CORPORATE RATINGS

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Veolia Affirmed At 'BBB+/A-2' On €2.6 Bil. Capital Increase; Outlook Stable

Rationale

On June 12, 2007, Standard & Poor's Ratings Services affirmed its 'BBB+/A-2' long- and short-term corporate credit and all debt ratings on France-based environmental services group Veolia Environnement S.A. (VE). The outlook is stable.

The affirmation follows VE's announcement of a fully underwritten €2.6 billion capital increase to refinance recent acquisitions. VE recently decided to acquire Italian waste-to-energy operator TMT, and Thermal North America Inc. (TNAI), a leading U.S. heating and cooling system operator, for enterprise values of €338 million (of which 25% will only be paid in 2011/2012), and $788 million, respectively. These purchases closely follow that in April 2007 of Sulo, Germany's second-largest waste management company, for an enterprise value of €1.45 billion.

We are affirming the ratings despite this substantial capital increase, as VE is likely to continue its targeted midsize acquisitions. The affirmation also factors in that, following these acquisitions and prior to this capital increase, VE's financial profile was at the low end of our expectations for the ratings.

TMT operates seven waste-to-energy facilities and has 2006 proforma sales of €97 million. With sales of about $425 million in 2007, TNAI has the largest heating and cooling network portfolio in the U.S. and is present in various regional markets. Both companies are profitable.

The ratings on VE are underpinned by its leading positions worldwide in water utility and waste management activities, and its strong European presence in energy services.

These strengths are tempered by an increased focus on debt-funded external growth, which this capital increase will enable VE to pursue. In addition, VE remains exposed to a degree of price competition at renewal time and renewal risk at contract maturity, as a result of its focus on operating service contracts rather than on owning assets.

The group is very diversified, with leading positions in water (54% of recurring EBIT in 2006); waste (30%); energy services (18%); and transport (2%). It is also highly diversified geographically and by contract. VE should continue to perform strongly in 2007, with both sales and EBIT likely to grow by at least 10%.

VE's financial profile is moderate given the group's focus on growth, which entails significant capital expenditures of about €4 billion per year, complemented by add-on acquisitions such as those it has just announced. The group also has a policy of steadily growing dividends, which for 2006 will be up by 23.5% and by at least another 10% in 2007. Funds from operations (FFO) coverage of adjusted net debt stood at 19.3% in 2006.

Short-term credit factors

The 'A-2' short-term rating is underpinned by the strong visibility provided by VE's contractual revenues, and by the group's satisfactory liquidity. VE had about €2 billion of immediately available cash at the end of December 2006, as well as a seven-year €4 billion back-up line put in place in 2005, and €1,075 million of undrawn committed bilateral lines, of which €150 million matures within one year. These more than covered the group's €3.35 billion of short-term debt at year-end 2006, of which €733 million was CP outstanding. VE also has limited debt maturities between 2009 and 2011.

Outlook

The stable outlook factors in that, following this capital increase, VE has the flexibility within the 'BBB+' rating to pursue further midsize acquisitions. The outlook also reflects that, despite the recent external growth in other sectors, water will remain the group's primary earnings contributor. To sustain the ratings, VE must maintain FFO coverage of adjusted net debt at 15%-20%, but it cannot remain for too long at the lower end of that range.

Ratings List

Corporate credit rating	BBB+/Stable/A-2
Senior unsecured debt	BBB
CP	A-2

NB: This list does not include all ratings affected.

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