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Summary:

Veolia Environnement S.A.

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Summary:

Veolia Environnement S.A.

Credit Rating: BBB+/Stable/A-2

Rationale

The ratings on France-based environmental services group Veolia Environnement S.A. (VE) are underpinned by its leading positions worldwide in water utility and waste management activities, and its strong European presence in energy services. VE benefits from diversified and recurring revenues under long-term municipal concessions and shorter term industrial outsourcing contracts.

These strengths are tempered by the scale of the group's €15 billion-€20 billion investment program between 2007 and 2009, increased appetite for external growth, and moderate financial policy despite the €2.6 billon capital increase completed in 2007. In addition, as a result of VE's focus on operating service contracts rather than on owning assets, the group is exposed to some price competition and risk when maturing contracts come up for renewal.

The group is broadly diversified by contract and by business. It has leading positions in water (44% of 2007 consolidated EBITDA before central costs of €27 million), waste (34%), energy services (15%), and transport (7%). It is also highly diversified geographically, with 56% of sales generated outside France in 2007, notably in the rest of Europe as well as the U.S. and the Asia-Pacific region.

VE continued to perform strongly in 2007, with 14% sales growth and a 9.8% advance in EBITDA. For 2008, the group is targeting at least 10% sales growth and a double-digit increase in EBITDA. VE's profitability should continue to benefit from sales growth, the maturing of contracts signed in recent years, the full impact of recently completed acquisitions, ongoing productivity improvements, and some strengthening in earnings in the transport business.

VE's financial profile is moderate given the group's substantial investments, which totaled a hefty €6.1 billion in 2007. With reported debt to EBITDA plus repayment of financial receivables at 3.3x at year-end 2007, the group was short of the lower end of its internal target range of 3.5x-4x. Still, VE's financial profile is moderate, with funds from operations (FFO) coverage of adjusted net debt of about 19%. In light of the capital intensity of the group's growth--VE plans €4 billion in capital expenditures on maintenance and organic growth in 2008--as well as possible further acquisitions and a high dividend payout, VE's financial profile is unlikely to improve in coming years despite projected increases in earnings and cash flow.

Short-term credit factors

The 'A-2' short-term rating is supported by the strong visibility provided by VE's contractual revenues, and by the group's satisfactory liquidity. VE had about €2.5 billion of immediately available cash at the end of 2007, as well as a seven-year, undrawn €4 billion back-up line put in place in 2005, and about €1 billion of undrawn committed bilateral lines, none of which contain financial covenants. These more than covered the group's €4.2 billion of short-term debt at the end of 2007, of which €1.2 billion is bonds maturing in 2008.

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VE has spread out its debt maturities, and these are manageable beyond 2008.

Outlook

The stable outlook is underpinned by the good visibility provided by VE's contractual revenues. It also reflects that based on expected continued growth in earnings and cash flows and the €2.6 billion capital increase, VE has some flexibility within the 'BBB+' rating for its substantial investment program. To sustain the ratings, VE must maintain FFO coverage of adjusted net debt at 15%-20%, but not remain for too long at the lower end of this range. The ratings will come under pressure if VE's financial profile stays at or falls below the lower end of the range.

Although VE's business profile could sustain a higher rating, the group's growth strategy and sizable investments limit any ratings upside.

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