Tweedy,
Browne
Company LLC

Tel 203.703.0600
Fax 203.703.0749
www.tweedy.com

One Station Place Stamford, CT 06902

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Mr. Antony Burgmans
Chairman of the Supervisory Board
AkzoNobel
Christian Neefestraat 2
1077 WW Amsterdam
NETHERLANDS

Dear Mr. Burgmans,

Tweedy, Browne has owned shares in Akzo Nobel since 1992, and we think we brought patience and a long-term perspective to our investment. Being shareholders for 25 years has unfortunately not been a fruitful experience and our patience is wearing thin. In our calculations, the growth of the value of each Akzo Nobel share hardly held up with inflation. The reason to stay invested was continuous undervaluation; holding on was both rational and disappointing. Had we bought "reasonably priced" PPG shares instead of "cheap" Akzo Nobel shares in 1992, the people who have entrusted their savings and pensions to us would today have 50% more money.

In our view, if all was well at Akzo Nobel, there would be no need for archaic anti-takeover measures and the stonewalling of shareholders by management. There would be no panicked politicians contemplating emergency intervention. Underlying revenue growth at the company would be considerably higher than the compound 1.3% in the last 10 years and margins in the paints and coatings businesses would be 2-3 percentage points higher. Akzo Nobel shares would trade at EUR 95-100 on their own steam. The company would put the position of the Chairman of the Board up for the vote of its own volition every year. At the recent shareholders' meeting, 1/4 of the shareholders would have not voted against the discharge of management and board, nor would 1/3 of the shareholders have voted against the company's ability to issue shares. This is a pyrrhic victory at best for management and reflects that there is a crisis of confidence in the shareholder base. Management would not be defensive and feel obliged to give answers that are free of content when shareholders ask important questions. In this situation, a takeover approach by PPG would be inconceivable; there would be nothing to gain.

Alas; that is not the situation and all is not well. Is the damage self-inflicted? Do barbarians only show up at the gates of weak castles? It certainly looks like it. It took the PPG approach to raise Akzo Nobel's share price; nothing more and nothing less. PPG's overture is possible only because the house is not in order. The reaction of shareholders to management's new strategic plan is subdued because there is no faith. It seems there is only one explanation for the fact that the share trades at EUR 80 while there is a buyer willing to pay EUR 99 cum dividend: the stock market puts the agency cost of management at more than EUR 4 bln.

Progress in the long-term value of each Akzo Nobel share was meager because the company had relatively low margins, low real growth and poor discipline around investment decisions. Going by the reported numbers, the company sells roughly 5% percent less coatings and paints today than 10 years ago. Furthermore, the prices paid for acquisitions over the years were high. All of this was unpleasant for shareholders and detrimental to employment. Since 2006, the total number of employees has fallen by 25%, from 62,000 to 46,000. Businesses bought and sold will of course distort this number – we have no way to adjust – but the conclusion remains that there has been a drastic fall in employment. When compared to the employment history at PPG, Akzo Nobel's record looks even less palatable. PPG's headcount increased from 32,000 to 47,000 over the period; a 46% increase. Which company is better at creating and protecting jobs? A priori, PPG seems the safer bet. If past is prelude, both employees and shareholders of Akzo Nobel should be anxious about quickly dismissing PPG's overture.

Enthusiasm about the future does not repudiate bad economics. Over the years there has been a succession of management teams for whom running Akzo Nobel was simply the next job in a career encompassing numerous stops in any number of companies and sectors along the way. They dutifully and loudly prayed at the altars of "shareholder value" and "growth", but the results unfortunately didn't follow. Real progress beats talk on every occasion. The people who run PPG have been working at the company for decades and they have driven value per share by 6-7% per year for many years in a row. It is not a pleasant conclusion, but PPG is simply in a different league.

Akzo Nobel was certainly not deal shy over the years. It was able to buy Nobel, Courtaulds, ICI and some other businesses. We must assume that the managements of all those companies were thinking about all stakeholders when they decided to engage with Akzo Nobel. They weighed the pluses and minuses of a transaction and got as much information as they could before making up their minds. At the moment, however, Akzo Nobel resists what potentially could be in the interest of employees and shareholders. Dutch companies like Numico, Wolters Kluwer, Unilever, Reed Elsevier and Ahold have a rich (and sometimes checkered) history of buying companies abroad. Why is the reverse problematic? Is this the (in)famous and self-defined "level playing field"? Or is this asymmetrical capitalism in the fashion of Orwell, where different rules apply to different players? Is buying more acceptable than being bought?

According to the annual report, 93% of Akzo Nobel shares are held outside the Netherlands. This represents a value of about EUR 18.5 bln. Some 48% of these shares are held in North America. Dutch investors own the remaining 7% of the shares, totaling a EUR 1.5 billion investment. It is something to think about in a global world; a foreign company is attempting to acquire a Dutch company with a shareholder base that is overwhelmingly foreign. Shouldn't the owners of the business, foreign or otherwise, have a voice in the direction of the company and not simply be held hostage to the desires of the management? Are they all sharks, or, alternatively, naïve fools who are to remain silent as they risk their billions?

All of this should have high urgency to you. Does “Dutch corporate governance” mean that the people in charge always know better? We might as well be honest and propose to bring to a vote the idea that any reference to corporate governance be removed from the annual report as the last few weeks seem to indicate it is all a hoax anyway. If we’re lucky, management will agree and we’ll actually get to vote. Should the Dutch government step up to the plate and make foreign ownership of its securities illegal, or should Dutch companies like Akzo Nobel be able to continue to court foreign investors as long as they are “well behaved”? It is disconcerting to think about the signals all of this gives to any investor thinking about buying shares in the Netherlands and it makes a rational capital allocator want to scratch his head and think twice next time. Does one own a fraction of a business or an option on the possibility of less brazen behavior by the company and country’s government in the future? If the shareholders aren’t the owners, then who are they?

One of the basic functions of free capital markets is to provide a system of checks and balances in order to make sure that economic outcomes are maximized for the benefit of everyone. This adds the element of risk to highly paid jobs. It is supposed to stimulate entrepreneurial rather than administrative behavior. In this system, choices have consequences; the bell can toll, but it generally doesn’t toll for the best stewards of all stakeholders’ long-term interests. So why is it tolling now? There is no doubt that there is a lot of wildness, abuse and rough outcomes in American style capitalism and that it sometimes has nasty predatory elements; but the price to pay for the absence of this corrective mechanism while management kicks the can down the road in the name of stakeholder interests, is much more devastating. It means fewer jobs, less tax revenue, less growth and lower returns on financial assets. It is a bulletproof way to decrease economic dynamism and create disappointed and skeptical shareholders. Who wants to invest pension money in an environment like that? Who wants to be a pensioner?

There are no valid reasons left for Akzo Nobel to not at least talk to PPG. It owes no less to everybody involved. The decision not to proceed can still be made but it would of course require transparency and a detailed explanation rather than qualitative smoke and mirrors. Akzo Nobel's management should do just as the management of ICI, Courtaulds and Nobel did before them; honestly consider and negotiate. In doing so, those companies fulfilled their capitalist as well as their fiduciary duty and kept the interest of all parties involved in mind. This is what the owners of the company paid them for. PPG can cut non-labor costs while maintaining or growing employment much more easily than Akzo Nobel. If management goals for the next couple of years mean anything, many jobs will have to go in the stand-alone scenario. It makes no sense to be in denial about this. A transaction is also likely to create better opportunities for shareholders, as a step up in value creation for the combined group seems more likely than not. Akzo Nobel’s board and management should engage with PPG for the benefit of all constituencies.

Sincerely,

Roger de Bree
Partner and Investment Committee member

cc: Ben Verwaayen, Byron Grote (Deputy Chairman), Dick Sluimers, Louis Hughes, Dr. Pamela Kirby, Peggy Bruzelius, Sari Baldauf