

RatingsDirect®

Research Update:

Akzo Nobel Rating Raised To 'A-' On Stronger Credit Metrics; Outlook Stable

Primary Credit Analyst:

Paulina Grabowiec, London (44) 20-7176-7051; paulina.grabowiec@spglobal.com

Secondary Contact:

G.Andrew A Stillman, CFA, London (44) 20-7176-7036; andrew.stillman@spglobal.com

Table Of Contents

Overview

Rating Action

Rationale

Outlook

Ratings Score Snapshot

Related Criteria And Research

Ratings List

Research Update:

Akzo Nobel Rating Raised To 'A-' On Stronger Credit Metrics; Outlook Stable

Overview

- We anticipate that Netherlands-based Akzo Nobel N.V. will continue to generate robust cash flows in 2017, leading to an adjusted FFO-to-debt ratio of about 70%-75%.
- We are therefore raising our long- and short-term corporate credit ratings on Akzo Nobel to 'A-/A-1'.
- The stable outlook on Akzo Nobel reflects S&P Global Ratings' view that the company's credit metrics will remain well above our guidance of adjusted FFO to debt of 35%-40% for an 'A-' rating, and therefore we see significant headroom in the current rating.

Rating Action

On Oct. 21, 2016, S&P Global Ratings raised its long- and short-term corporate credit ratings on Netherlands-based leading manufacturer of paints, coatings, and specialty chemicals, Akzo Nobel N.V. (Akzo), to 'A-/A-1' from 'BBB+/A-2'. The outlook is stable.

We also raised the issue ratings on Akzo's revolving credit facility (RCF), euro medium-term note program, and senior unsecured debt to 'A-', in line with the corporate credit rating.

Rationale

The rating actions reflect the continued strengthening of Akzo's credit metrics with an anticipated funds from operations (FFO)-to-debt ratio of 55%-60% in 2016 and 70%-75% in 2017. Although forecast leverage in our base case could support a higher rating, we understand that the company's financial policy is geared toward maintaining a strong 'BBB+' rating.

In the first nine months of 2016, Akzo operated against a backdrop of mixed volume growth, owing to protracted soft conditions in the marine and oil and gas industries, and adverse price/mix and currency effects. However, despite these challenging conditions, the company delivered strong improvement to its reported EBITDA margin, which increased to 16% in the first nine months of 2016, up from about 14.1% the year before. The improvement was chiefly due to the benefits of restructuring and organization-wide costs savings, as well as lower raw material costs. We view this margin improvement as largely sustainable. As a result, we anticipate that in combination with moderate capital expenditure (capex) and dividends, and ongoing focus on working

capital management, Akzo will generate robust cash flows in 2017. Under our base-case scenario we also forecast that its acquisition of the Industrial Coatings division from BASF will be primarily funded with operating cash flow.

Notwithstanding Akzo's strong performance, we recognize the uncertainty in many countries and segments in which the company operates, as well as its strategy of bolt-on acquisitions and potential shareholder returns. The rating therefore incorporates significant headroom for such actions.

In our base-case, we assume:

- Negative revenue growth of 3% to 4% in 2016, primarily due to an unfavorable currency effect (as seen in the first nine months of 2016), and price/mix developments, partly offset by volume growth. We assume sales contribution from the acquisition of the industrial coatings business from BASF only in 2017.
- Considerable improvement in reported EBITDA margins (after restructuring) to about 15.5%-16.5% in 2016 and 2017, up from an average of 11.3% from 2010-2014, factoring in better operating efficiency due to the benefits of the continuous improvement program and management delayering, and lower costs of raw materials.
- In 2016, an increase in the International Financial Reporting Standards (IFRS) pension deficit, reflecting lower discount rates, and the €612 million adverse effect of insurance buy-in transactions for the U.K. schemes (based on the first nine months of 2016), partly offset by pension top-up payments of about €320 million and higher returns from pension assets. From 2017 onward we assume a gradual decrease in Akzo's IFRS deficit, reflecting our assumption of a similar level of pension top-up payments, but also lower volatility of the U.K. pension fund following an extensive derisking program. That said, changes in actuarial assumptions--notably discount rates--could still have a negative effect on the overall deficit, in our view.
- Restructuring charges at 1% of sales in 2016 and thereafter.
- Capital expenditure (capex) at about 4% of sales.
- Acquisition of the industrial coatings business from BASF for €475 million will be completed in the later part of the second half of 2016. We also assume a small amount of discretionary bolt-on acquisitions in both 2016 and 2017.
- Dividends averaging about €300 million-€350 million in both years (including minority shareholders).
- Neutral working capital.

Based on these assumptions, we arrive at the following:

- Reported EBITDA of about €2.2 billion in 2016 and €2.2 billion-€2.3 billion in 2017.
- Adjusted debt to EBITDA of 1.3x in 2016, and about 1.0x in 2017.
- Adjusted FFO to debt of about 55%-60% in 2016 and 70%-75% in 2017.
- Material positive FOCF in both 2016 and 2017.

Akzo continues to benefit from its favorable business position and significantly lower cyclicalities, relative to other chemical companies. The

company is a leading producer of decorative paints and performance coatings, which together account for about two-thirds of company sales, complemented by its midsize specialty chemical activities. Akzo's paints and coatings segments have low capital-intensity and it has a portfolio of major brands. Demand has historically mirrored GDP trends. In 2015, the company generated about 47% of total sales from emerging markets, of which 27% derived from Asia--of which about half came from China.

Our comparable rating analysis constrains the rating by one notch, reflecting our view that Akzo's profitability is lower than that of its immediate peers, notably PPG Industries and Sherwin-Williams. Having said that, we recognize a strong, and in our view largely sustainable, improvement in Akzo's margins in 2015 and the first nine months of 2016, as well as the robust margins of Akzo's Specialty Chemicals business, which in the first nine months of 2016 were above the 12%-20% range we view as average for the specialty chemicals industry.

We believe that Akzo's financial policy supports a strong 'BBB+' rating. That said, we view the company's track record of conservative risk management as supportive of a higher rating. We also factor in substantial rating headroom for bolt-on acquisitions and dividends.

Liquidity

The 'A-1' short-term rating reflects our view of Akzo's liquidity as exceptional under our criteria, with the ratio of sources to uses above 2.0x over the 24 months.

Principal liquidity sources include:

- Reported cash of about €1.4 billion at the end of Sept. 30, 2016. We treat €0.3 billion of this as "trapped cash" not available for immediate debt reduction.
- Undrawn RCF of €1.8 billion due in 2021, which is not subject to any financial covenants.
- Cash FFO of about €1.4 billion-€1.5 billion.

Principal liquidity uses include:

- Short-term debt of about €0.2 billion as of Sept. 30, 2016.
- Capital expenditure at about 4% of sales.
- Seasonal working capital outflows of €0.5 billion-€0.6 billion in the first half of the year, and inflows in the second half of the year, as in the past.
- Dividend payments (including to minority shareholders) of about €330 million-€350 million.
- Acquisition of BASF's Industrial Coatings business of €475 million. Additionally, we factor in discretionary small bolt-on acquisitions in 2016 and 2017.

Outlook

The stable outlook on Akzo reflects S&P Global Ratings' view that the company's cash flow generation will remain robust in 2017, leading to an adjusted FFO-to-debt ratio of about 70%-75%. This is well above our guidance of adjusted FFO to debt of 35%-40% for an 'A-' rating, and therefore we see significant headroom within the current rating.

Upside scenario

Potential for an upgrade is currently limited by Akzo's financial policy, which targets a strong 'BBB+' rating. Therefore, an upgrade would primarily depend on management's commitment to higher credit metrics, notably adjusted FFO to debt comfortably exceeding 40% through the cycle, as well as Akzo's continued sustainable positive FOCF generation.

Downside scenario

A downgrade is currently limited given substantial headroom within the rating for the company to pursue acquisitions or pay higher dividends. However, we could consider a downgrade if Akzo's adjusted FFO to debt declined below 35% without near-term prospects of recovery, for example due to a large debt-financed acquisition.

Ratings Score Snapshot

Corporate Credit Rating: A-/Stable/A-1

Business risk: Strong

- Country risk: Intermediate
- Industry risk: Low
- Competitive position: Strong

Financial risk: Minimal

- Cash flow/Leverage: Minimal

Anchor: aa-

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Negative (-2 notches)
- Liquidity: Exceptional (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Negative (-1 notch)

Related Criteria And Research

- General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Industrials: Key Credit Factors For The Specialty Chemicals Industry, Dec. 31, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General: Corporate Methodology, Nov. 19, 2013
- General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Legal Criteria: Guarantee Criteria--Structured Finance, May 7, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

Upgraded

	To	From
Akzo Nobel N.V.		
Corporate Credit Rating	A-/Stable/A-1	BBB+/Stable/A-2
Senior Unsecured	A-	BBB+
Commercial Paper	A-1	A-2
Akzo Nobel Sweden Finance AB (publ)		
Senior Unsecured*	A-	BBB+

*Guaranteed by Akzo Nobel N.V.

Additional Contact:

Industrial Ratings Europe; Corporate_Admin_London@spglobal.com

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global

Research Update: Akzo Nobel Rating Raised To 'A-' On Stronger Credit Metrics; Outlook Stable

Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

Copyright © 2016 by S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED, OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses, and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw, or suspend such acknowledgement at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal, or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription) and www.spcapitaliq.com (subscription) and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.