Moody's Investors Service

Credit Opinion: Suez Environnement Company

Global Credit Research - 27 Oct 2009

Paris, France

Ratings

Category	Moody's Rating
Outlook	Negative
Issuer Rating -Dom Curr	A3
Senior Unsecured -Dom Curr	A3
Other Short Term -Dom Curr	P-2

Contacts

Analyst	Phone
Niel Bisset/London	44.20.7772.5454
Paul Marty/London	
Monica Merli/London	

Key Indicators

Suez Environnement Company

	2008	2007	2006	2005
EBIT Margin	9.8%	9.9%	11.3%	9.9%
EBIT/Interest Expense	2.6x	2.9x	3.3x	2.8x
FFO Interest Coverage	4.8x	5.2x	5.5x	4.9x
FFO/Net Debt	22.2%	23.5%	28.6%	25.9%
RCF/Net Debt	16.0%	16.0%	20.4%	16.4%
RCF/Capex+ Acquisitions (net of divestitures)	43%	67%	76%	138%

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 SA ("SUEZ Environnement/SE/the company, or group"), rated A3/Prime-2, with a negative outlook is one of two major groups active globally in environmental services. As part of the merger of Suez with GDF (to create the GDF SUEZ Group, rated Aa3) 65% of SE 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 remains controlled through a shareholder agreement by GDF SUEZ, which itself retains 35.4% of the share capital.

SUEZ Environnement, which provides drinking water, wastewater treatment and waste management services to municipalities and industrial customers, generated EUR 5.9 billion revenues during 1H2009. 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 includes three main divisions: (1) Water Europe, the most profitable, comprises mainly the fully-owned Lyonnaise des Eaux, and the Spanish utility Aguas de Barcelona (Agbar, rated A2, under review for possible downgrade), in which SE recently announced it planned to raise its economic holding from 45.9% to 75%. Most of its clients in water are local authorities, with which SE enters into Delegation of Public Services (DSP) contracts in France (or their equivalent elsewhere). Water Europe accounted for 33 % of revenues in 1H2009; (2) Waste Europe, which has a broader geographical reach than Water Europe, is the largest division by revenue, and accounted for 44% of the Group's turnover in 1H2009; and (3) International, which includes engineering activities worldwide (Degrémont) and selected positions in the United States with United Water (rated A3), Central Europe, China, Australia, Mediterranean countries and the Middle East. The International division accounted for 23 % of revenues in1H2009.

Recent Developments

On 23 October 2009 Moody's changed to negative from stable the outlook on SE's A3 senior unsecured ratings following the announcement that it had entered into an agreement with Criteria Caixacorp (`Criteria') to enter into a series of transactions (or `global transaction') which if completed as planned would increase SE's economic holding in Agbar to 75% from the current 45.9%. The A3 and Prime-2 ratings were affirmed. The outlook change reflects that although Moody's considers the transaction to be positive

from a strategic and business risk perspective, its net debt impact of up to EUR 1.2 billion will reduce Suez Environnement's financial flexibility, leaving the rating weakly positioned in the A3 category in Moody's view.

Under the terms of the agreement the following transactions are planned:

(i) a delisting offer of EUR 20 to the 10% minority shareholders that own Agbar's free float for a total consideration of up to EUR 299 million;

(ii) the acquisition by Suez Environnement from Criteria of Agbar shares, at EUR 20 per share, in order for Suez Environnement to achieve a total 75% stake in Agbar - for a consideration of EUR 647 million; and

(iii) a simultaneous disposal by Agbar to Criteria of its 54.8% shareholding in Adeslas, the Spanish health insurer. In parallel, Criteria will acquire a further 45% stake in Adeslas from Malakoff Mederic.

The proposed transactions remain subject to the approval of Agbar shareholders as well as certain regulatory and anti-trust authorities. Moody's understand that SE and Criteria expect the delisting of the company to be finalized in Q1 2010 and to be able to close the global transaction by mid 2010.

Rating Rationale

The A3/Prime-2 ratings are based on Moody's assessment that SUEZ Environnement Company displays a relatively low business risk profile overall. This factors in that it operates in the relatively low-risk water sector, as well as in waste, both of which benefit from positive underlying structural growth dynamics, and that its operating cash flows are underpinned by long term contracts with creditworthy counterparties. It also factors in the strong positions that SE enjoys within its core markets, and assumes that following the planned increase of its investment in Agbar its growth strategy is more likely to focus on expanding these through development capex and manageable `tuck-in' acquisitions. The rating takes account of structural considerations and the positioning of a substantial proportion debt at subsidiary level. Accordingly Moody's notches Suez Environnement's A3 long-term ratings by one notch down from the consolidated group's credit quality, which is seen as mid single-A.

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 France) and Spain (through Agbar), and through its SITA subsidiaries in waste in France, Benelux, Scandinavia and the United Kingdom. Moody's also takes account of Degremont's contribution both in terms of direct revenues, and its ability to lead international development together with Safège. In Moody's view these positions are important to securing future revenues streams, and should help form the basis for growth in the more fragmented and competitive waste sector where barriers to entry are lower.

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 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'. However, Moody's cautions that these positive trends are partly offset by the negative impact of environmental concerns on water consumption and slowing waste volume growth.

Moody's views the planned Agbar transaction as consistent with SE's strategy to grow while maintaining the existing balance across the Group, so that as it expands it will maintain its present shape and business mix. The Group will continue to develop its positioning throughout the value chains in water and waste; and in terms of regional emphasis, its priority is to (i) consolidate and strengthen its positions in Europe; and (ii) to expand its positions in what are faster growing international markets, where the emphasis is expected to be selective and to leverage on existing positions in US water, China and Australia.

Were SE to increase its holding in Agbar to 75% as planned, Moody's believes this should improve the Group's business risk profile in a number of ways. In taking full control of Agbar (through a new shareholder agreement with Criteria, which will retain a shareholding of up to 25% in Agbar) the Group would reinforce its positions in water in Spain, Chile, the UK and China, as well being in a position to set a clearer strategic direction. It would also increase the proportion of lower risk regulated activities in its business mix through its assets in Chile and the UK. Finally, the planned sale by Agbar of Adeslas, the health insurer, would enhance the Group's focus on its core water and waste activities.

SE'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 above 90 % for Agbar and Lyonnaise des Eaux France's (LDEF) in recent years, and the capacity to leverage existing positions to develop new services and activities.

ASSESSMENT OF FINANCIAL RISK FACTORS

From a financial strategy perspective, Moody's views management's maintenance of a moderate financial risk appetite as an important supporting factor, and notes its stated commitment to maintaining net debt/EBITDA below 3x (compared with the reported ratio of 3.18x at end June 2009). In the event that either EBITDA or net debt were to vary from expectations, Moody's assumes that management would utilise flexibility in capital investment and/or take other measures as appropriate to manage debt accordingly such as to ensure ongoing adherence to its leverage target even if that were to limit growth in the short-term.

In that connection Moody's notes that in the tougher market conditions of 1H2009 the Group has adapted its short term priorities to focus on free cash flow by reducing temporarily investments, increasing capex selectivity and accelerating its Compass cost-reduction program. In a weaker economic environment, the rating assumes that the Group will continue to manage investment according to its financial strategy, and will therefore calibrate capital expenditure according to the cash generated from operations,

and its success at making targeted disposals. During 1H2009, for example, SE was able to increase free cash flow (before dividends) to EUR 428 million from EUR 275 million in 1H2009 mainly by controlling working capital and curbing maintenance capital expenditure, which declined to 4.9% of revenues from 5.3% in 1H2008.

Notwithstanding the business risk positives of the planned Agbar transaction noted above, the change of outlook to negative reflects that in Moody's view these are offset by the reduction in financial flexibility implied by the associated rise in net debt. Although the final size of the global transaction will remain dependent on the take-up of the delisting tender offer by Agbar minority shareholders, Suez Environnement's net debt could increase by up to EUR 1.2 billion as a result of assumed debt and the purchase of Agbar shares from Criteria. The Group estimates this would represent an increase of circa 0.25 in net financial debt to EBITDA ratio. Moody's assumes that consistent with the Group's stated commitment to maintaining net debt/EBITDA below 3x, it will take the measures necessary to reduce leverage in the event that this is exceeded.

Moody's views the relative predictability of the water business as positive, and notes that this has been reflected in the stability of the results recorded over 2006 to 2008 when revenues increased from EUR 11.3 billion to EUR 12.4 billion, and the EBITDA margin remained between 16.9% to 17.1%. During 1H2009 the resilience of the Water Europe (whose revenues and EBITDA increased organically by 3% and 7.5% respectively) and International (up by 1% and 8.6% respectively) partly offset the decline in revenues (-10.3%) and EBITDA (-21.1%) at Waste Europe, whose results were impacted especially by price and volume weakness in its Sorting and Recycling activities. Helped also by the savings from Compass, Group EBITDA declined by 5.5% (or 4.2% at constant exchange rates) to EUR 951 million. Finally, Moody's views as positive the ongoing control exercised by GDF SUEZ (rated Aa3) over SUEZ Environnement. Also highlighted is the importance of the Financial Framework agreement between GDF SUEZ and the Group in underwriting its liquidity.

Structural Considerations

SUEZ Environnement A3/P-2 issuer ratings take into account the structural subordination of bond holders to creditors at subsidiary level given the large amount of debt located at subsidiaries. The ratings thereby reflect bondholders' distance from the operating companies' cash flows, and the low proportion of gross and net debt carried at the holding company level. Accordingly Moody's notches SUEZ Environnement's own rating by one notch down from the consolidated Group's credit quality, which is seen as weakly positioned mid single-A. Moody's recognises that the Group plans to refinance a large proportion of its subsidiary debt at the holding company level but believes that this process will take time to implement.

Liquidity

Moody's considers the Group's liquidity profile is adequate, supported by substantial cash balances, bilateral committed facilities and the Financial Framework Agreement with GDF SUEZ. In Moody's view, when combined with solid cash flow generation, these should leave the Group well positioned to fund the potential outgoings associated with the planned Agbar transaction in addition to its capital expenditure, dividend and refinancing commitments.

At June 2009 the Group had EUR 3.2 billion of cash and marketable securities (excluding EUR 500 million proceeds from its 15 year bonds which settled in July, and the proceeds from the sale of its stake in Gas Natural), comfortably covering approximately EUR 2.6 billion of external debt repayments due in the next eighteen months, and in line with the Group's financial policy of maintaining sufficient cash on hand to meet the next twelve months' maturities. In addition it had unused committed bank facilities of EUR 1.2 billion, which expire between 2009 and 2014. Most of these facilities contain no triggers, covenants, MAC or general restrictions.

Moody's notes that over the course of 2009 the Group has diversified its funding sources and extended its debt maturity profile to 5.7 years at July 2009 through a series of bond issues totalling EUR 3 billion under its newly established EMTN programme. Borrowing from GDF SUEZ currently represents some 21% of gross debt, down from 39% at end-2008. Moody's additionally draws comfort from the contractually agreed Framework Agreement which ensures that SUEZ Environnement has the necessary access to GDF SUEZ liquidity until the Agreement's expiry at end-2010.

Rating Outlook

The rating outlook is negative. While Moody's acknowledges that Suez Environnement anticipates its planned investment in Agbar should generate an estimated 10 % increase in current EBITDA (EUR 2.1 billion in 2008) and be free cash flow positive from the outset, the negative outlook nevertheless reflects that net debt could increase by up to EUR 1.2 billion as a result of assumed debt and the purchase of Agbar shares from Criteria, and the risk therefore that SE's credit metrics could fall below guidance for the current A3 rating.

What Could Change the Rating - Down

Negative pressure would develop on the rating in the event of a sustained deterioration in financial profile - as would be evidenced for example by RCF/debt ratios declining on a sustainable basis to less than 16%, and FFO/Interest cover to materially below 4.5x - whether as a result of the higher debt associated with the planned Agbar investment, or lower than expected profitability and cash flow generation.

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