 16,461 | 17,645 |
| Total Liabilities | 34,129 | 30,560 | 28,933 | 31,585 | 32,938 |
| **Cash Flow** | | | | | |
| FFO | 2,494 | 2,328 | 2,376 | 2,713 | 2,870 |
| Dividends | 434 | 175 | 294 | 548 | 556 |
| RCF | 2,060 | 2,153 | 2,083 | 2,165 | 2,314 |
| CFO | 2,293 | 2,201 | 2,412 | 2,828 | 2,918 |
| Capex | (2,785) | (2,273) | (2,268) | (2,236) | (2,270) |
| FCF | (927) | (248) | (150) | 45 | 92 |
| **Profitability** | | | | | |
| % Change in Sales (YoY) | -19.3% | -1.7% | 4.3% | 4.7% | -2.2% |
| EBITDA Margin % | 14.2% | 13.6% | 15.6% | 14.2% | 14.7% |
| EBIT Margin % | 5.6% | 4.6% | 7.2% | 5.6% | 5.7% |
| **Interest Coverage** | | | | | |
| EBIT / Interest Expense | 1.5x | 1.4x | 2.6x | 2.3x | 2.4x |
| (FFO + Interest Expense) / Interest Expense | 3.9x | 4.2x | 4.6x | 5.5x | 6.0x |
| **Leverage and Cash Flow** | | | | | |
| Debt / EBITDA | 5.8x | 5.1x | 3.9x | 4.8x | 5.1x |
| Net Debt/EBITDA | 4.3x | 3.8x | 3.1x | 3.7x | 3.6x |
| FFO / Net Debt | 17.3% | 19.5% | 20.2% | 20.6% | 21.9% |
| RCF / Net Debt | 14.3% | 18.0% | 17.7% | 16.4% | 17.7% |
| FCF / Net Debt | -6.4% | -2.1% | -1.3% | 0.3% | 0.7% |

All figures are calculated using Moody's estimates and standard adjustments.
*Source: Moody's Investors Service*

Exhibit 10

### Peer Comparison Table

| | Veolia Environnement S.A. Baa1 Stable | | | SUEZ A3 Stable | | | Hera S.p.A. Baa1 Negative | | | ACEA S.p.A. Baa2 Stable | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| (in EUR million) | FYE Dec-15 | FYE Dec-16 | LTM Jun-17 | FYE Dec-14 | FYE Dec-15 | FYE Dec-16 | FYE Dec-15 | FYE Dec-16 | LTM Jun-17 | FYE Dec-15 | FYE Dec-16 | LTM Jun-17 |
| Revenue | 25,138 | 24,591 | 25,090 | 14,324 | 15,135 | 15,322 | 4,487 | 4,460 | 4,711 | 2,801 | 2,709 | 2,685 |
| EBITDA | 3,572 | 3,608 | 3,540 | 2,683 | 2,788 | 2,794 | 783 | 815 | 843 | 636 | 813 | 778 |
| Total Debt | 17,112 | 18,404 | 18,621 | 12,030 | 12,731 | 13,890 | 3,622 | 3,303 | 3,351 | 3,299 | 3,364 | 3,541 |
| Cash & Cash Equiv. | 3,922 | 5,314 | 4,889 | 2,281 | 2,107 | 2,968 | 548 | 352 | 324 | 815 | 666 | 554 |
| EBIT Margin | 5.6% | 5.7% | 5.4% | 6.8% | 6.9% | 6.7% | 9.7% | 10.3% | 10.0% | 14.2% | 19.8% | 17.7% |
| EBIT / Int. Exp. | 2.3x | 2.4x | 2.3x | 2.2x | 2.3x | 2.2x | 3.4x | 4.0x | 4.4x | 3.8x | 5.7x | 5.3x |
| Debt / EBITDA | 4.8x | 5.1x | 5.3x | 4.5x | 4.6x | 5.0x | 4.6x | 4.1x | 4.0x | 5.2x | 4.1x | 4.6x |
| FFO / Net Debt | 20.6% | 21.9% | 20.8% | 24.9% | 21.4% | 20.6% | 18.1% | 19.9% | 20.4% | 19.8% | 23.6% | 21.3% |
| RCF / Net Debt | 16.4% | 17.7% | 16.5% | 19.1% | 16.2% | 15.2% | 13.4% | 15.0% | 15.6% | 15.7% | 19.5% | 16.8% |

All figures are calculated using Moody's estimates and standard adjustments.
*Source: Moody's Investors Service*

Exhibit 11

### Veolia's Adjusted Debt Breakdown

| (in EUR Millions) | FYE Dec-12 | FYE Dec-13 | FYE Dec-14 | FYE Dec-15 | FYE Dec-16 |
|---|---|---|---|---|---|
| **As Reported Debt** | **15,990.1** | **12,901.1** | **11,544.0** | **12,341.0** | **13,350.5** |
| Pensions | 653.2 | 603.4 | 679.8 | 701.4 | 796.5 |
| Operating Leases | 2,298.9 | 1,445.1 | 1,435.8 | 1,338.6 | 1,471.8 |
| Hybrid Securities | 0.0 | 739.9 | 756.8 | 772.5 | 733.6 |
| Securitizations | 179.7 | 185.0 | 221.0 | 332.5 | 512.1 |
| Non-Standard Adjustments | 298.4 | 187.0 | 106.6 | 1,625.9 | 1,539.3 |
| **Moody's-Adjusted Debt** | **19,420.3** | **16,061.5** | **14,744.0** | **17,111.9** | **18,403.8** |

All figures are calculated using Moody's estimates and standard adjustments.
*Source: Moody's Investors Service*

Exhibit 12

### Veolia's Adjusted EBITDA Breakdown

| (in EUR Millions) | FYE Dec-12 | FYE Dec-13 | FYE Dec-14 | FYE Dec-15 | FYE Dec-16 |
|---|---|---|---|---|---|
| **As Reported EBITDA** | **2,226.8** | **2,248.2** | **2,936.7** | **2,699.3** | **2,667.1** |
| Pensions | 23.6 | 20.3 | 15.0 | 9.2 | 26.8 |
| Operating Leases | 513.1 | 481.7 | 478.6 | 446.2 | 471.4 |
| Discounting | -50.3 | -41.7 | -45.3 | -39.0 | -41.7 |
| Securitizations | 5.9 | 7.1 | 6.8 | 9.9 | 15.1 |
| Non-Standard Adjustments | 610.5 | 420.2 | 356.8 | 446.9 | 469.7 |
| **Moody's-Adjusted EBITDA** | **3,329.6** | **3,135.8** | **3,748.6** | **3,572.5** | **3,608.4** |

All figures are calculated using Moody's estimates and standard adjustments.
*Source: Moody's Investors Service*

## Moody's related research

### Sector in-depth:

» French non-financial corporates: Stable credit quality, solid markets point to clear skies for debt issuance, 19 October 2017

### Rating actions:

» Moody's assigns Baa1 rating to Veolia's convertible bonds, 10 March 2016

### Issuer comment:

» Veolia Announces Credit-Positive Sale of Transdev Stake, 4 August 2016

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