

Research Update:

# Veolia Environnement S.A. 'BBB' Rating Affirmed On Strategic Plan Update; Outlook Stable

April 4, 2024

## Rating Action Overview

- French environmental and energy group Veolia Environnement S.A. (Veolia) presented its four-year strategic plan, which is broadly in line with the one presented last year. Veolia intends to accelerate investments to about €4 billion per year to fuel organic growth and earmarks €500 million, net of strategic asset sales, on medium-sized debt-funded acquisitions per year.
- We anticipate positive discretionary cash flow generation over the planning horizon, thanks to disciplined investments and the group's focus on profitable growth in water, waste, and energy. We view Veolia's liquidity as strong.
- We affirmed our 'BBB' long-term issuer credit rating on Veolia.
- The stable outlook indicates our view that credit metrics will remain at levels that are consistent with our 'BBB' rating, with S&P Global Ratings-adjusted funds from operations (FFO) to debt of about 21%-22%, a contained debt increase that totals about €3 billion over 2004-2026, and debt to EBITDA just above 3.5x.

## Rating Action Rationale

**Veolia's four-year strategic plan, which focuses on organic growth, is broadly in line with the one the group presented after the acquisition of Suez.** Veolia's 2024-2027 Green Up plan focuses on the group's core market positions in water, waste, and local energy. It aims to take advantage of global trends, including the circular economy, depollution, and decarbonization. While certain sub-divisions, namely hazardous waste, water technologies, and bioenergy, will likely experience higher growth rates, the group's business mix is unlikely to change significantly by 2027, compared with 2023. Indeed, we expect it will remain skewed to long-term contracted (France, Spain) or regulated municipal water concessions (U.S., Chile), both of which accounted for 39% of the group's EBITDA in 2023. We also expect cash flow visibility will remain high, with water concessions and the long-term contracted activities of municipal waste and district heating networks--100% owned by Veolia--representing about 50% of EBITDA through 2027. By divisions, revenue growth from water concessions will benefit from inflation pass-through and the fact that increasing investment needs in the U.S. are fully covered by tariffs. Revenue growth from district

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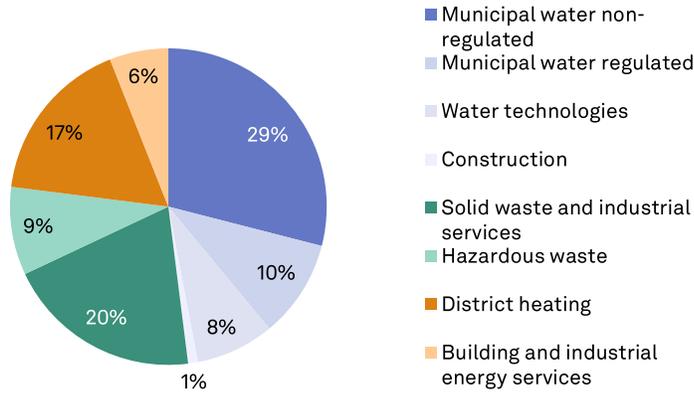
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heating, including co-generation earnings, will reduce on the back of normalizing power and energy prices. It will return to low single digits because of an increase in network connections and tariffs that are set as cost plus and indexed to fuel costs.

Chart 1

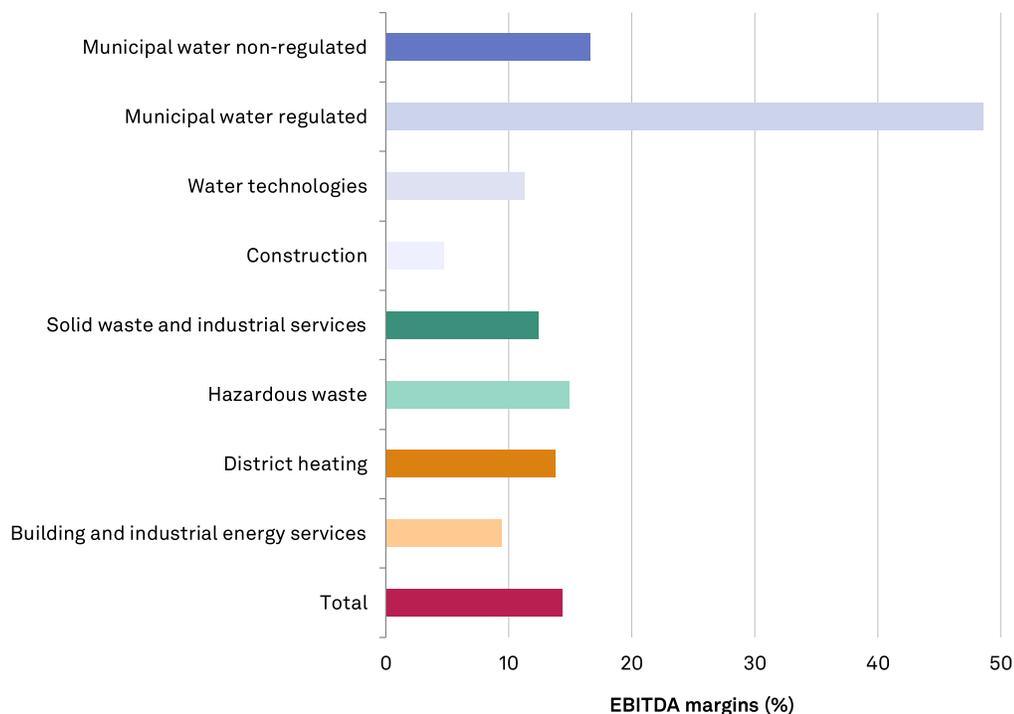
**2023 EBITDA split by business unit\***



\*BVAG included in energy, excluded from water. Source: S&P Global Ratings.

Chart 2

**2023 EBITDA margins per business unit**



Source: S&P Global Ratings.  
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**We anticipate EBITDA growth in 2024 will benefit from solid organic revenue growth and further cost efficiencies.** In line with Veolia's guidance, we expect half of the group's EBITDA growth of 5%-6% in 2024 will stem from topline growth, reflecting strong pricing power, good commercial performance, and resilient volumes. In particular, the group guides for mid-to-high-digit revenue growth for the following booster subdivisions:

- Hazardous waste, thanks to numerous projects that will come into service by 2025. The largest projects are in the U.S., Germany, and the UAE.
- Water technologies, which offers value-added services--such as desalination, separation technologies, and ultrapure water through nanofiltration--in an expanding addressable market of industrial clients.
- Bioenergy and energy efficiency services, where Veolia intends to invest in renewable capacity and power flexibility. For example, Veolia agreed to buy a 430 megawatt combined cycle gas turbine in Hungary from Uniper (BBB-/Stable/--) to increase its total flexible power capacity to 2.4 gigawatt. Also, the group intends to reap energy synergies from its other activities, including the deployment of solar panels on closed landfills and recycling used water to produce electricity.

Further cost efficiencies will contribute €350 million to EBITDA and the remaining cost synergies

from the Suez acquisition will contribute €185 million by 2025.

**We now have clarity on the group's capital deployment over the next four years.** We view the acceleration of investments embedded in the Green Up plan as manageable, leading to slightly positive discretionary cash flows on the back of relatively short payback capital expenditure (capex). The €3 billion increase in adjusted debt to €25.7 billion by the end of 2026 mainly results from mid-sized acquisitions. The group intends to increase capex to about €3.8 billion-€4.0 billion annually, €2.0 billion-€2.5 billion of which relate to growth. We expect Veolia will invest about 50% of capex in booster subdivisions and 50% in infrastructure-type activities, including water concessions, municipal waste, and district heating networks. Investments will remain selective, with a minimum rate of return fixed at the weighted average cost of capital plus 400 basis points (bps). Additionally, the group will target opportunistic and non-transformative acquisitions up to €1 billion per year, mitigated by industrial divestments up to €500 million. The closed sale of the French SADE construction business in March 2024 illustrates the potential non-strategic business the company could decide to dispose.

**Veolia pursues a disciplined financial policy that is in line with the 'BBB' rating, with leverage of up to 3.0x, based on reported data.** We view the group's financial policy as supportive of the 'BBB' rating, with the focus on cash flow generation and disciplined investments. While dividends will increase annually by 10% over the coming three years and will therefore exceed EBITDA growth of about 5%, we view that shareholder distributions are in line with the sector average and manageable, considering a dividends-to-FFO ratio of 26%. We also view as supportive the positive discretionary cash flow, which is containing the debt trajectory. Overall, we forecast the group's financials will be solidly positioned in the 'BBB' category, with adjusted FFO to debt remaining at about 21%-22% and adjusted debt to EBITDA hovering just above 3.5x.

**All divisions and geographies will contribute to Veolia's operational performance over 2024-2026.** The group's strong market positions and large diversified geographical footprint will support earnings over the next three years. Veolia reinforced its water activities, notably by operating municipal water concessions that provide long-term cash flow visibility. Additionally, the group built high barriers to entry in the hazardous waste segment, with a network of 300 treatment sites in 29 countries with permits associated. In the hazardous waste segment, Veolia is active in markets that have a strong growth potential, are driven by depollution requirements, and are subject to more stringent regulations, notably the pharma, chemicals, and oil and gas sectors. District heating networks in Poland, Hungary, Germany, and the Czech Republic also reduce business risk by adding resilient cash flows, with tariff set as cost plus and indexed to fuel costs. We estimate that EBITDA contributions from these networks, excluding China and cogeneration, equaled about 10% of the group's EBITDA in 2023. We believe it is unlikely that Veolia will rebalance the three divisions by 2030 but it will intensify its expansion to geographies outside of Europe--including the U.S., the Middle East, and Australia--over the planning horizon.

## Outlook

The stable outlook reflects our expectation that Veolia's portfolio of activities will remain balanced, with municipal water and district heating accounting for almost 50% of activities. Based on reported EBITDA, which is up by mid-single digits annually on an organic basis, FFO to debt will remain at 21%-22% over 2024-2026, including contained debt-funded acquisitions.

## Downside scenario

We could lower the rating if adjusted FFO to debt does not remain sustainably above 18%, for example because of higher-than-expected debt-funded acquisitions or--less likely--a sharp deterioration in Veolia's profitability and operating performance that could result from adverse commercial developments or a weaker performance of the more macroeconomic-sensitive waste activities.

## Upside scenario

We could revise the outlook upward if Veolia's financial profile strengthened further. This could happen if capital allocation led to a higher-than-anticipated return on investments and debt-financed growth investments remained contained so that FFO to debt increased to about 23% and leverage remained below 3.5x on a sustainable basis. This would assume regulated and long-term contracted activities to continue contributing about half to the group's EBITDA.

## Company Description

Veolia operates globally across three main businesses: Water services, waste services, and energy services.

- Water services integrate drinking water and wastewater activities, such as water distribution, water and wastewater treatment, industrial process water, and the manufacturing of water treatment equipment and technologies.
- Waste services collect, process, and dispose household, commercial, and industrial waste.
- Energy services produce renewable energy comprising heat and electricity generated primarily from waste. They also incorporate district heating and cooling networks, as well as thermal and multi-technical services.

Water services have been Veolia's core business since the group's inception in 1853. Since 2003, the group has increased its projects in waste, especially hazardous waste. In 2022, Veolia acquired Suez, which enabled it to increase its global presence and enhance its strong positioning throughout its business lines across all geographies. At year-end 2023, Veolia reported revenues of €45.4 billion, EBITDA of €6.5 billion, and net debt of €17.9 billion, including IFRS 16. In 2023, water services represented 48% of EBITDA, waste services 29%, and energy services 23%. Geographically, 20% of EBITDA came from France and special waste Europe, 40% from the rest of Europe, and 37% from the rest of the world and water technologies.

## Our Base-Case Scenario

- High external and organic revenue growth driven by the water technologies segment over the planning horizon, notably in the U.S., coupled with significant project launches in hazardous waste.
- Recovery in solid waste revenues, with steady growth and continued stable performance growth in municipal water, boosted by U.S. activities.
- Increasing EBITDA margins under IFRIC 12 and principal payments on operating financial assets to 14.0%-14.5% from 13.0%, with increased margins in water technologies and

hazardous waste. The water business will continue to account for about 50% of EBITDA.

- EBITDA growth in the mid-to-high single digits range in the water technologies and hazardous waste segments over the planning horizon.
- Annual cost savings of €350 million per year, combined with additional cost synergies that will total €500 million by 2025, in line with the integration of Suez.
- Tax rate of 24% over 2024-2026 and 27% from 2027.
- Growing cash interest on refinancing paid at higher market rates.
- Annual capex of about €4 billion, half of which is maintenance, partially offset by €200 million in industrial divestments.
- Acquisitions of about €1 billion per year and non-strategic assets disposals of about €500 million per year.
- Ordinary dividends, including to minorities, to increase to about €1.4 billion in 2026, from €1.2 billion in 2023.

## Key metrics

### Veolia Environnement S.A.--Forecast summary

(Bil. €)	--Fiscal year ends Dec. 31--				
	2022a	2023a	2024e	2025f	2026f
EBITDA	5.7	6.1	6.3-6.5	6.7-6.9	7.0-7.2
Debt	22.3	22.5	23.5-23.7	24.6-24.8	25.6-25.8
Capital expenditure	2.8	3.1	3.8-4.0	3.8-4.0	3.8-4.0
Dividends	1.0	1.3	1.1-1.3	1.2-1.4	1.4-1.5
<b>Adjusted ratios</b>					
Debt/EBITDA (x)	3.9	3.7	3.5-4.0	3.5-4.0	3.5-4.0
Fund from operations/debt (%)	19.7	21.4	21.0-21.5	21.0-21.5	21.5-22.0

All figures are adjusted by S&P Global Ratings, unless stated as reported. a--Actual. e--Estimate. f--Forecast.

## Liquidity

We revise Veolia's liquidity assessment to strong from adequate, in line with our forecast that liquidity sources will exceed uses by at least 1.5x over the next 12 months and by more than 1.0x over the subsequent 12 months. We assess that the group's good access to capital markets, proactive liability management, and solid relationships with banks support its liquidity position. We also believe that Veolia has entered a consolidation phase after the transformative Suez acquisition, with medium-sized acquisitions as part of the Green Up plan. If the group embarks into sizeable debt-funded acquisitions, we will review our assessment. We understand no debt is subject to financial covenants.

Principal liquidity sources over the 12 months from Jan. 1, 2024, include:

- About €10.2 billion in available cash or highly liquid money market funds as of Dec. 31, 2023;

- About €5.5 billion in available committed credit lines maturing beyond 12 months and about €4.8 billion remaining available beyond the subsequent 12 months; and
- Our forecast for FFO of about €5 billion.

Principal liquidity uses over the same period include:

- Debt repayment of about €7.6 billion, of which €4.7 billion relate to the commercial paper;
- Our estimate of €3.9 billion in annual capex, including expansion capex and net of ongoing industrial divestments;
- Annual working capital outflows of about €150 million-€200 million;
- Acquisitions of about €1 billion, mitigated by up to €500 million of asset disposals; and
- Annual dividends of about €1.2 billion-€1.3 billion.

## **Environmental, Social, And Governance**

ESG factors have an overall neutral influence on our credit rating analysis of Veolia. Veolia is the global leader in environmental services, benefiting from megatrends, such as the circular economy. The group's main growth pillars are water scarcity management, water regeneration, waste management (including hazardous waste), and energy efficiency services. However, to reduce the carbon footprint of its energy division, the group needs to dedicate significant capex to make its district heating portfolio more environmentally friendly. Veolia aims to invest a total €1.65 billion in Europe over 2018-2030, with a target to reduce its current annual emissions to 2.7 million tons of carbon dioxide equivalents. We will monitor if the delivery of Veolia's coal exit program is in line with the schedule. The program started in Poland (€529 million were spent by year-end 2023) and will continue in the Czech Republic, with another €515 million in investments planned over 2024-2027 in the eastern European countries. The group will also dedicate €85 million on methane capture over 2024-2027, with the goal to increase the capture rate to 70%, from 40%, in Latin America, Asia, and Australia.

Governance has a neutral influence on our rating, in line with our view of management and governance as satisfactory. We view the merger with Suez as successful, considering its size and complexity, the time taken to execute, the completion of the integration process in all geographies, and the delivery of cost synergies ahead of the schedule. The group demonstrated its ability to manage human resources and retain talent, evidenced by the absence of a disruptive loss of expertise and despite the initial hostile nature of the takeover. We understand staff and activities of the acquired part of Suez were integrated in all geographies within six months.

## **Issue Ratings - Subordination Risk Analysis**

### **Capital structure**

Veolia's debt currently comprises senior unsecured debt--mostly bonds--and €3.6 billion in hybrids. All debt, including the hybrids, are at Veolia's level, so we apply no notching.

### **Analytical conclusions**

We rate Veolia's financial debt at the same level as Veolia's current stand-alone financial debt, namely at 'BBB'. The hybrids are rated two notches below at 'BB+'.

## 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
Anchor	bbb
Modifiers:	
Diversification/portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Strong
Management and governance	Neutral (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile	bbb

## Related Criteria

- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- 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

- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## Ratings List

### Ratings Affirmed

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**Veolia Environnement S.A.**

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Issuer Credit Rating    BBB/Stable/A-2

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**Veolia Environnement S.A.**

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Senior Unsecured        BBB

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Junior Subordinated    BB+

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Commercial Paper       A-2

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