MOODY'S
INVESTORS SERVICE

Credit Opinion: Suez Environnement Company

Global Credit Research - 02 May 2013

Paris, France

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating -Dom Curr	A3
Senior Unsecured	A3
Pref. Stock -Dom Curr	Baa2
Commercial Paper -Dom Curr	P-2
Other Short Term -Dom Curr	(P)P-2

Contacts

Analyst	Phone
Niel Bisset/London	44.20.7772.5454
Neil Griffiths-Lambeth/London	
Monica Merli/London	

Key Indicators

Suez Environnement Company[1]

	12/31/2012	12/31/2011	12/31/2010	12/31/2009	12/31/2008
EBIT Margin	**8.1%**	**7.3%**	**7.3%**	**8.4%**	**9.7%**
EBIT/Interest Expense	**2.1x**	**2.0x**	**2.0x**	**2.4x**	**2.6x**
FFO Interest Coverage [2]	**4.6x**	**5.0x**	**4.9x**	**5.0x**	**4.9x**
FFO/Net Debt [2]	**19.8%**	**21.7%**	**20.4%**	**21.3%**	**21.7%**
RCF/Net Debt [2]	**14.3%**	**19.0%**	**15.8%**	**15.9%**	**15.6%**
RCF/Capex+ Acquisitions (net of divestitures)	**90%**	**93%**	**78%**	**76%**	**43%**

[1] All ratios are calculated using Moody's Standard Adjustments. [2] Pro forma in 2010

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Corporate Profile

Headquartered in Paris, France, SUEZ Environnement Company ("SUEZ Environnement/the company, or group"), rated A3/Prime-2, with a stable outlook is one of two leading groups active globally in environmental services. As part of the merger of Suez with GDF (to create the GDF SUEZ Group, rated A1, negative) 65% of the company was spun off to Suez shareholders and simultaneously listed on the Euronext Paris and Brussels stock exchanges through an IPO in July 2008. The company is controlled through a shareholder agreement by GDF SUEZ, which itself retains 35.7% of the share capital. The agreement will not be renewed when it ends in July 2013, although the two groups will continue to work together in future through an industrial and commercial cooperation agreement.

SUEZ Environnement, which provides drinking water to 97 million people, wastewater treatment to 66 million people and waste management services to municipalities and industrial customers, generated EUR15.1 billion revenues in 2012. As one of the largest operators in the field, the group ranks second in France, Europe and globally in the water sector (including the leading position in Spain); and second in France and Europe, and third worldwide in the waste sector.

The Group consists of three main divisions: (1) Water Europe, the most profitable in EBITDA terms, comprises mainly the fully-owned Lyonnaise des Eaux, and the Spanish utility Aguas de Barcelona (Agbar), of which it owns 75.4%. Most of its clients in water are local authorities, with which the company enters into Delegation of Public Services (DSP) contracts in France, or their equivalent elsewhere. Water Europe accounted for 29% of revenues in 2012; (2) Waste Europe, which has a wider presence in the north of Europe, is the largest division by revenue, and accounted for 43% of the Group's 2012 turnover; and (3) International, which generated 28% of 2012 revenues, includes engineering activities worldwide (Degrémont) and selected positions in the United States with United Water, China, Australia, and the Middle East.

Rating Rationale

The A3/Prime-2 ratings are based on Moody's assessment that SUEZ Environnement Company has a relatively low business risk profile overall. This factors in that it operates in the lower-risk water sector, as well as in waste, both of which benefit from positive underlying structural growth, and that its operating cash flows are underpinned by long term contracts to deliver essential services, mainly to relatively low risk counterparties in the public sector. These positive underlying trends are partly offset by the negative effect of environmental concerns on water consumption and a flat outlook for waste volume growth in Western countries. However, the diversification of its contract portfolio by service, contract type, and geography has helped mitigate the Group's overall revenue and cash flow volatility during recent economic weakness, despite the waste business's relatively high exposure to the economic cycle.

The ratings also factor in the strong positions that SUEZ Environnement has within its core markets, and that its growth strategy focuses on expanding these through monitored development capex and manageable `tuck-in' acquisitions. From the financial risk perspective, the ratings take account of the company's leverage target (net financial debt/EBITDA of around 3 times) and a relatively high dividend payout. Moody's expects credit metrics should strengthen nevertheless in 2013 such as to be comfortably consistent with guidance for the rating, which includes RCF/net debt comfortably in the mid-teens, and FFO/net debt in excess of 20%. Although subsidiary debt remains significant, Moody's expects that its proportion within Suez Environnement's debt structure will continue to decline as a result of the group's funding policy, and considers that the subordination risk of parent company creditors is mitigated by the broad diversification of the group's asset portfolio. In Moody's view, therefore, although subsidiary debt implies some residual risk for parent company creditors, this can be accommodated at the A3 rating level.

Recent Developments

On 1 May, Moody's affirmed the company's ratings. The affirmation factored in the combination of (i) a revision downwards of the consolidated group's credit quality to A3 from mid single-A, which reflected that although Moody's expects some recovery in credit metrics in 2013, the group's medium-term financial performance will be more consistent with the A3 rating level; and (ii) moderated by the group's progress in reducing the proportion of debt at subsidiary level in line with its policy of refinancing subsidiary debt at group level except where risk sharing, regulatory or currency considerations support the use of local debt.

Rating Drivers

ASSESSMENT OF BUSINESS RISK FACTORS

The A3 rating is underpinned by SUEZ Environnement's long track record, and the leading positions it has established in many of the markets in which it operates, notably in water in both France (through Lyonnaise des Eaux) and Spain (through Agbar), and through its SITA subsidiaries in waste in France, Benelux, Germany, Scandinavia and the United Kingdom. Moody's also takes account of Degrémont's contribution both in terms of direct revenues, its ability to lead international development and technical expertise. In Moody's view these positions are important to securing future revenue streams, and should help support activity in the more fragmented and competitive waste sector where barriers to entry are usually lower except for the more sophisticated treatment activities.

The group's rating factors in positive underlying industry dynamics, with population growth, the ongoing trend to urbanisation and industrialisation, and an expectation of rising living standards and stricter regulation exerting pressure on water distribution and waste management infrastructure in most countries. Together with public and regulatory concern at the impact of climate change on scarce resources this is combining (i) to increase demand for existing technologies for the provision of water, waste water and waste management services; and (ii) to extend demand into new service areas and technologies, and so expand the respective `value chains'. These positive underlying trends are partly offset by the negative impact of environmental concerns on water consumption and a flat outlook for waste volume growth in Western countries. The steady, structural, contraction in like-for-like water volumes, especially in Europe, is driven mainly by a more `resource-aware' population rather than de-industrialisation. In France, for example, the group continues to experience a structural decline in volumes of potable water billed of between 0.5% to 1.5% per annum - a trend also apparent during 1Q2013. In Moody's view these trends will continue to exert negative pressure on turnover growth with a potential impact on margins. This can be to an extent offset by indexation increases, new services and efficiencies - but customers are increasingly looking to maximize their share of savings.

More generally, the group plans to offset the shift towards lower water volumes in mature markets and the problems of overcapacity in the waste market in Western Europe by growing high value added services. These include services with a high technological content such as smart water meters and service contracts with industrial customers facing complex challenges in terms of water supply or treatment. They represent investment in platforms for medium-term revenue growth, rather than short-term profitability boosts in Moody's view. In the waste business the group will continue to switch to recovery (energy from waste and sorting/recycling) from elimination (landfill). Of 24.2 million tonnes treated by the company in Europe in 2012, recovery accounted for 58%, a share which the company is expected to grow to around two thirds in the medium-term. The company has won several contracts with municipalities recently for large waste-to-energy facilities in the UK (Cornwall, Merseyside) and in Poland (Poznan), although these facilities are not expected to be operational before 2016.

Exposure to the economic cycle varies by division, and is moderated by the essential nature of its services: delivering water & waste services to individuals and small businesses on their behalf, often through a contract with local municipalities. Although demand for water continues to experience a slow structural decline in advanced economies, variations in water consumption tend mainly to be affected by the weather. By billing consumers for water directly in its main markets (ie France and Spain) the company avoids exposure to cash-strapped municipalities in the water division. However, performance of Waste Europe, which accounted for about 33% of group EBITDA in 2012, is in general more exposed to changes in economic activity, and more specifically to industrial output, reflecting both the high proportion of industrial and commercial customers (roughly two thirds) under relatively short term contracts, contract terms more often linked to volumes collected or processed, and the exposure of the sorting and recycling business (about a quarter of the division's revenues) to commodity price movements. Lower industrial production in Europe in 2012 caused a 2.5% year-on-year decline in treated volumes, as higher treated volumes in recovery (+3.1% in 2012) did not compensate for lower volumes in elimination (-9.5%), and lower commodity prices impacted revenues by approximately EUR87 million. The Waste division's sensitivity to the economic cycle was again highlighted by the decrease in treated volumes during Q1 2013, although this was accentuated by unfavourable climatic conditions.

Over the next few years revenues generated by activities beyond Europe are likely to grow as the group develops in emerging markets with growing populations and infrastructure needs and rising concerns about water scarcity and environmental damage. These markets include for example South America through its Agbar subsidiary, or China. The group's geographical presence will continue to shift gradually, until Europe represents about two thirds (from 69% now, and 80% in 2008), and the rest of the world the balance. While acknowledging the group's cautious approach to capital deployment (relatively short term O&M contracts are more likely to feature than the more capital intensive French concession model) and the use of local partners where capital is invested, Moody's considers that growth in international activities often implies incremental risk.

The difficulties faced by Degrémont in 2011 in relation to the construction of the huge Melbourne desalination plant were an example of this. Although there were no technological issues, poor weather and industrial action caused a 6 month delay on completion of the project. This had a negative impact of EUR153 million on EBITDA in 2011 and of EUR114 million in 2012 as a result of cost overruns and liquidated damages, with further smaller losses expected in 2013.The company and its construction partner have lodged a claim for more than AUD1 billion. While Moody's notes the group's argument that these issues represent a `one-off', and that it retains the 27 year O&M contract on the plant, the company will in future limit the scale of overseas contracts it takes on.

SUEZ Environnement's ratings factor in that its contract-driven business model relies on its ability to renew contracts at maturity. In addition to simply retaining the business, renewal is an important point at which to expand the range of services or investment within a contract and can help also to offset negative pricing pressure which might be exerted by the client. In that connection, Moody's notes that the group has a sound record of renewing contracts at expiry, with a renewal rate of more than 85% for Lyonnaise des Eaux in 2012. At 27.4% in 2012 (vs

28.8% in 2011) EBITDA margins have so far been resilient in the Water Europe division, notwithstanding the negative effect from the sale of higher margin regulated activities, Eurawasser and Bristol Water. Nevertheless, as contracts mature the group's revenue base is at risk - whether with respect to pressure on tariffs or non-renewal - both from industrial competitors and the local authorities themselves, even if SUEZ Environnement is able to an extent to offset contract losses with wins elsewhere and contracts outside France tend to have longer maturities. Moreover, in Moody's view, such pressure is likely to be more intense during periods of weaker economic growth, such as the present, although the savings opportunities and the incremental tax capacity (where billing is direct to the consumer) underpins the appeal of outsourcing.

ASSESSMENT OF FINANCIAL RISK FACTORS

The A3 rating takes account of the group's solid track record of limited volatility in turnover and EBITDA, which reflects the resilience of its diversified asset base. In 2012, the 1.8% rise in sales to EUR15.1 billion (versus 5.0% growth in 2011) balanced modest increases in Water and Waste Europe revenues against lower revenue from International, negatively affected on a comparative basis by completion of the Melbourne construction contract. The 2.5% drop in EBITDA to EUR 2,450 million in 2012 reflected mainly the underperformance of Waste Europe where EBITDA decreased by 9% because of lower treated volumes and commodity prices. These dynamics have by and large extended into Q1 2013 when an overall 2.6% decline in revenue reflected lower Waste Europe (down 5.3% year-on-year) and International (down 4.1%) sales on a like-for-like basis, only partly offset by Water Europe's 3.4% increase. First quarter EBITDA was flat at EUR570 million reflecting the compensating effects of the company's cost cutting.

A weak economy and lower industrial production is expected to result in a further drop in waste volumes in 2013, following the 2.5% decline in 2012, and pressure on commodity prices. Ongoing structural volume declines and pricing pressure in French water limit the ability of that segment fully to offset pressure in waste. Nevertheless, Suez Environnement is able partly to offset negative pressure on profitability through its ongoing Compass cost cutting programme which is expected to contribute EUR150 million EBITDA in 2013. This year will also see lower losses on Melbourne, at EUR 58 million, versus EUR 114 million in 2012. Overall therefore, the group targets an increase in EBITDA to at least EUR2,550 million from EUR2,450 million in 2012, and a net financial debt/EBITDA ratio of around 3 times.

The rating assumes that the Group will continue to manage investment according to its financial strategy, and will therefore calibrate development capital expenditure according to the cash generated from operations and any asset rotation. In the event that organic growth were to fall short of plan, Moody's assumes Suez Environnement would moderate investment accordingly such as to ensure that the Group continues to respect its own leverage targets. It is able to respond quite quickly to changes in the economy, and can manage both development and maintenance capex accordingly. Capex is targeted at EUR 1.3 billion in 2013, but Moody's assumes spending would be reduced if activity was lower than planned - as it was in 2012. The company maintains a prudent strategy focusing mainly on organic growth, and targets free cash flow (excluding dividend and development capex) of more than EUR1 billion. If a tuck-in acquisition opportunity were to arise, Moody's assumes the group would maintain financial flexibility through the disposal of non-core assets.

Weaker cashflow ratios in 2012 (FFO/net debt at 19.8% versus 21.6% in 2011; and RCF/net debt at 14.3% from 19.0%, when retained cashflow was boosted by the scrip dividend) reflected the combination of lower cashflow generation, an all cash dividend and higher net debt including Moody's adjustments. This rose from EUR10.1 billion to EUR10.6 billion after Moody's adjustments which include `adding back' EUR 287 million of securitised receivables which benefit from off balance sheet treatment under IFRS.

Prospectively, and notwithstanding the risks to profitability from a tough operating environment and a relatively high dividend payout, Moody's expects some recovery in metrics in 2013, such as to be comfortably consistent with Moody's revised guidance for the A3 rating - which includes RCF/net debt comfortably in the mid-teens, FFO/net debt in excess of 20% and FFO Interest Cover Ratio (ICR) above 4x.

Structural Considerations

The A3 rating factors in the progress made by the group in reducing the proportion of debt located at subsidiaries. This reflects the group's policy of progressively refinancing subsidiary debt at group level except where risk sharing, regulatory or currency considerations support the use of local debt. Although subsidiary debt remains significant, Moody's expects that its proportion within Suez Environnement's debt structure will continue to decline as a result of the group's funding policy, and considers that the subordination risk of parent company creditors is mitigated by the broad diversification of the group's asset portfolio. In Moody's view, therefore, although subsidiary debt implies some residual risk for parent company creditors, this can be accommodated at the A3 rating level.

Liquidity

Moody's considers that the group's liquidity profile is sound, supported by substantial cash balances and confirmed credit facilities. In Moody's view, when combined with solid cash flow generation, these should leave the group well positioned to fund its capital expenditures, dividend payments, and refinancing commitments.

At December 2012 the group had EUR2.5 billion of cash and marketable securities, in line with its financial policy of maintaining sufficient cash on hand to meet the next twelve months' maturities (approximately EUR1.4 billion of external debt repayments). In addition, it had unused confirmed credit facilities of EUR2.3 billion, of a total EUR4.9 billion. Most of these contain no triggers, covenants, MAC or general restrictions.

Moody's notes that in 2012 the group kept diversified funding sources and maintained average debt maturity at 6.5 years (52% of gross debt has a maturity of more than 5 years). The company's funding sources also include a commercial paper programme of EUR1.5 billion launched last December to benefit from low short term funding costs, and a EUR400 million securitisation programme on its SITA subsidiary's waste receivables. The Financial Framework Agreement with GDF SUEZ which comprises a EUR 350 million facility (currently undrawn) extended to SUEZ Environnement will not be renewed at expiry in July 2013. However, this will have no meaningful impact as the facility has never been drawn.

Rating Outlook

The stable outlook is based upon modest growth in operating profitability in 2013, continued capital discipline and ongoing efforts to reduce structural subordination. It therefore assumes that credit metrics should strengthen within Moody's guidance for the A3 rating, which includes RCF/net debt comfortably in the mid-teens, FFO/net debt in excess of 20% and FFO Interest Cover Ratio (ICR) above 4x.

What Could Change the Rating - Up

Conversely, ratings could be upgraded if RCF/net debt and FFO/net debt were to strengthen sustainably in excess of 20% and 25% respectively.

What Could Change the Rating - Down

Suez Environnement's ratings would come under pressure if (i) operating performance shortfalls or increased investments versus plan were to cause metrics to fall short of guidance for the A3 rating on a sustainable basis; or (ii) if there were a reversal of the policy of concentrating funding at group level.

MOODY'S INVESTORS SERVICE