

Tear Sheet:

Akzo Nobel N.V.

July 28, 2023

Akzo's rating headroom will remain very limited in the next 12-18 months due to elevated leverage, despite a gradual improving trend in credit metrics. Given stabilizing volumes, sustained price increases in first-half 2023, and expected ongoing raw materials price deflation, Akzo revised up its full-year guidance for 2023 to €1.40 billion-€1.55 billion from €1.20 billion-€1.50 billion. Accordingly, we expect S&P Global Ratings-adjusted EBITDA to increase to €1.35 billion-€1.45 billion in 2023 and further to €1.50 billion-€1.70 billion in 2024 from €1.11 billion in 2022. This will result in adjusted FFO to debt of 23%-27% for 2023, up to 28%-32% in 2024. This indicates very limited rating headroom compared to the 30%-45% range commensurate with the rating.

We expect to see stronger cash flow generation helped by a working capital normalization, supporting net debt reduction. Higher profits combined with Akzo's efforts to reduce inventory levels have led to free operating cash flow (FOCF) increasing by more than €400 million in the first half versus last year. We expect inventory to come down further with declining raw materials costs and Akzo's ongoing focus on improving working capital. As a result, we estimate a strong FOCF of €0.7 billion-€1.0 billion in 2023-2024, a rebound from about nil in 2022.

A prudent financial policy is key for maintaining the rating. We expect Akzo to focus on margin improvement and deleveraging through cost reduction and working capital optimization. We understand that management is committed to the current rating and is keen to reduce leverage toward 2x net debt to EBITDA (as reported by company), although this will occur beyond 2023. We factor into our rating a supportive financial policy, including capex, M&A, and shareholder remuneration, which will allow FFO to debt to gradually improve and remain sustainably above 30%.

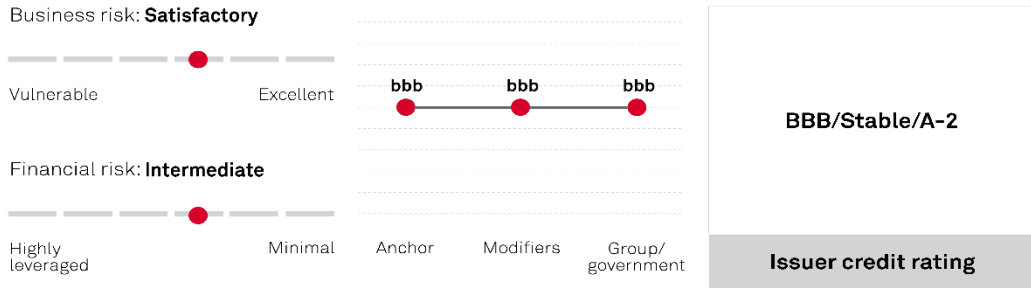
Ratings Score Snapshot

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Recent Research

- Industry Top Trends Update Europe: Chemicals, Jul. 18, 2023
- Tear Sheet: Akzo Nobel N.V., Mar. 1, 2023
- Dutch Paints And Coatings Producer Akzo Nobel N.V. Downgraded To 'BBB' From 'BBB+' On Elevated Leverage; Outlook Stable, Nov. 22, 2022

Company Description

Headquartered in the Netherlands, Akzo is a global leading producer of decorative paints (about 47% of group EBITDA in 2022) and performance coatings (about 53%). In 2022, it generated total sales of €10.85 billion and adjusted EBITDA of €1.10 billion. Akzo derives about 40% of its revenue from decorative paints, 20% from industrial coatings, 13% from powder coatings, 13% from auto and specialty coatings, and 13% from marine and protective coatings. The company has a global footprint with 46% of sales generated in EMEA in 2022, 16% in North Asia, 13% in South Asia Pacific, 13% in North America, and 12% in Latin America. Akzo is publicly listed with a market capitalization of about €13 billion as of late July 2023.

Outlook

The stable outlook reflects that, despite macroeconomic headwinds and weakening market demand, we expect Akzo to improve its EBITDA, profitability, and FOCF in 2023, with FFO to debt increasing toward 25% in the next 12 months and further to above 30% in the next 24 months. We consider FFO to debt of 30%-45% commensurate with the 'BBB' rating.

Downside scenario

We could lower the rating if Akzo fails to achieve effective price retention and improve its margin in the next 12-18 months, resulting in adjusted FFO to debt remaining below 30% without prospects of a swift recovery.

Upside scenario

We could raise the rating if Akzo increases its profitability and improves cash flow, strengthening its adjusted FFO to debt to above 45%. A prudent financial policy, including disciplined capex, mergers and acquisitions, and shareholder distributions, would support the

rebuilding of rating headroom. For an upgrade, we would be looking for a strong commitment from management to maintain FFO to debt comfortably above 45%, which is commensurate with a higher rating.

Key Metrics

Akzo Nobel N.V.--Forecast summary

Period ending	Dec-31-2021	Dec-31-2022	Dec-31-2023	Dec-31-2024
(Mil. EUR)	2021a	2022a	2023f	2024f
Revenue	9,587	10,846	10,500-11,000	11,000-11,500
Annual revenue growth (%)	12.4	13.1	(1.5)-1.5	3.5-4.5
EBITDA	1,468	1,106	1,350-1,450	1,500-1,700
EBITDA margin (%)	15.3	10.2	~13.0	~14.0
Funds from operations (FFO)	1,169	804	950-1,100	1,000-1,200
Interest expense	74	106	160-175	170-185
Capital expenditure (capex)	288	292	290-300	300-310
Free operating cash flow (FOCF)	332	(1)	800-1,000	700-950
Dividends	391	379	340-360	360-380
Share repurchases (reported)	1,135	669	--	--
Debt	2,373	4,100	4,100-4,200	3,800-4,000
Adjusted ratios				
Debt/EBITDA (x)	1.6	3.7	~3.0	~2.5
FFO/debt (%)	49.3	19.6	23-27	28-32
FFO cash interest coverage (x)	16.2	11.3	6.0-7.0	6.5-7.5
FOCF/debt (%)	14.0	(0.0)	19-24	18-23

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

Financial Summary

Akzo Nobel N.V.--Financial Summary

Period ending	Dec-31-2017	Dec-31-2018	Dec-31-2019	Dec-31-2020	Dec-31-2021	Dec-31-2022
Reporting period	2017a	2018a	2019a	2020a	2021a	2022a
Display currency (mil.)	EUR	EUR	EUR	EUR	EUR	EUR
Revenues	9,612	9,256	9,276	8,530	9,587	10,846
EBITDA	1,265	1,047	1,219	1,359	1,468	1,106
Funds from operations (FFO)	810	771	969	1,147	1,169	804
Interest expense	142	114	76	66	74	106

Akzo Nobel N.V.--Financial Summary

Cash interest paid	117	111	66	47	77	78
Operating cash flow (OCF)	414	306	46	1,245	620	291
Capital expenditure	257	160	214	258	288	292
Free operating cash flow (FOCF)	157	146	(168)	987	332	(1)
Discretionary cash flow (DCF)	(1,190)	(490)	(4,134)	47	(1,194)	(1,049)
Cash and short-term investments	1,322	8,251	1,388	1,842	1,196	1,775
Gross available cash	1,322	8,251	1,388	1,842	1,196	1,775
Debt	2,893	0	843	1,048	2,373	4,100
Common equity	6,307	12,038	6,568	5,950	5,636	4,548
Adjusted ratios						
EBITDA margin (%)	13.2	11.3	13.1	15.9	15.3	10.2
Return on capital (%)	9.1	6.8	9.0	14.0	15.1	8.9
EBITDA interest coverage (x)	8.9	9.2	16.0	20.6	19.8	10.4
FFO cash interest coverage (x)	7.9	7.9	15.7	25.4	16.2	11.3
Debt/EBITDA (x)	2.3	0.0	0.7	0.8	1.6	3.7
FFO/debt (%)	28.0	NM	114.9	109.4	49.3	19.6
OCF/debt (%)	14.3	NM	5.5	118.8	26.1	7.1
FOCF/debt (%)	5.4	NM	(19.9)	94.2	14.0	(0.0)
DCF/debt (%)	(41.1)	NM	(490.1)	4.5	(50.3)	(25.6)

Peer Comparison**Akzo Nobel N.V.--Peer Comparisons**

	Akzo Nobel N.V.	PPG Industries Inc.	Sherwin-Williams Co.	Axalta Coating Systems Ltd.
Foreign currency issuer credit rating	BBB/Stable/A-2	BBB+/Negative/A-2	BBB/Stable/A-2	BB/Stable/--
Local currency issuer credit rating	BBB/Stable/A-2	BBB+/Negative/A-2	BBB/Stable/A-2	BB/Stable/--
Period	Annual	Annual	Annual	Annual
Period ending	2022-12-31	2022-12-31	2022-12-31	2022-12-31
Mil.	EUR	EUR	EUR	EUR
Revenue	10,846	16,517	20,724	4,570
EBITDA	1,106	2,380	3,911	730
Funds from operations (FFO)	804	1,791	2,962	531
Interest	106	177	425	138
Cash interest paid	78	167	406	140
Operating cash flow (OCF)	291	1,123	2,203	303
Capital expenditure	292	485	603	139
Free operating cash flow (FOCF)	(1)	638	1,600	165

Akzo Nobel N.V.--Peer Comparisons

Discretionary cash flow (DCF)	(1,049)	(73)	195	(23)
Cash and short-term investments	1,775	1,080	186	604
Gross available cash	1,775	1,080	186	604
Debt	4,100	6,987	11,840	3,111
Equity	4,548	6,277	2,903	1,403
EBITDA margin (%)	10.2	14.4	18.9	16.0
Return on capital (%)	8.9	12.3	20.4	9.0
EBITDA interest coverage (x)	10.4	13.4	9.2	5.3
FFO cash interest coverage (x)	11.3	11.7	8.3	4.8
Debt/EBITDA (x)	3.7	2.9	3.0	4.3
FFO/debt (%)	19.6	25.6	25.0	17.1
OCF/debt (%)	7.1	16.1	18.6	9.7
FOCF/debt (%)	(0.0)	9.1	13.5	5.3
DCF/debt (%)	(25.6)	(1.0)	1.6	(0.7)

Environmental, Social, And Governance

ESG Credit Indicators



ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumeric 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicator Definitions And Applications," published Oct. 13, 2021.

ESG factors have an overall neutral influence on our credit rating analysis of Akzo. As a leading specialty chemicals producer focusing on paints and coatings, it has lower energy intensity and greenhouse gas emissions compared to the industry average. It reduced its combined scope 1 and 2 emissions by 28% in 2022 versus the 2018 baseline. It aims to achieve a 50% reduction by 2030 through increasing its share of renewable electricity to 100% and reducing energy consumption by 30%. In 2022, about 45% of its electricity needs was met by renewables, and in Europe and North America it achieved 100% renewables usages in early 2022 and 2023, respectively. The company is also developing more-sustainable products. Its sustainable solutions have better environmental characteristics than mainstream offerings and accounted for more than 40% of sales in 2022, which Akzo aims to increase to more than 50% by 2030. Akzo is the first paints and coatings company to receive approval from the Science Based Targets initiative for its carbon reduction target including scope 3--a 50% reduction in carbon emissions in the full value chain by 2030 compared with 2018.

Rating Component Scores

Foreign currency issuer credit rating	BBB/Stable/A-2
Local currency issuer credit rating	BBB/Stable/A-2
Business risk	Satisfactory
Country risk	Intermediate
Industry risk	Low
Competitive position	Satisfactory
Financial risk	Intermediate
Cash flow/leverage	Intermediate
Anchor	bbb
Diversification/portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Satisfactory (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile	bbb

Related Criteria

- 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
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

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