

Veolia **E**nvironnement

Management's discussion of operations

2005 consolidated financial statements

temporary non audited

1. RESULTS OF OPERATIONS IN 2005

1.1 Overview

Since its initial public listing, Veolia Environnement has progressively established its independence and been fully reorganized. In 2004, the final year in this process, Veolia Environnement sold its non-strategic US assets and its stake in the Spanish company FCC.

A strong business model

The Company has demonstrated that its environmental services business model, when combined with long-term contracts, can generate steady growth in profitability. Revenue rose by more than 12% and recurring operating income by more than 17% in 2005. Recurring net income attributable to equity holders of the parent rose by more than 30% and return on capital employed (ROCE) by more than 9%, yielding an increase in profitability together with a favorable risk profile.

These performances are the result of attempts to optimize the use of resources in the Company's businesses, to rebalance activities toward Europe, North America and certain Asian countries, and to develop business with large industrial companies.

Increase in synergies between businesses

The Veolia Environnement 2005 efficiency plan, which aimed to achieve €300 million in annual savings in 2006, reached its objective in 2005. In 2005, annual savings totaled €284 million at the level of operating income and €20 million with respect to the other components of net income. The plan was a success in part because the resources of the Company's various businesses were pooled.

A new milestone was also achieved in November 2005 with the roll-out of a new branding program, which will bring the company's water, waste management, energy services and transportation divisions together under a single name: Veolia. This new brand roll-out will support the Group's common sales and marketing efforts and will help to better integrate service offerings, which is expected to further enhance the Group's existing multi-services offering.

Forward-looking choices

In 2005, the Company pursued and consolidated its research and development efforts. Scientific and technical expertise from all businesses were pooled, and new, cross-disciplinary research programs were launched (sludge processing, legionella, etc.).

In France, several new training programs were instituted for all employee categories, following the signing of a Company-wide agreement on skills development. Additional resources were obtained through the pooling of funds earmarked for this purpose. Moreover, in September 2005, the Company launched the *Veolia Compétences* program, which led to 2,650 new employees being hired under work-study degree programs. This program will be renewed and expanded in 2006.

1.2 Refocused on its core businesses, the Company continued to grow

The most important event affecting 2005 revenue was the finalization of the acquisition of the Braunschweig contract, relating to water, heating, gas and electricity distribution. This contract represents an investment of €374 million in order to acquire a 74.9% stake and generated revenue of €349.6 million in 2005. At the end of 2005, Veolia Environnement also won a related wastewater treatment contract, which will generate additional revenue in 2006.

The Company also won other contracts during 2005 that will begin to affect revenue and income as they are implemented :

- In March 2005, Veolia Environmental Services was awarded the only electricity production project relying on biogas collection and recovery from household and non-hazardous industrial waste in the "Biomass Biogas" competitive bid organized by the French Ministry for Industry and the *Commission de Régulation de l'Electricité* (CRE) to promote renewable energies. The contract was signed for a period of 16 years, with operations expected to begin at the end of 2006 (estimated total cumulative revenue of more than €160 million).

- On March 29, 2005, PSA Peugeot Citroën entrusted Veolia Environnement with environmental services management at its new Trnava facility in Slovakia. This contract was signed for a period of 8 years, with operations expected to begin in early 2006 (estimated total cumulative revenue of nearly €65 million). In December 2005, the scope of services to be managed by Veolia Environnement was extended, when PSA awarded it the management of rail traffic on the private branch line to the Trnava automobile plant. This service will begin in July 2006.
- In March 2005, the York Regional Transit Authority chose Veolia Transport to operate the express right-of-way bus network in this suburb of Toronto (Ontario, Canada) for a period of five years. (estimated cumulative revenue of approximately €54 million).
- In June 2005, Veolia Water won the operating contract for water services granted by the Hradec Kralove water company, the public water authority of Eastern Bohemia (Czech Republic). This contract encompasses production and distribution of drinking water, customer relationships, as well as wastewater collection and treatment. This 30-year contract represents estimated total cumulative revenue of approximately €560 million.
- Veolia Water purchased various contracts from ENEL during 2005 for €36 million. They generated revenue from ordinary activities of €33.8 million in 2005.
- In July 2005, Veolia Environmental Services was included in the final phase of competitive bids for a 26-year integrated management contract covering household waste for Nottinghamshire (UK). Cumulative revenue is expected to total approximately €1.2 billion under the contract.
- In May 2005, Veolia Environmental Services and the Chinese environmental services company Shenzhen Dongjiang Environmental formed a joint venture and won a contract for the design, construction and 30-year operation of a future hazardous waste treatment center for the province of Guandong. Revenue from the contract is expected to total €197 million.
- In July 2005, Veolia Environmental Services won a 30-year concession from the municipality of Foshan (China) involving the financing, construction and operation of a new household waste landfill (estimated total cumulative revenue of approximately €270 million) .
- In August 2005, Veolia Energy Services agreed to purchase the company that manages the district heating network of the city of Lodz (Poland) and that produces heat and electricity by cogeneration. ZEC Lodz has annual revenue estimated at €167 million.
- In June and September 2005, Veolia Water won three water service contracts in China for estimated total cumulative revenues of approximately €990 million, with contract terms ranging from 23 to 30 years (Urumqi, Handan and Changzhou).
- In July 2005, Arjo Wiggins, the creative and technical paper manufacturer, awarded Veolia Energy Services a 12-year contract to build and operate a new steam production facility on its site at Wizernes in northern France (estimated total cumulative revenue of approximately €135 million). The new facility is expected to begin operations on November 1, 2006.
- In November 2005, Veolia Water won the water management contract for the city of Kunming (southwest China). Awarded through an international call for tenders, this 30-year contract represents estimated total cumulative revenue of more than €1.1 billion. Operations are expected to begin in 2006.
- On December 14, 2005, Veolia Water signed a water management contract with the city of Yerevan, the capital of Armenia. Awarded through an international call for tenders, this 10-year contract represents estimated total cumulative revenue of approximately €160 million.

During 2005, Veolia Environnement also strengthened its position in certain regions of the world through acquisitions:

- In January 2005, Veolia Transportation acquired half of Dortmunder Eisenbahn (DE) in Germany for €3.4 million, obtaining control of the company's operations. This acquisition gives Veolia Transportation the opportunity to become the largest private freight operator in Germany, in particular in the steel sector.
- In September 2005, Veolia Transportation acquired the North American transportation company ATC for €77.7 million, generating revenue of €74.8 million over the last four months of 2005.
- In October 2005, Veolia Environmental Services took control of the hazardous waste business of Shanks, a UK company, for €43 million. The acquired activities include waste collection, preparation, transfer, processing and energy recovery from liquid and solid hazardous wastes.
- Finally, Veolia Environnement's Energy Services division has played an early role in the greenhouse gas emissions market in Europe, in particular France, the Czech Republic, Lithuania and Estonia. Veolia Environnement has an emission rights surplus and does not expect to be in a negative position in the medium-term.

1.3 The thorough review of assets continued in 2005

In 2005, the principal divestitures were as follows:

- Veolia Water sold its minority shareholding in Acque Potabili in Italy for €20.9 million and the balance of its stake in Bonna Sabla for €35.8 million.
- Veolia Energy Services sold its nuclear maintenance business in the first quarter of 2005 for €17 million.
- In the first half of 2005, Veolia Transport finalized the sale of CBM, a company that sells spare parts for buses, for €31.5 million.
- In 2005, the Company also sold other industrial assets and stakes for a total of €242.9 million.

1.4 Moody's upgrades its rating

Following its annual review, the Moody's rating agency upgraded Veolia Environnement's long-term debt rating from Baa1 to A3 in June 2005.

1.5 Developments in the EDF-Veolia Environnement partnership regarding Dalkia

Under the terms of the agreement signed in December 2000, EDF held a call option enabling it to increase its investment in Dalkia to 50%, provided that a number of conditions were met.

The conditions of this option were clarified in an amendment to the agreement signed by EDF and Veolia Environnement on April 19, 2005. This amendment stated in particular that EDF had until July 31, 2005 to exercise this option and that the option would only be considered definitively exercised at the date of conclusion by the parties of a formal agreement covering notably the reorganization of their relationship under the industrial and commercial agreement and their rights and obligations under the shareholders' agreement, including governance rules. This formal agreement had to be concluded by September 30, 2005 at the latest.

In this context, EDF exercised its call option on July 28, 2005 as a conservative measure. However, in the absence of a formal agreement covering amendments to the industrial and commercial agreement and the shareholders' agreement, the option became null and void as of October 1, 2005. Supposing that no other EDF competitor takes control of the company, EDF no longer holds any call options in respect of Dalkia and its subsidiaries.

The original partnership agreement remains unchanged, and EDF and Veolia Environnement have confirmed their intention to exploit together any new opportunities in the European energy context.

2. ACCOUNTING AND FINANCIAL INFORMATION

2.1 Definitions and accounting context

The term "organic growth" includes growth resulting from:

- the expansion of an existing contract, resulting from an increase in prices and/or volumes distributed or processed;
- new contracts;
- the acquisition of assets attributed to a particular contract or project.

The term "external growth" includes growth through acquisitions, net of divestitures, of entities and/or assets deployed in different markets and/or containing a portfolio of more than one contract.

Net financial debt represents gross financial debt (long-term borrowings, short-term borrowings, bank overdrafts), net of cash and cash equivalents and excluding revaluation of hedging instruments.

Finance costs, net represent the cost of gross financial fair value debt, including profit and loss on related interest rate and exchange rate hedging, less income on cash and cash equivalents.

The net income (expenses) on discontinued operations is the total of income and expenses, net of tax, related to businesses sold or in the process of being sold, in accordance with IFRS 5. It is the income or expense generated over the period by the assets and liabilities included in the specific, balance-sheet line items “Assets of discontinued operations” and “Liabilities of discontinued operations”.

Recurring net income attributable to equity holders of the parent is defined as follows: recurring part of operating income + recurring part of financial items + recurring share of net income of associates + recurring portion of net income attributable to minority interests + normative income tax expense. An accounting item is non-recurring if it is unlikely to recur during each period and if it substantially changes the economics of one or more cash-generating units.

Accounting context

Because of the nature of its activities, the Company has commitments under many concession contracts in all divisions and in most of the countries in which it is present.

In 2004, when it prepared its first IFRS-compliant financial statements, the Company had for the most part maintained its historical accounting treatment of concession contracts, while restating, to a limited extent, certain presentations that did not comply with existing IFRS. As explained in update no. 1 to the 2004 Reference Document, dated May 25, 2005, this decision was made in the expectation that the International Financial Reporting Interpretation Committee (IFRIC) would soon publish a draft interpretation to harmonize the application of IFRS to concession accounting.

In March 2005, IFRIC published Draft Interpretations D12, D13 and D14, the contents of which are summarized in note 1.20 to the financial statements. Nevertheless, as of March 2006, IFRIC’s work was still ongoing, and definitive versions of the interpretations are not expected to be published before the third quarter of 2006.

For 2005, given the very high number of contracts affected by these draft interpretations, the Company has decided to isolate the assets related to concession contracts on a distinct line entitled, “Publicly-owned utility networks”. Concession assets are amortized on the basis of their useful life, in accordance with IAS 38, “Intangible assets”, except for the assets of privatized companies, which are treated according to IAS 16 “Property, Plant and Equipment”. Maintenance and repair expenses deriving from contractual obligations on concession assets accounted for under IAS 38 are analyzed in accordance with IAS 37 “Provisions”. If necessary, provisions are recognized in respect of those obligations. This presentation complies with existing standards and has not had a significant impact on the equity or the net income of Veolia Environnement compared with the information presented in update no. 3 to the 2004 Reference Document, dated October 24, 2005.

For 2006, Veolia Environnement has decided to implement the draft interpretations published by IFRIC, even though their adoption is still uncertain. Veolia Environnement believes that these draft interpretations constitute an advancement in the application of IFRS and a sufficient basis for changing the accounting presentation of the related assets. As a result, the Company has undertaken a detailed review of its very large portfolio of contracts, a project that will extend over several months. Subject to further changes, the Company intends to adopt the draft interpretations for the first time in 2006.

2.2 Revenue

2.2.1 General comments

2005 (in € M)	2004 (in € M)	% change 2005/2004	of which organic growth	of which external growth	of which currency fluctuation
25,244.9	22,500.3	+12.2%	+9.2%	+2.2%	+0.8%

The Company’s consolidated revenue rose by 12.2% to €25,244.9 million, versus €22,500.3 million in 2004. Positive currency effects of €180.9 million resulted from appreciation in the currencies of certain Eastern European countries (€89.2 million), the US dollar (€13.9 million) and certain Asian currencies. Organic growth was 9.2%. Revenue from outside France amounted to €12,991.2 million, or 51.5% of the total.

2.2.2 Revenue by division

(in € millions, except for %)	2005	2004	% change 2005/2004
Water	8,888.7	7,777.4	+14.3%
Waste Management	6,604.1	6,214.4	+6.3%
Energy Services	5,402.4	4,919.8	+9.8%
Transportation	4,349.7	3,588.7	+21.2%
Revenue	25,244.9	22,500.3	+12.2%
Revenue at 2004 exchange rates	25,064.0	22,500.3	+11.4%

WATER

2005 (in € millions)	2004 (in € millions)	% change 2005/2004	of which organic growth	of which external growth	of which currency fluctuation
8,888.7	7,777.4	+14.3%	+10.7%	+2.8%	+0.8%

- In **France**, the distribution business performed well, despite slightly lower volumes, and the construction business continued to grow. As a result, organic growth in revenue totaled 4.5%.
- **Outside France**, excluding Veolia Water Systems & Technologies, revenue was up strongly (+19.7% at constant scope and exchange rates). In Europe, strong revenue growth (+28.4% at constant exchange rates) was driven by the Braunschweig contract in Germany, other new contracts signed in the last few months, in particular in the Czech Republic, as well as a five-year contract extension in the United Kingdom. In North America, revenue advanced by more than 8.3% at constant exchange rates, owing to favorable revenue levels in general and from the commencement of operations under a contract in Indianapolis. In the Asia-Pacific region, the start-up of the Shenzhen, Qingdao, Lugouqiao, Baoji and other contracts in China and the services business in Japan resulted in revenue growth of more than 25%.
- The commencement of **operations** under several large construction and engineering contracts in France and abroad, plus the acquisition of companies in Germany and the United Kingdom, enabled Veolia Water Systems & Technologies to record growth in revenue of nearly 24% (+8.8% at constant scope and exchange rates).

The Water division recorded external growth of 2.8% during 2005, which was due to several factors. The Company made acquisitions in the engineering sector in Germany at the end of 2004 and in the United Kingdom in the third quarter of 2005, while also increasing its stake in certain Italian water companies in the second quarter of 2005.

WASTE MANAGEMENT

2005 (in € millions)	2004 (in € millions)	% change 2005/2004	of which organic growth	of which external growth	of which currency fluctuation
6,604.1	6,214.4	+6.3%	+5.4%	+0.1%	+0.8%

- In **France**, organic growth in revenue totaled 2.4%. This growth was achieved despite a relatively unfavorable economic context, which put pressure on the industrial non-hazardous waste segment.
- **Outside France**, organic growth accelerated and reached 8.2%. Large integrated contracts began to contribute greater revenues, tonnage collection increased in the United Kingdom and growth was strong in the Asia-Pacific region in particular (+18.9%). In North America, new contracts were signed, toxic waste volumes were elevated and revenue was high in industrial services, leading to revenue growth of 8.5% at constant exchange rates.

ENERGY SERVICES

2005 (in € millions)	2004 (in € millions)	% change 2005/2004	of which organic growth	of which external growth	of which currency fluctuation
5,402.4	4,919.8	+9.8%	+8.9%	-	+0.9%

- In **France**, revenue was up 7.6% organically and continued to benefit from the increase in energy prices in thermal services.
- **Outside France**, revenue increased by 14.6% (+11.0% organically). Growth was especially high in Central Europe (+37.8%), driven, in particular, by the full impact of new contracts in Poland (in particular Poznan and start-up at Lodz), Hungary and Romania. In Southern Europe (Spain, Italy) revenue grew by 14.9% (+8.3% organically).

The Group worked on strengthening its business portfolio by disposing of certain assets, resulting in no net external growth. The Company expanded in Spain, but sold the nuclear industry construction business of its specialized French subsidiaries. It also sold its German facilities management business.

TRANSPORTATION

2005 (in € millions)	2004 (in € millions)	% change 2005/2004	of which organic growth	of which external growth	of which currency fluctuation
4,349.7	3,588.7	+21.2%	+12.5%	+7.9%	+0.8%

- In **France**, passenger transportation revenues increased strongly by 17.2%, due in particular to the full impact of urban transit contracts renewed in 2004 as well as the impact of the contract in Toulouse, which was awarded for 2005.
- **Outside France**, passenger transportation revenues grew by 23.6%, due in particular to the full impact of the Melbourne contract and new operations in the United States (Denver, Metrolink contract) and Europe (Dublin tramway, Helsinki bus contract).

Separately, the freight transportation business recorded growth in revenues of 26.8%, amounting to €151.7 million in 2005.

External growth (+7.9%) was due in particular to the acquisition of ATC in the United States in September 2005.

2.2.3 Revenue by geographic region

(€ millions, except %)	2005	2004	% change 2005/2004
France	12,253.7	11,476.4	+6.8%
United Kingdom	1,541.2	1,401.7	+10.0%
Germany	1,794.7	1,332.8	+34.7%
Other European countries	4,908.1	4,310.0	+13.9%
United States	2,156.5	1,882.6	+14.5%
Oceania	878.6	644.0	+36.4%
Asia	573.1	483.9	+18.4%
Rest of the world	1,139.0	968.9	+17.6%
Revenue	25,244.9	22,500.3	+12.2%

France

The increase in revenue in France was driven primarily by an increase at the Transportation division, which recorded strong growth of 15.4% at constant scope. This increase was in turn primarily related to growth in the urban transportation business, where revenue strongly increased by 34.1% at constant scope in 2005.

United Kingdom

The increase in revenue from ordinary activities in the United Kingdom was due in particular to growth in the Water division, which benefited from the impact of a five-year contract extension, and the Waste Management division, which recorded higher revenues from integrated service contracts.

Germany

The increase in revenue from ordinary activities in Germany was mostly due to the integration of the Braunschweig contract water, which generated revenue of €349.6 million in 2005.

Other European countries

The contribution to revenues from Central and Eastern Europe rose significantly, in particular in Water in the Czech Republic and in Energy Services in Poland, where Veolia Environnement acquired the company that holds the Lodz contract. In addition, the Poznan contract contributed for the full year in 2005.

United States

Apart from favorable currency fluctuations, the increase in revenue in the United States was primarily due to an increase in revenues recorded at Veolia Environmental Services and Veolia Transportation. Revenue from the Environmental Services division increased at year-end in particular, while revenue from ordinary activities at Veolia Transportation increased due to the acquisition of ATC, which generated €74.8 million in revenue over four months in 2005.

Oceania

Apart from favorable currency fluctuations of €34.5 million, the increase in revenue was due mainly to increased contributions from the Transportation and Waste Management divisions in Australia. Veolia Transportation benefited from the full impact of the Melbourne and Auckland contracts, while Veolia Environmental Services recorded strong growth in industrial services and landfilling.

Asia

The increase in revenue in Asia was due primarily to growth in the Water division, which recorded organic growth of 9.9%. The Shenzhen contract went into production, generating €35 million in revenue in 2005, and operations commenced under several other Chinese contracts signed in 2003 and 2004. In South Korea, revenue declined by €23 million due to completion of construction of installations relating to the Incheon contract, which was only partially offset by the €10 million increase generated by the start-up of the Mansu and Songdo plants.

Rest of the world

There was a favorable currency effect in South America of €18.1 million. This principally affected Proactiva, which manages Water and Waste Management contracts in the region. In Israel, Veolia Energy Services acquired Kalorit Israel, which generated €14.7 million in revenue from ordinary activities in 2005.

2.3 Other income (expenses) statement items

2.3.1 Operating income

Growth in operating income and in recurring operating income broke down as follows:

(€ millions, except %)	Operating income			Recurring operating income		
	2005	2004	% change	2005	2004	% change
Water	1,007.3	799.5	+26.0%	1,002.1	854.7	+17.2%
Waste Management	530.5	467.5	+13.5%	540.5	467.5	+15.6%
Energy Services	326.1	250.3	+30.3%	332.0	264.1	+25.7%
Transportation	114.1	31.4	+263.3%	114.1	101.4	+12.5%
Holding companies	-85.1	-68.1	-25.0%	-85.1	-68.1	-25.0%
Total	1,892.9	1,480.6	+27.8%	1,903.6	1,619.6	17.5%
Total at 2004 exchange rates	1,867.6	1,480.6	+26.1%	1,878.3	1,619.6	16.0%

In 2004 and 2005 the breakdown between recurring and non-recurring operating income was as follows:

2005 (€ millions)	Recurring	Non-recurring		Total
		Impairment	Other	
Water	1,002.1	5.2	-	1,007.3
Waste Management	540.5	-10.0	-	530.5
Energy Services	332.0	-4.7	-1.2	326.1
Transportation	114.1	-	-	114.1
Holding companies	-85.1	-	-	-85.1
Total	1,903.6	-9.5	-1.2	1,892.9

2004 (€ millions)	Recurring	Non-recurring		Total
		Impairment	Other	
Water	854.7	-	-55.2 ⁽²⁾	799.5
Waste Management	467.5	-	-	467.5
Energy Services	264.1	-	-13.8 ⁽³⁾	250.3
Transportation	101.4	-70.0 ⁽¹⁾	-	31.4
Holding companies	-68.1	-	-	-68.1
Total	1,619.6	-70.0	-69.0	1,480.6

(1) Impairment losses on Scandinavian goodwill in the Transportation division.

(2) Loss on divestiture of Berlikomm.

(3) Resolution of a dispute in Italy.

Operating income grew by 27.8% in 2005, and by 16% at constant exchange rates and excluding non-recurring items.

WATER

Operating income from the Water division totaled €1,007.3 million in 2005, a 26.0% increase from the €799.5 million recorded in 2004. In 2004, operating income was negatively affected by a €55.2 million loss relating to the sale of Berlikomm. At constant exchange rates and excluding non-recurring items, operating income grew by 15.8%.

In France, the program to improve operating performance continued to be implemented, and the distribution and construction businesses performed well, boosting operating income.

In the rest of Europe, the rise in operating income was largely due to the integration of the Braunschweig contract. In addition, contracts were reviewed in the United Kingdom, there were positive developments in the Czech Republic and Italy, and the BOT contracts in Brussels and The Hague delivered their first positive contributions. In Asia-Pacific, operating income improved due to the commencement of operations in China and South Korea. Finally, engineering and technology solutions took another step toward recovery after refocusing on profitable activities.

The ratio of recurring operating income to revenue from ordinary activities increased by 0.3%, from 11.0% in 2004 to 11.3% in 2005.

WASTE MANAGEMENT

Operating income from the Waste Management division increased by 13.5%, from €467.5 million in 2004 to €530.5 million in 2005. Excluding non-recurring items and at constant exchange rates, operating income rose by 14.5%.

In France, the increase in operating income was primarily the result of action plans initiated in previous years, in particular with respect to waste collection and landfills. In the rest of Europe, operating income increased primarily because integrated contracts posted strong growth and, more generally, as a result of strong performance in the waste collection business and increased tonnage amounts in UK landfills. In the United States, the profitability of toxic waste, industrial services and solid waste activities increased.

The ratio of recurring operating income to revenue increased by 0.7%, from 7.5% in 2004 to 8.2% in 2005.

ENERGY SERVICES

Operating income from the Energy Services division increased by 30.3%, from €250.3 million in 2004 to €326.1 million in 2005. In 2004, operating income was negatively affected by a €13.8 million payment to settle a dispute in Italy, while in 2005 non-recurring items totaled a negative €5.9 million. At constant exchange rates and excluding non-recurring items, operating income grew by 23.3%.

In France, the profitability of thermal services in the areas of installation and services improved. Operating income was also enhanced by proceeds from the sale of greenhouse gas emission rights. Given the overall balanced nature of the contract portfolio, the rise in energy prices during 2005 had no net effect on profitability. Rising gas prices have caused the selling prices of electricity produced through co-generation to reach their ceiling. Legislative changes at the end of 2005 limited this phenomenon, and the opportunity loss was offset by an upturn in energy management margins on other contracts. In the rest of Europe, the rise in operating income resulted directly from new contracts in Central Europe (Lodz and Poznan). This region was only marginally exposed to the rise in fuel prices in 2005, given the energy sources used. Finally, measures to improve energy efficiency were successful in the various regions where this division operates.

Given these items, the ratio of recurring operating income to revenue increased by 0.7%, from 5.4% in 2004 to 6.1% in 2005.

TRANSPORTATION

Operating income from the Transportation division increased substantially, from €31.4 million in 2004 to €114.1 million in 2005. Excluding non-recurring items (impairment losses on Scandinavian goodwill in 2004), operating income increased by 12.5% (+11.0% at constant exchange rates). This result was achieved despite the negative impact of the rise in fuel prices, which totaled €17 million outside France. Price increases outside of France could not be fully passed on to the customer.

In France, operating income increased in both the urban and inter-city transportation segments. Outside France, the Scandinavian business posted recovery in line with a profit improvement plan. In other regions, Transportation operating income benefited from new contracts and increased in accordance with business plans.

Because of the negative impact of rising energy prices, the ratio of recurring operating income to revenue from ordinary activities decreased by 0.2 points, from 2.8% in 2004 to 2.6% in 2005.

2.3.2 Finance costs, net

(€ millions)	2005	2004
Income	68.3	97.0
Expense	-781.7	-829.1
Total	-713.4	-732.1

The financing rate is 5.12%, compared to 5.04% in 2004.

This slight increase in the financing rate mainly reflects the appreciation of several currencies against the euro and in particular the US dollar, and the cost of extending the maturity of borrowings. In addition, net finance costs in 2005 include €26 million in respect of the redemption of the 2008 bonds in the amount of €1,150 million. This early redemption was performed in order to optimize the maturity and future cost of borrowings. In addition, fair value movements on derivative instruments not qualifying for hedge accounting totaled +€12.0 million, compared to +€7.6 million in 2004. These movements, where are calculated in accordance with IAS 39, are highly volatile in nature.

2.3.3 Other financial income and expenses

(€ millions)	2005	2004
Loan income	37.0	55.4
Dividends	6.5	5.9
Foreign exchange gains (losses)	14.3	-13.9
Financial provisions	24.2	-
Other income (expenses)	-51.5	-1.3
Total	30.5	46.1

Other financial income and expenses fell from €46.1 million in 2004 to €30.5 million in 2005.

In 2004, other financial income and expenses included the capital gain realized on the sale of Vinci shares of €44.4 million. Excluding this capital gain, other financial income and expenses increased €28.8 million on 2004, mainly due to foreign exchange gains.

In 2005:

- loan income and dividends fell to €43.5 million;
- foreign exchange gains totaled €14.3 million;
- the reverse discounting of site restoration provisions had an impact of -€15.7 million;
- the revaluation of embedded derivatives had an impact of -€2.5 million.

2004 was marked by:

- a capital gain of €44.4 million realized on the sale of Vinci shares by the Energy Services segment;
- foreign exchange losses of €13.9 million;
- the revaluation of embedded derivatives (-€12.9 million);
- loan income and dividends of €61.3 million;
- the reverse discounting of site restoration provisions (-€10.8 million).

2.3.4 Income tax expense

Income tax expense totaled €422.9 million in 2005, consisting of €309.4 million in current income taxes and €113.5 million in deferred income taxes, compared to a total expense of €184.1 million in 2004, consisting of €225.1 million in current income taxes and a deferred income tax benefit of €41.0 million.

The increase in income tax was primarily due to an increase in operating income. Moreover, in 2004 the prospect of future profits prompted the Company to capitalize additional tax-loss carryforwards, limiting deferred tax expense.

2.3.5 Share of net income associates

The share of net income of associates decreased from €24.2 million for the year ended December 31, 2004 to €14.9 million for the year ended December 31, 2005, following the transfer of certain investments in associates to non-consolidated investments.

The largest net income shares in 2005 were generated by Water segment associates (€10.8 million).

2.3.6 Net income (expense) from discontinued operations

In 2005, there was no income from discontinued operations. In 2004, discontinued operations generated a loss of €105.7 million. This loss broke down as follows: a €162.2 million loss from US water businesses, a €58.4 million gain from FCC and a €1.9 million loss from UK transportation activities.

2.3.7 Net income for the year attributable to minority interests

Net income attributable to minority interests for the year ended December 31, 2005 is €179.0 million, compared to €137.5 million for the year ended December 31, 2004. This heading mainly concerns minority interests in the Water segment (€86.7 million), the Waste Management segment (€25.7 million), the Energy Services segment (€57.0 million) and the Transportation segment (€9.9 million). The increase between 2004 and 2005 is mainly attributable to the Water segment following the consolidation of the Braunschweig contract (+€9.8 million) and the improvement in the results of the Berlin water companies (+€31.7 million), whose 2004 results were affected by the capital loss generated by the sale of Berlikomm.

Net income attributable to minority interests for the year ended December 31, 2004 is €137.5 million. This heading mainly concerns minority interests in the Water segment (€49.2 million), and primarily the Berlin water companies, the Energy Services segment (€53.1 million), the Waste Management segment (€21.5 million) and the Transportation segment (€13.9 million).

2.3.8 Net income attributable to equity holders

Net income attributable to equity holders was €623.0 million in 2005, compared to €391.5 million in 2004. Recurring net income was €627.4 million in 2005, compared to €470.8 million in 2004.

The weighted average number of shares outstanding was 390.4 million on December 31, 2005 and 396.2 million on December 31, 2004. On this basis, net earnings per share attributable to the equity holders was €1.60 compared to €0.99 in 2004. Recurring net earnings per share was €1.61 in 2005, compared to €1.19 in 2004.

In 2005, net income broke down as follows:

2005 (€ millions)	Recurring	Non- recurring	Total	Notes
Operating income	1,903.6	-10.7	1,892.9	2.3.1
Finance costs, net	-713.4	-	-713.4	2.3.2
Other financial income and expenses	30.5	-	30.5	2.3.3
Income tax expense	-427.2	4.3	-422.9	2.3.4
Share of net income of associates	14.9	-	14.9	2.3.5
Net income from discontinued operations	-	-	-	2.3.6
Minority interests	-181.0	2.0	-179.0	2.3.7
Net income attributable to equity holders of the parent	627.4	-4.4	623.0	

In 2004, net income broke down as follows:

2004 (€ millions)	Recurring	Non- recurring	Total	Notes
Operating income	1,619.6	-139.0	1,480.6	2.3.1
Finance costs, net	-715.6	-16.5	-732.1	2.3.2
Other financial income and expenses	1.7	44.4	46.1	2.3.3
Income tax expense	-321.6	137.5	-184.1	2.3.4
Share of net income of associates	24.2	-	24.2	2.3.5
Net income from discontinued operations	-	-105.7	-105.7	2.3.6
Minority interests	-137.5	-	-137.5	2.3.7
Net income attributable to equity holders of the parent	470.8	-79.3	391.5	

Recurring net income rose from €470.8 million in 2004 to €627.4 million in 2005, an increase of 33.3%. This rise was primarily due to the increase in operating income and control of financial interest expense.

3. FINANCING

3.1 Cash flows

Operating cash flow before change in working capital (“operating cash flow”) increased by 6.6%, from €3,460.6 million in 2004 to €3,687.3 million in 2005. Excluding the cash flow of discontinued operations in 2004 (€232.8 million), operating flows increased by 14.2%, reflecting the Group’s improved operating performance. The definition of operating cash flows recommended by the *Conseil national de la comptabilité* (French National Accounting Council) excludes the impact of financing activities and taxation.

Net cash flow from operating activities decreased from €3,517.0 million in 2004 to €3,296.3 million in 2005. Apart from the change in operating cash flow, the reduction occurred because working capital requirements increased by €52.2 million in 2005, whereas they had declined by €294.4 million in 2004. The slight increase in working capital requirements during 2005 was the result of growth in the Company’s business.

Net cash from (used in) investing activities totaled -€2,540.2 million in 2005, compared to a net cash inflow of €174.6 million in 2004. In 2004, net cash from investing activities included €2,150 million in proceeds from strategic divestitures, specifically water assets in the United States and FCC. Excluding these items, net cash of -€1,975.4 million was used in investing activities in 2004. The increase of €564.8 million in net cash used in 2005 was mainly due to the €327 million (amount net of acquired cash) investment in the company that holds the Braunschweig contract and from the €154 million investment in the company that manages the Polish city of Lodz's district heating network.

Net cash used in financing activities rose from -€1,795.5 million in 2004 to -€3,152.8 million in 2005.

In 2004, proceeds from asset divestitures were used to repay long-term borrowing.

In 2005:

- €1,535 million was paid to redeem outstanding convertible bonds (known by their French acronym as OCEANES);
- €500 million was paid to redeem outstanding euro-medium term notes in November 2005;
- borrowings to finance sales of receivables declined by €547 million.
- €1,150 million was paid to partially redeem a bond issue maturing in 2008;
- €300 million was paid to redeem subordinated notes redeemable in shares (TSARs);

and conversely:

- €2,726 million in bonds were issued.

As a result of the cash flows described above, cash and cash equivalents totaled €1,829.3 million at December 31, 2005, compared to €4,240.2 million at December 31, 2004. Cash and cash equivalents were higher at the end of 2004 because of the need to repay outstanding OCEANES that matured on January 3, 2005.

3.2 Sources of funds

As of December 31, 2005, Moody's and Standard & Poor's rated the Company as follows:

	Short-term	Long term	Outlook	Recent events
Moody's	P-2	A3	Stable	Moody's upgraded its rating on Veolia Environnement's long-term debt on June 27, 2005 from Baa1 to A3.
Standard and Poor's ⁽¹⁾	A-2	BBB+	Stable	Standard & Poor's confirmed its ratings on Veolia Environnement on December 6, 2005.

⁽¹⁾The EMTN program is rated BBB by S&P.

In 2005, Veolia Environnement pursued an active refinancing policy aimed at strengthening its financial condition and extending its debt maturities.

The principal debt items that matured in 2005 and that were either repaid or refinanced were as follows:

- The OCEANES convertible into Vivendi Universal shares, issued on April 26, 1999 and maturing on January 1, 2005, were fully repaid for €1,535.3 million, including a redemption premium of €91 million.
- The Berlin contract acquisition debt incurred by RWE/Veolia Wasser Beteiligungs AG (RVB), totaling €600 million and maturing January 15, 2005, was fully refinanced for the same value three years and will mature on January 15, 2008.
- The €500 million of euro medium-term notes issued on November 8, 2001 and bearing interest at a fixed rate of 4.75% matured on November 8, 2005 and were redeemed by the Company.
- In addition, the subordinated loan notes redeemable in preference shares (TSARs) issued on December 28, 2001 by the subsidiary VEFO and maturing on December 28, 2006 were redeemed prior to maturity on March 31, 2005 for €300 million.

All of these 2005 financing transactions, both on the capital markets and with banks, were intended to optimize the Company's debt profile with an emphasis on: 1) achieving a better match between assets and liabilities, 2) extending the average maturity of long-term debt, 3) smoothing out the debt repayment schedule, 4) diversifying financing sources and 5) taking best advantage of market conditions.

Veolia Environnement's main financing activities in 2005 were as follows:

- On June 17, 2005, Veolia Environnement issued bonds indexed to the inflation rate of the euro zone. This €600 million issuance matures in 10 years and bears interest at 1.75% plus the euro-zone's ex-tobacco inflation rate. The Company's natural exposure to inflation – many contracts are indexed to sectorial price trends and hence indirectly to inflation – makes it logical for Veolia Environnement to issue this type of instrument.
- On November 30, 2005, Veolia Environnement issued €500 million in a variable-rate private placement at 3-month Euribor +0.07%, with a maturity of 18 months.
- On December 12, 2005, Veolia Environnement carried out the following two-stage transaction:
 - It repurchased part of the outstandings under the June 2008 bond issue for €1.15 billion. This issue originally totaled €2.0 billion. Following a partial repurchase in early 2004, outstandings totaled €1.85 billion.
 - It issued €1.5 billion in bonds in two tranches:
 - a €900 million, 10-year issue maturing in February 2016, with a nominal coupon of 4%, and
 - a €600 million, 15-year issue maturing in December 2020, with a nominal coupon of 4.375%.

The principal refinancing activities in bank debt were as follows in 2005:

- Syndicated credit facility in Czech korunas (CZK): On July 29, 2005, Veolia Environnement refinanced its CZK 8 billion syndicated loan, maturing in November 2008 with a CZK 12 billion two-tranche credit facility, one maturing in seven years (CZK 4 billion) and the other maturing in five years (CZK 8 billion). There were two reasons for this refinancing: 1) cover all the needs of Czech subsidiaries at particularly favorable terms while 2) maintaining flexibility by extending maturity dates.
- On January 15, 2005, the Berlin contract acquisition debt of €600 million incurred by RWE/Veolia Berliner Wasser Beteiligungs AG (RVB) was refinanced for three years.

At the same time, Veolia Environnement sought to optimize the cost and maturity profile of its debt financing through the following transactions:

- Refinancing of the €3.5 billion syndicated loan: On April 21, 2005, Veolia Environnement entered into a new, €4 billion, seven-year syndicated loan to refinance the €3.5 billion, five-year syndicated loan entered into on February 19, 2004. Apart from extending the maturity of its commitments, this refinancing enabled the Company to achieve a significant reduction in the cost of this facility.
- Renegotiation of bilateral facilities: Veolia Environnement pursued negotiations aimed at extending the maturity of existing bilateral lines of credit, at renewing maturing lines and at implementing new, principally medium-term lines of credit. The average maturity of bilateral lines nearly doubled from two to four years. As of December 31, 2005, credit lines totaled €975 million, including €250 million short-term, fully-undrawn lines.

The syndicated credit documentation and credit lines contain no financial debt covenants.

As of December 31, 2005, net financial debt broke down as follows:

(€ millions)	December 31, 2005	December 31, 2004
Long-term borrowings	13,722.8	12,157.0
Short-term borrowings	2,138.2	5,426.1
Bank overdrafts	506.8	420.1
Sub-total, financial debt	16,367.8	18,003.2
Cash and cash equivalents	-2,336.1	-4,660.3
Less fair value on hedging instruments	-161.1	-284.0
Net financial debt	13,870.6	13,058.9
- Long-term and short-term financial loans and marketable securities	-2,775.0	-2,763.4
Economic net debt	11,095.6	10,295.5

The table below shows the Company's maturity schedule for long-term borrowings, as of December 31, 2005:

(€ millions)	Total	Payments due by period		
		1-2 years	2-5 years	> 5 years
Bank loans	5,864.9	1,798.0	1,936.8	2,130.1
Bonds	7,857.9	550.8	883.8	6,423.3
Total	13,722.8	2,348.8	2,820.6	8,553.4

3.3 Divestitures

Asset divestitures totaled €348.1 million in 2005, and €327.5 million net of the cash of companies sold.

Financial divestitures in 2005, which totaled €174.6 million excluding cash of companies sold, included the following items:

- a minority stake in Acque Potabili (Veolia Water in Italy) for €20.9 million;
- a 20% stake in a company that owns Bonna Sabla (Veolia Water in France) for €35.8 million;
- CBM (Veolia Transport in France) for €31.5 million;
- the Portuguese business of Veolia Environmental Services for €18 million;
- maintenance services for the nuclear energy industry (Veolia Energy Services) for €17 million.

Cash related to financial divestitures totaled a negative €20.6 million, due essentially to a negative €6 million related to Connex Transport Ireland.

The principal industrial divestitures in 2005, which totaled €173.5 million, included the following items:

- a block of properties in Norway belonging to Veolia Environmental Services for €19 million;
- a New Zealand business belonging to Veolia Environmental Services for €12 million;
- other industrial assets with individual values of less than €10 million and essentially representing rotation of operating assets.

3.4 Capital expenditures

(€ millions)	Industrial investments (1)		Financial investments (2)		New IFRIC 4 loans	
	2005	2004	2005	2004	2005	2004
Water	912	861	614	185	174	161
Waste management	739	710	105	53	3	-
Energy Services	252	247	203	88	85	5
Transportation	195	153	175	67	7	11
Other	30	126	1	42	-	-
TOTAL	2,128	2,097	1,098	435	269	177

(1) including those financed through capital leases

(2) excluding cash and cash equivalents of acquired companies

Industrial investments

Industrial investments, excluding investments through capital leases, totaled €2,081.9 million in 2005, compared to €1,964.0 million in 2004, representing a moderate rise of 6%. In 2004, these figures included €100 million in investments related to FCC.

Investments including those financed through capital leases totaled €2,128 million and broke down as follows:

- Water: €912 million, an increase of 5.9% from 2004, of which €328 million were for growth-related spending and €584 million were for replacement and maintenance spending.
- Waste Management: €739 million, an increase of 4.1% from 2004, of which €207 million were for growth-related spending and €532 million were for replacement and maintenance spending.
- Energy Services: €252 million, an increase of 2.0% from 2004, of which €81 million were for growth-related spending and €171 million were for replacement and maintenance spending.
- Transportation: €195 million, an increase of 27.5% from 2004, of which €67 million were for growth-related spending and €128 million were for replacement and maintenance spending.

Financial investments

Financial investments, including net cash borrowings of acquired companies of -€154 million in 2005, totaled €944 million in 2005, compared to €334 million in 2004. In 2004, these investments included €32 million related to FCC.

Financial investments (excluding cash of acquired companies) totaled €1,098 million and broke down as follows in 2005:

- Water: €614 million, compared to €185 million in 2004. The principal financial investments related to the Braunschweig contract (€374 million), acquired contracts in China (€62 million) and in Australia (€16 million), where the Company bought 47.5 % of United Water, previously held by Thames Water, and in the United Kingdom the acquisition of the engineering company Weir Techna for €41 millions .
- Waste Management: €105 million, compared to €53 million in 2004. Shanks' toxic waste business in the United Kingdom was acquired for €43 million, the minority interests in Onyx Norway were bought out for €11 million and Vasko was acquired in North America for €16 million.
- Energy Services: €203 million, compared to €88 million in 2004, including the Lodz acquisition in Poland for €171 million and the purchase of Conade, a Chilean company, for €8 million.
- Transportation: €175 million, compared to €67 million in 2004. The principal investments were in Norway, where the Company acquired Helgelandske for €20 million, and in the United States, where it acquired ATC/Vancom for €77 million.

Cash related to financial investments totaled €154 million, related essentially to the Braunschweig (€47 million), Weir Techna (€20 million) and Lodz (€17 million) companies.

Financing on behalf of third parties (IFRIC 4 loans)

Project financing in the form of IFRIC 4 financial loans totaled €269 million in 2005, compared to €177 million in 2004, representing a rise of 52.0%.

Investments through IFRIC 4 financial loans broke down as follows:

- Water: €173.7 million, up 8.1% from 2004, owing to progress on construction projects in Europe (The Hague and Brussels), partially offset by project start-ups in Asia.
- Waste management: €2.8 million, essentially in the United Kingdom;
- Energy Services: €85.4 million, compared to €5 million in 2004. These investments were principally in France, with €52.1 million in the co-generation subsidiaries and €11.1 million in Italy.
- Transportation: €7.4 million, a decline of 36.4% from 2004. €5 million of these investments related to Spanish contracts.

3.5 Working capital requirements

Net working capital requirements changed direction in 2005. After declining by €294.4 million in 2004, they rose by €52.2 million in 2005. This slight increase resulted from growth in the business.

3.6 Market risk

Please see note 34 to the financial statements.

4. RETURN ON CAPITAL EMPLOYED (ROCE)

To track the Company's overall profitability and that of each division, the Company has decided to rely on return on capital employed (ROCE), which measures Veolia Environnement's ability to earn a return on the funds provided to it by shareholders and lenders.

Return on capital employed is defined as the ratio of:

- results of operations net of tax, share of net income of associates excluding revenue from financing on behalf of third parties (return on IFRIC 4 loans), divided by
- average capital employed during the year.

Net results of operations are calculated as follows:

(€ millions)	2005	2004
Recurring operating income	1,903.6	1,619.6
Revenue from financing on behalf of third parties	-125.8	-96.7
Share of net income of associates	14.9	24.9
Income tax expense ⁽¹⁾	-402.1	-322.5
Net results of operations	1,390.6	1,225.3

(1) In 2004, the financial restructuring transactions that followed the divestiture of US businesses generated tax-loss carryforwards recognized in the consolidated balance sheet. Given its exceptional character, €138 million, representing the gain in earnings, was eliminated from the calculation of ROCE. In 2005, the use of these carryforwards led to a €21 million charge, which was also eliminated from the ROCE calculation.

Average capital employed during the year is defined as the average between capital employed at the beginning and the end of the year.

Capital employed is defined as the sum of all net intangible assets, net property, plant & equipment, goodwill net of impairment, investments in associates net operating and non-operating working capital requirements, less provisions and other non-current liabilities.

Capital employed is calculated in the following manner:

(€ millions)	December 31, 2005	December 31, 2004	December 31, 2003
Net property, plant & equipment and net intangible assets	13,523.0	12,017.1	11,884.0
Goodwill net of impairment	4,863.1	4,383.6	4,256.6
Investments in associates	201.5	219.2	225.9
Net operating and non-operating working capital requirement (1)	269.7	308.6	945.6
Provisions	-2,387.4	-2,006.5	-1,968.6
Other non-current liabilities	-362.2	-353.6	-372.4
Capital employed	16,107.7	14,568.4	14,965.1
Average capital employed	15,338.1	14,766.8	

(1) including net deferred tax but excluding deferred tax related to US divestitures and related restructurings (€126 million in 2004 and €117 million in 2005).

The Company's return on capital employed (ROCE) is as follows:

(€ millions)	Net results of operations	Average capital employed during the year	ROCE
2005	1,390.6	15,338.1	9.1%
2004	1,225.3	14,766.8	8.3%

In contrast to the intermediate balances of the income statement, ROCE is relatively insensitive to currency effects.

The positive change in ROCE in 2005 reflected the combined effect of the Veolia Environnement 2005 efficiency plan, further maturity in the contract portfolio and control over capital employed.

5. STATUTORY AUDITORS' FEES

In 2004 and 2005, Veolia Environnement paid the following fees to its Statutory Auditors for services rendered in connection with all consolidated companies:

(€ millions)	KPMG network		Ernst & Young network	
	2005	2004	2005	2004
Audit services, ⁽¹⁾	13.1	12.2	13.0	11.8
Audit-related services ⁽¹⁾⁽²⁾	6.6	4.9	3.9	7.3
Other services (tax services, etc.) ⁽¹⁾	-	-	-	0.4
Total	19.7	17.1	16.9	19.5

(1) Includes fees relating to proportionally consolidated companies.

(2) Includes fees relating to the preparation of comfort letters, attestations, acquisition audits and IFRS review.

6. OUTLOOK

6.1 Forecasts

For 2006, Veolia Environnement will seek to increase revenue by 6% to 8%, to achieve a proportionally greater increase in operating income than in revenue, and to generate positive free cash flow before new projects. It aims to achieve these objectives while maintaining a sound balance sheet. Specifically the Company is targeting a net debt to cash flow ratio (1) equal to or less than 3.5.

6.2 Objectives and outlook

In the medium term, Veolia Environnement will seek to take advantage of the strong growth in the markets in which it operates in order to achieve growth in revenues (1) targeted at between 6% and 8% annually and a return on capital employed (1) objective of 10% in 2007.

(1) These targets are not part of forecasts information submitted to auditors' report.