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Research Update:

Akzo Nobel Ratings Placed On CreditWatch Negative On Potential Corporate Actions

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Overview

- Since March 2017, Akzo Nobel has received three unsolicited offers from PPG to acquire all of its share capital and is currently continuing to discuss internally the third proposal.
- If Akzo remains independent, it intends to separate its paints and coatings and specialty chemicals businesses. This would be with a view to IPO, spin-off, or sale of specialty chemicals within approximately 12 months and return the majority of the net proceeds to shareholders.
- We are placing our 'A-' long-term rating on Akzo on CreditWatch negative to reflect the uncertainty around the policy choices currently available to Akzo regarding future ownership, leverage, and strategic direction of the company.
- We could lower the rating by one or two notches, ultimately reflecting our view on the resulting business and leverage of Akzo in the implemented scenario. We note the commitment of management to a strong 'BBB+' rating if Akzo were to remain independent.
- We aim to resolve the CreditWatch as soon as there is more clarity on the above issues.

Rating Action

On May 5, 2017, S&P Global Ratings placed its 'A-' long-term corporate credit rating on Netherlands-based manufacturer of paints, coatings, and speciality chemicals Akzo Nobel N.V. on CreditWatch with negative implications.

At the same time, we lowered our short-term corporate credit rating on Akzo to 'A-2' from 'A-1' reflecting our recently updated criteria mapping long-term and short-term ratings. (See "Methodology For Linking Long-Term And Short-Term Ratings" published on April 7, 2017 on RatingsDirect.)

We also placed our issue ratings on Akzo's revolving credit facility (RCF), euro medium-term note program, and senior unsecured debt on CreditWatch negative.

Rationale

Our rating actions reflect the uncertainty around the policy choices currently available to Akzo regarding future ownership, leverage, and strategic direction. These will depend on whether the company is acquired by PPG or remains independent.

Since March 2017, Akzo has received three unsolicited proposals from PPG to acquire all of its share capital. Of the proposals, two were rejected by management primarily due to valuation, regulatory risks, and potential job losses. Currently, Akzo is continuing to consider internally the third proposal from PPG valuing the company at $28.8 billion (€26.9 billion). If the offer is rejected there is a risk, in our view, that PPG could attempt a hostile takeover by June 1, 2017. We believe such an attempt would prolong the uncertainty around the ownership of Akzo as PPG would need to overcome a defence mechanism in a foundation with priority shares to block the hostile takeover. The rating of the combined group, if the deal is approved by the regulators, would likely be lower than 'A-', primarily reflecting higher leverage as a result of the transaction, and notwithstanding a stronger market position and synergies that would undoubtedly be derived from the merger of the two businesses.

Under the scenario where Akzo remains independent, it would implement its alternative strategy to accelerate value creation for shareholders as announced on April 19, 2017. The new strategy envisages the separation of the paints and coatings and specialty chemicals businesses, and the plan to sell the latter either by IPO, spin-off, or sale. According to the announcement, the sale could be conducted within 12 months, with Akzo returning the vast majority of net proceeds to its shareholders. In 2016, the specialty chemicals business accounted for approximately 40% of Akzo's EBITDA on a 20% margin, which is stronger than the rest of the group. According to management, the creation of two fully separate business units will allow for a more focused growth strategy, clearer customer focus, and additional cost efficiencies of about €200 million per year. These would allow Akzo to target an EBIT margin of 15% for paints and coatings and 16% for specialty chemicals by 2020. In our view, while Akzo has an extensive track record of restructuring, the new targets will require a thorough cost review in the organization, and for specialty chemicals business may be challenging to achieve given its already top-of-the-cycle margins.

If Akzo remained independent, our assessment of the legacy business would take into account not only its credit metrics, but also its smaller size and diversity after the disposal of specialty chemicals. We understand that management remains committed to ensuring that leverage (including pensions) is appropriate for a strong 'BBB+' rating. We also believe that the paints and coatings business will continue generating stable and strong cash flows more than sufficient to cover modest capital expenditure at about 3% of sales and dividends of about €0.3 billion (similar level to Akzo historically). In 2017, a special cash dividend of €1 billion will be paid to shareholders as advance proceeds from the sale of specialty chemicals.

CreditWatch

The CreditWatch placement captures the uncertainty around the policy choices currently available to Akzo regarding future ownership, leverage, and strategic direction of Akzo, depending on whether it becomes part of PPG or continues operations as an independent entity. We could lower the rating by one or two notches, ultimately reflecting our view on the resulting business and leverage of Akzo in the implemented scenario. We plan to resolve the CreditWatch placement as soon as there is more clarity on the above issues.

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Specialty Chemicals Industry, Dec. 31, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 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
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action; Downgraded

	To	From
Akzo Nobel N.V.		
Corporate Credit Rating	A-/Watch Neg/A-2	A-/Stable/A-1
Commercial Paper	A-2	A-1

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Akzo Nobel N.V.		
Senior Unsecured	A-/Watch Neg	A-
Akzo Nobel Sweden Finance AB (publ)		
Senior Unsecured*	A-/Watch Neg	A-

*Guaranteed by Akzo Nobel N.V.

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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 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.