

Akzo Nobel N.V.

Primary Credit Analyst:

Sophia Dedemadis, London (44) 20-7176-7013; sophia_dedemadis@standardandpoors.com

Secondary Credit Analyst:

Karl Nietvelt, Paris (33) 1-4420-6751; karl_nietvelt@standardandpoors.com

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Akzo Nobel N.V.

Major Rating Factors

Strengths:

- Track record of a healthy balance sheet and strong liquidity.
- The world's largest producer of paints, carrying leading brand names with significantly lower cyclicalities than other chemicals businesses.
- Sizable, well-diversified worldwide operations by country and market, including in higher-growth emerging and Asian markets.

Weaknesses:

- Strong correlation of growth to GDP, resulting in deterioration of operating results during periods of slow or declining economic growth.
- Cyclical demand for specialty chemicals products.
- Potential for margin squeeze from both raw material costs and pricing pressure from end markets.

Corporate Credit Rating

BBB+/Stable/A-2

Rationale

The ratings on The Netherlands-based coatings and chemicals producer Akzo Nobel N.V. reflect what Standard & Poor's Ratings Services views as the company's "strong" business risk profile and "intermediate" financial risk profile.

Akzo Nobel's strong business benefits from a favorable business position and significantly lower cyclicalities, relative to other chemicals companies. It enjoys a worldwide leading position in performance coatings and decorative paints, strong regional diversification, relatively low capital intensity, and a portfolio of major brands. Demand in the paints and coatings industry has historically increased broadly in line with GDP. Based on our global economic assumptions and the company's revenue profile, we believe annual revenue growth will likely average around 3.5% over the next two years. Relative weaknesses, however, are some exposure to a softening in general economic conditions and to volatile and rising input costs that the company may be unable to fully pass on to customers--thus constraining profitability. Despite still challenging market conditions given pricing and margin pressure, volumes improved during the first half of the year and appear to have stabilized.

The ratings are constrained by the company's intermediate financial risk profile. We view the company's historical credit metrics as only average, affected by its sizable postretirement benefit obligations and the strongly increased pension deficit in 2009, as well as by past generous shareholder policies. On the other hand, we believe Akzo Nobel's generation of funds from operations (FFO) will show measured but sustained improvement in 2010, with a commensurate strengthening in credit protection ratios. Also, Akzo Nobel has "strong" liquidity, in our view. The expected \$1.3 billion cash proceeds from the disposal of the National Starch division, and the transfer of about \$120 million in pension obligations to the buyer, will likely further enhance the company's liquidity profile and balance sheet. In this respect, we have assumed that Akzo Nobel will use most of the funds in a credit-friendly way, including repayment of upcoming debt maturities.

Key business and profitability developments

For the second quarter of 2010, Akzo Nobel reported revenues of €3.9 billion. The company continued to show improvement in demand with volumes increasing 8% compared with the same period last year. The performance coatings and specialty chemicals segments made key volume gains, posting improvements of 12% and 15%, respectively. Pricing for the group declined 2%, however, but mainly as a result of product mix changes in decorative paints and performance coatings. For example, in Latin America, Akzo Nobel is moving into lower tier product ranges from premium brands. In mature markets, prices increased in line with inflation, at approximately 2%-3%. Finally, Akzo Nobel's reported operating margin of 14.2% like for like was 2% higher than the same period last year due to efficiency and cost cutting gains, and despite the fact that the company was not able to pass on all raw material costs. We assume that raw material costs will increase overall during 2010 by around 5% on 2009 levels.

Key cash flow and capital-structure developments

For the rolling 12 months ended June 30, 2010, Akzo Nobel generated adjusted FFO of €1.2 billion. Working capital outflows stood at €287 million in the first half of 2010. Akzo Nobel's management is looking to achieve further working capital efficiencies in 2010, with staff remuneration tied to working capital targets. However, we believe this may be challenging as inventory levels stand to increase during the year, in part due to rising costs and some modest build up.

Liquidity

The 'A-2' short-term rating reflects our view of the company's "strong" liquidity profile.

On June 30, 2010, Akzo Nobel reported €1.7 billion in on-balance-sheet cash and cash equivalents versus €448 million in short-term debt due in 2010. Reported long-term debt on the same date was €3.6 billion.

Akzo Nobel has €1.5 billion in credit facilities maturing in 2013 that are not subject to any financial covenants and were reported as undrawn at June 30, 2010. Liquidity is further supported by about \$1.3 billion from the pending sale of National Starch, which is expected to close in second-half 2010.

We assume the company will remain free cash flow positive over the next few years, after about €600 million-€650 million in capital expenditures annually and dividend payments of below €400 million. We anticipate, however, that Akzo Nobel will not engage in share buybacks in 2010. We also assume that the company will continue making small bolt-on acquisitions of about €250 million. We do not factor any large-scale acquisitions into our analysis.

Akzo Nobel also has a euro-denominated commercial paper (CP) program totaling €1.5 billion and a U.S. dollar-denominated CP program totaling \$1.0 billion. Both facilities are currently undrawn.

Outlook

The stable outlook reflects our view that Akzo Nobel's credit metrics will likely improve this year as a result of stronger operating performance and FFO generation. We have assumed that adjusted net debt will reduce by year-end 2010, because of the National Starch disposal proceeds expected later this year. We have not factored any material acquisitions or shareholder distributions into our rating assumptions. We consider a level of FFO to debt of above 30%--while the company remains free cash flow positive--to be consistent with the ratings.

If global economic conditions deteriorate materially, or if the company uses projected large cash balances over the

coming years for major acquisitions or shareholder distributions, we might lower the ratings.

We do not see any major ratings upside at this time, given the company's intermediate financial risk profile and the tepid global economic recovery.

Business Description

Akzo Nobel is the leading global manufacturer of decorative paints and coatings, and produces specialty chemicals. Its current business portfolio results from the major transformation process that began in 2007 when the company divested its pharmaceuticals division. It used the proceeds to acquire ICI in January 2008 for approximately £8 billion, and subsequently disposed of ICI's adhesives and electronic materials business to Henkel AG & Co. KGaA (A-/Stable/A-2) for approximately €3.6 billion. The recently announced National Starch disposal is the last major transaction completing the transformation process.

The company is now organized into three operating divisions: Decorative Paints, Performance Coatings, and Specialty Chemicals (see charts 1 and 2). For the six months ended June 30, 2010, Akzo Nobel's reported revenues and EBITDA were €7.1 billion and €1 billion, respectively.

Chart 1

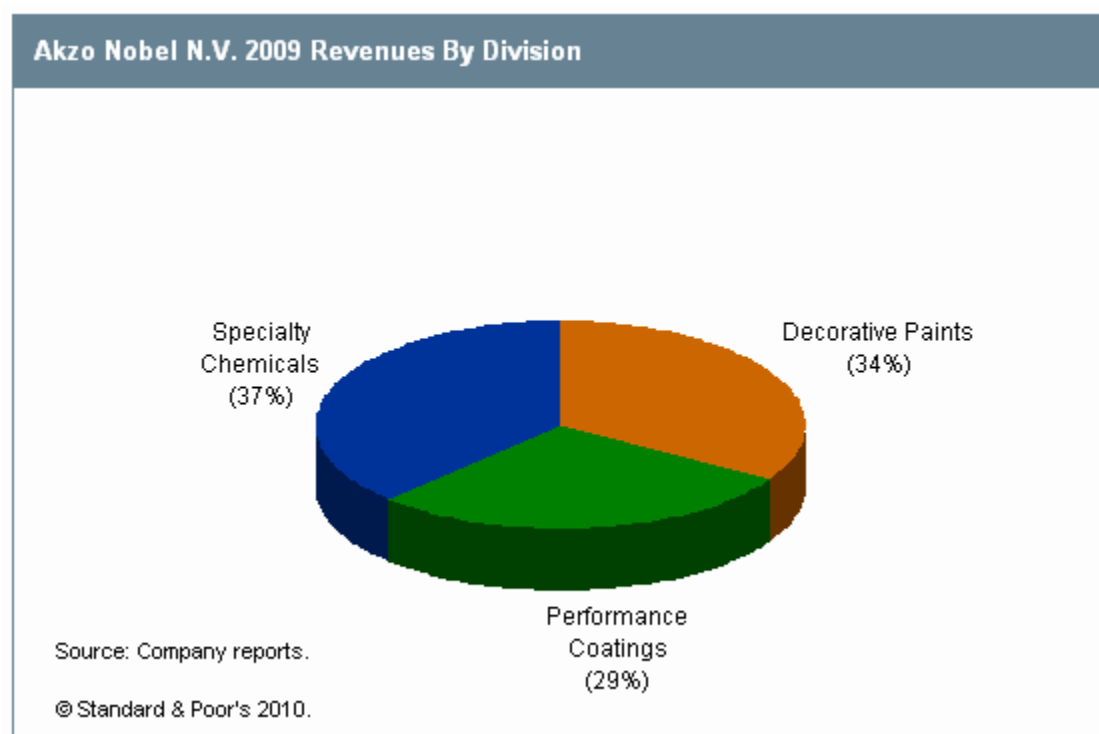
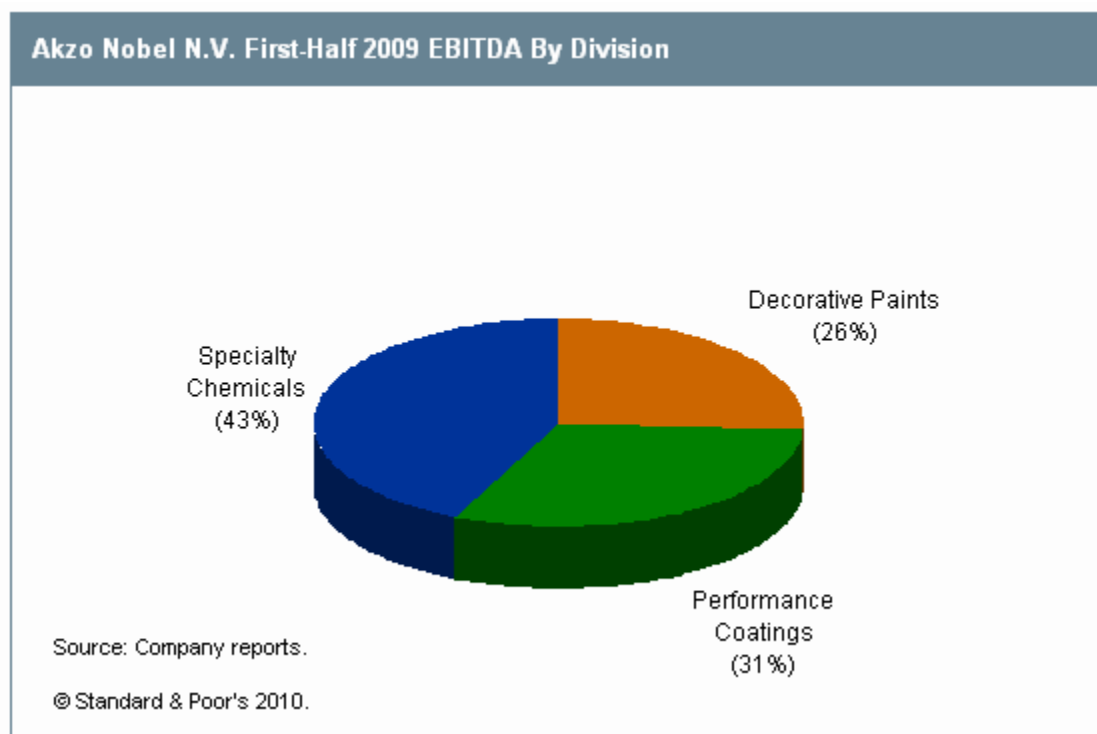


Chart 2



Business Risk Profile: Benefits From Leading Market Positions With Global Diversification

The major supports of Akzo Nobel's business risk profile, which we view as "strong," are:

- The company holds a leading position in many of its end markets and good geographic diversification (see chart 3 below). Nevertheless, Akzo Nobel's geographic diversity means that it is exposed to currency fluctuations that can have a negative impact on results. However, the company's asset base is also well diversified.
- Akzo Nobel has lower capital intensity and is less cyclical than most companies in the chemicals industry. For instance, maintenance and repair work, which represents an estimated 80% of overall demand in the decorative paints industry, is historically counter-cyclical. The recent economic crisis in the U.S. was a notable exception to this trend.
- Raw materials--which are volatile and can increase significantly in price--only account for approximately 50% of input costs. This compares with commodity chemical companies, where raw materials can account for about 80% of the cost of goods sold.
- Long-term growth prospects for Akzo Nobel's businesses are strong. The company is well positioned in high-growth regions such as Asia-Pacific, where annual spend per household on paints and coatings is expected to increase at a much higher rate than in mature markets.

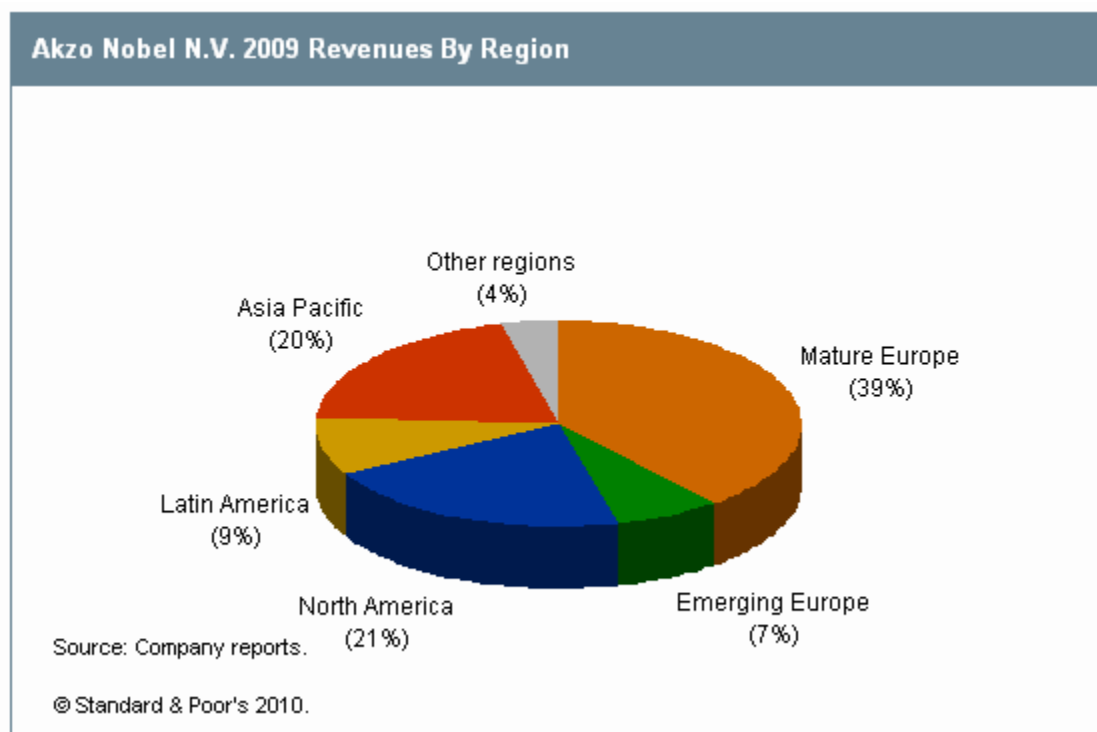
These supports are partially offset by the following:

- Akzo Nobel's growth is strongly correlated to global economic growth. This results in a weakening of the

company's operating performance during slow or recessionary economic environments.

- The company's profitability over the past few years, which has been lower than for peers, both in terms of adjusted return on capital and EBITDA margins. We note that due to the efficiency programs the company launched in late 2008, EBITDA margins have shown improvement over the past few quarters.
- The specialty chemicals segment is sensitive to supply capacity developments.

Chart 3



Financial Risk Profile: Support From A Healthy Balance Sheet And Strong Liquidity

The main strengths of the company's financial risk profile, which we consider as "intermediate," are:

- Akzo Nobel's financial policy is generally conservative in terms of preserving balance-sheet strength, as the way the company acquired ICI in 2008 shows.
- The company's capital structure remains solid, notwithstanding it executed a major acquisition in 2008. Fully adjusted debt to EBITDA leverage has averaged around 2.5x since 2003.
- Akzo Nobel has maintained healthy liquidity as it has been successful in securing financing with a well-staggered debt maturity profile.

These strengths are moderated by the following:

- The recent recession has had a negative impact on Akzo Nobel's operating results in most of its markets.
- The company's shareholder-friendly policy has included material share buyback programs in recent years. However, in 2009 it cancelled the last share buyback program prior to completion in order to preserve liquidity.

The average dividend pay-out rate over the past five years has been around 40%. In what proved to be a challenging 2009, the company also paid out a significant €454 million in parent and minority dividends.

Financial Statistics/Adjustments

Akzo Nobel prepares its accounts under International Financial Reporting Standards (IFRS). Standard & Poor's adjustments are primarily for:

- A tax-effected pension deficit of €1.8 billion (after applying an estimated tax rate of 20%). This represents a €1 billion increase from 2008 primarily due to adjustments arising from higher inflation and a lower discount rate.
- Operating lease liabilities of €487 million.
- Estimated surplus cash of €1.7 billion, which we net from debt because we understand that the company doesn't intend to use it for major acquisitions or share buybacks. This corresponds to reported cash of €2.1 billion on Dec. 31, 2009, less €400 million for funds that we view as tied to operations.

Other adjustments include €319 million for one-off incidentals, restructuring charges, transformation costs, and results on divestment. Of these adjustments for one-off charges, we added back €250 million to FFO for an EU antitrust fine and cash payments for ICI related restructuring.

Related Criteria And Research

- Principles Of Corporate And Government Ratings, June 26, 2007
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- Methodology And Assumptions: Standard & Poor's Standardizes Liquidity Descriptors For Global Corporate Issuers, July 2, 2010
- Key Credit Factors: Business and Financial Risks In The Commodity And Specialty Chemical Industry, Nov. 20, 2008

Table 1

Reconciliation Of Akzo Nobel N.V. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. €)*									
--Fiscal year ended Dec. 31, 2009--									
Akzo Nobel N.V. reported amounts									
	Debt	Shareholders' equity	Operating income (before D&A)	Operating income (before D&A)	Operating income (after D&A)	Interest expense	Cash flow from operations	Cash flow from operations	Capital expenditures
Reported	3,872.0	7,775.0	1,550.0	1,550.0	870.0	285.0	1,240.0	1,240.0	534.0
Standard & Poor's adjustments									
Operating leases	487.1	--	167.5	30.8	30.8	30.8	136.7	136.7	163.6
Postretirement benefit obligations	1,809.0	(774.8)	(26.0)	(26.0)	(26.0)	174.0	163.9	163.9	--
Additional items included in debt	12.0	--	--	--	--	--	--	--	--
Surplus cash and near cash investments	(1,728.0)	--	--	--	--	--	--	--	--

Table 1

Reconciliation Of Akzo Nobel N.V. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. €)* (cont.)									
Capitalized interest	--	--	--	--	--	6.0	(6.0)	(6.0)	(6.0)
Share-based compensation expense	--	--	--	23.0	--	--	--	--	--
Reclassification of nonoperating income (expenses)	--	--	--	--	65.0	--	--	--	--
Reclassification of interest, dividend, and tax cash flows	--	--	--	--	--	--	70.0	70.0	--
Reclassification of working-capital cash flow changes	--	--	--	--	--	--	--	(639.0)	--
Minority interests	--	470.0	--	--	--	--	--	--	--
Other	--	--	319.0	319.0	319.0	--	250.0	250.0	--
Total adjustments	580.1	(304.8)	460.5	346.8	388.8	210.8	614.6	(24.4)	157.6

Standard & Poor's adjusted amounts

	Debt	Equity	Operating income (before D&A)	EBITDA	EBIT	Interest expense	Cash flow from operations	Funds from operations	Capital expenditures
Adjusted	4,452.1	7,470.2	2,010.5	1,896.8	1,258.8	495.8	1,854.6	1,215.6	691.6

*Please note that two reported amounts (operating income before D&A and cash flow from operations) are used to derive more than one Standard & Poor's-adjusted amount (operating income before D&A and EBITDA, and cash flow from operations and funds from operations, respectively). Consequently, the first section in some tables may feature duplicate descriptions and amounts. D&A--Depreciation and amortization.

Table 2

Akzo Nobel N.V. Peer Comparison*						
Industry Sector: Chemical companies						
	Akzo Nobel N.V.¶	PPG Industries Inc.	Sherwin-Williams Co.	Dow Chemical Co. (The)	DuPont (E.I.) De Nemours & Co.¶	
Rating as of Aug. 27, 2010	BBB+/Stable/A-2	BBB+/Stable/A-2	A-/Positive/A-2	BBB-/Positive/A-3	A/Stable/A-1	
(Mil. \$)	--Fiscal year ended Dec. 31, 2009--					
Revenues	19,932.3	12,284.0	7,094.2	44,875.0	27,268.0	
EBITDA	2,720.7	1,710.8	990.8	4,666.4	4,501.3	
Operating income (before D&A)	2,881.1	1,776.5	1,149.3	4,680.5	4,617.5	
Operating income (after D&A)	1,712.1	1,196.8	796.6	1,710.4	2,883.3	
Net income from continuing operations	398.8	336.0	435.8	538.0	1,755.0	
Funds from operations (FFO)	1,741.3	1,341.9	892.9	2,283.6	4,540.3	
Cash flow from operations	2,658.1	1,674.9	1,039.5	2,196.6	5,339.3	
Capital expenditures	1,008.1	372.9	387.6	2,063.5	1,352.8	
Free operating cash flow	1,650.0	1,302.0	651.9	133.1	3,986.5	

Table 2

Akzo Nobel N.V. Peer Comparison* (cont.)					
Cash and short-term investments	573.9	1,057.0	69.3	2,846.0	1,000.0
Debt	6,387.4	5,883.5	1,866.9	31,353.6	13,404.7
Equity	10,717.5	4,067.6	1,653.7	19,655.7	8,051.4
Debt and equity	17,105.0	9,951.1	3,520.7	51,009.3	21,456.1
Adjusted ratios					
EBITDA/revenues (%)	13.6	13.9	14.0	10.4	16.5
Operating income (before D&A)/revenues (%)	14.5	14.5	16.2	10.4	16.9
EBIT interest coverage (x)	2.5	3.9	9.7	1.4	6.0
EBITDA interest coverage (x)	3.8	5.5	12.4	2.6	9.1
Return on capital (%)	10.1	11.8	21.8	6.0	13.4
FFO/debt (%)	27.3	22.8	47.8	7.3	33.9
Debt/EBITDA (x)	2.3	3.4	1.9	6.7	3.0
Total debt/debt plus equity (%)	37.3	59.1	53.0	61.5	62.5

*Fully adjusted (including postretirement obligations). †Excess cash and investments netted against debt. D&A--Depreciation and amortization.

Table 3

Akzo Nobel N.V. Financial Summary*					
Industry Sector: Chemical companies					
--Fiscal year ended Dec. 31--					
	2009	2008	2007	2006	2005
Rating history	BBB+/Negative/A-2	A-/Negative/A-2	A-/Stable/A-2	A-/Stable/A-2	A-/Stable/A-2
(Mil. €)					
Revenues	13,893.0	15,415.0	10,217.0	10,023.0	13,000.0
EBITDA	1,896.8	1,894.7	1,410.8	1,180.0	1,748.9
Operating income (before D&A)	2,010.5	1,993.0	1,532.5	1,365.0	1,913.0
Operating income (after D&A)	1,193.8	1,262.7	1,023.8	764.0	1,167.9
Net income from continuing operations	278.0	(1,109.0)	410.0	715.0	961.0
Funds from operations (FFO)	1,215.6	1,122.7	1,035.5	795.8	1,412.8
Cash flow from operations	1,854.6	766.7	1,108.5	980.8	1,164.8
Capital expenditures	691.6	751.2	358.0	509.8	904.7
Free operating cash flow	1,163.0	15.4	750.5	471.0	260.1
Cash and short-term investments	400.0	400.0	11,200.0	200.0	200.0
Debt	4,452.1	3,941.2	4,802.3	3,673.1	4,666.3
Equity	7,470.2	7,954.0	11,113.4	4,106.7	3,336.6
Debt and equity	11,922.3	11,895.2	15,915.6	7,779.8	8,002.9
Adjusted ratios					
EBITDA/revenues (%)	13.7	12.3	13.8	11.8	13.5
Operating income (before D&A)/revenues (%)	14.5	12.9	15.0	13.6	14.7
EBIT interest coverage (x)	2.5	3.5	3.3	3.1	5.2
EBITDA interest coverage (x)	3.8	4.6	4.0	3.8	7.5
Return on capital (%)	10.0	10.1	9.7	12.1	16.3

Table 3

Akzo Nobel N.V. Financial Summary* (cont.)					
FFO/debt (%)	27.3	28.5	21.6	21.7	30.3
Debt/EBITDA (x)	2.3	2.1	3.4	3.1	2.7

*Fully adjusted (including postretirement obligations). Excess cash and investments netted against debt. D&A--Depreciation and amortization.

Ratings Detail (As Of August 27, 2010)*	
Akzo Nobel N.V.	
Corporate Credit Rating	BBB+/Stable/A-2
Commercial Paper	A-2
Senior Unsecured (3 Issues)	BBB+
Corporate Credit Ratings History	
13-Aug-2010	BBB+/Stable/A-2
25-Feb-2009	BBB+/Negative/A-2
29-Aug-2008	A-/Negative/A-2
Business Risk Profile	Strong
Financial Risk Profile	Intermediate
Debt Maturities	
On Dec. 31, 2009	
2010: €384 mil.	
2011: €533 mil.	
2013: €347 mil.	
2014: €993 mil.	
Thereafter: €1.403 bil.	
Related Entities	
Akzo Nobel Sweden Finance AB (PUBL)	
Senior Unsecured (2 Issues)	BBB+
Imperial Chemical Industries Ltd.	
Issuer Credit Rating	BBB+/Stable/A-2
Senior Unsecured (2 Issues)	BBB+

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

Additional Contact:

Industrial Ratings Europe; CorporateFinanceEurope@standardandpoors.com

Additional Contact:

Industrial Ratings Europe; CorporateFinanceEurope@standardandpoors.com

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