S&P Global
Ratings

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Koninklijke Philips N.V.

Primary Credit Analyst:
Tuomas E Ekholm, CFA, Frankfurt + 49 693 399 9123; tuomas.ekholm@spglobal.com

Secondary Contact:
Remi Bringuier, Paris + 33 14 420 6796; remi.bringuier@spglobal.com

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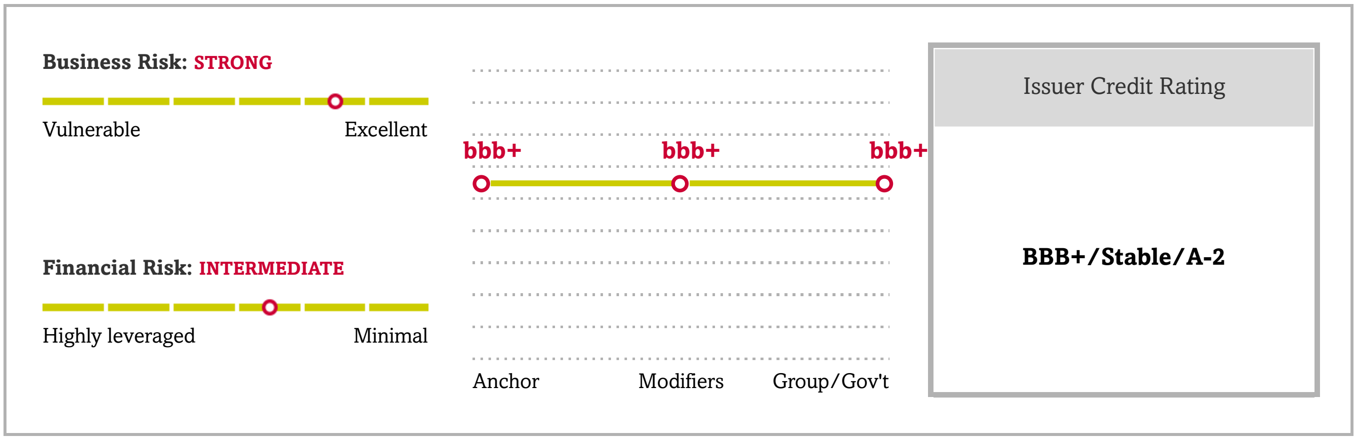
Koninklijke Philips N.V.



Credit Highlights

Overview

Key strengths	Key risks
Well-diversified offering with leadership positions in key categories, such as image-guided therapy, patient monitoring, and digitalized health care solutions and services.	Highly competitive market, where scale and leading positions are key for driving productivity and margin growth.
Operating in the health technology market, which continues to grow at about 5% per year, with rising underlying demand, although some pricing pressure.	Continuing quality issues related to respiratory care products could lead to further recall program related costs or fines, and negatively affect operating and financial performance beyond 2021.
Highly innovative portfolio--with strong capabilities in digital, artificial intelligence (AI), and informatics--supports strong brand recognition.	National protective policies could constrain free movement in goods and lead to continuing scarcity and higher prices for key materials and components.
Strong cash flow generation and disciplined capital allocation policy should allow for S&P Global Ratings-adjusted leverage at about 2x.	Cost inflation and supply chain disruptions are likely to negatively affect operating margin development over the next 12 months.
Environmental, social, and governance (ESG) issues are at the core of the group's strategy and culture, and will continue to support its growth and market leadership.	Potential more aggressive financial policy, mainly spending on large mergers and acquisitions (M&A) and share buybacks, could negatively affect credit metrics.

Koninklijke Philips N.V.'s (Philips') transition to a focused health technology group has been successfully completed now the group has closed its domestic appliances divestment. In September 2021, Philips closed the disposal of its domestic appliances business, with cash proceeds of €3 billion after taxes and transaction costs. This marked the completion of Philips' portfolio streamlining over the past few years, under which it has transformed into a focused and leading health technology group. We positively view the strategy and its execution, since we assume Philips will post more stable cash flows and higher margins, supported by its market position and positive fundamentals in the medical technology market. We view annual sales growth of about 5% over the medium term as achievable for all remaining Philips segments, and forecast an improvement in S&P Global Ratings-adjusted EBITDA margin to about 16%-17% from 2022 after 14.6% in 2019 and 15% in 2020, which was an extraordinary year due to COVID-19.

Investments in digitalization will strengthen the group's technological capabilities and fuel top-line growth and margin improvement. Over the past few years, Philips has invested heavily in digitalizing its product portfolio. This year alone it has acquired U.S.-based remote cardiac diagnostics and monitoring provider Bio Telemetry Inc. for about $2.8 billion, medical device integration and data technologies group Capsule Technologies Inc. for $635 million, and AI and cloud technology cardiac diagnostics specialist Cardiologs. Through its connected care segment, Philips caters to the increasing need for digitalization in health care, which we view as the most important driver to achieve higher system efficiency and better patient outcomes over the coming years. We also forecast that demand for integrated solutions, rather than stand-alone equipment, will continue to rise. Philips aims to increase revenue from solutions and related services to above 45% of sales by 2025 from the 2020 level of about 37%. We view this strategy positively because recurring revenue increases overall revenue stability and predictability. Moreover, in our view, providing solutions and service will offer higher customer value than only adding to technological capabilities of the equipment offered to compete with other leading providers.

Currently estimated risks related to product recalls are offset by solid free operating cash flow (FOCF) and financial flexibility. Ongoing product recalls related to sleep apnea and respiratory care devices show Philips' exposure to product safety and quality management risks. Philips has determined that there are potential health risks related to polyurethane foam used in certain devices, including foam-emitting volatile organic compounds. The group says it has identified all the devices with a potentially faulty component, most of which are first-generation DreamStation family products. It has initiated a repair and replacement program for these devices and expects to have substituted them all within approximately 12 months from the regulatory approval granted in September 2021. It anticipates repairs for one-third of the machines and replacements for two-thirds--new devices are currently not on sale. Since then the Food and Drug Administration has asked Philips to conduct independent tests on the replacement silicon-based foam used. Philips has provisioned approximately €500 million for the recall and repair program, which does not include potential litigation-related amounts. We are unaware of any existing information that confirms that the potential health risks identified could be linked to actual health-related issues, such as cancer.

The cost inflation and supply chain disruption that have weighed on Philips' performance and margins will likely ease from 2022. While the global hard-stop triggered by COVID-19 and its associated restrictions proved a difficult operating environment for the corporate sector, the restart has not been without its challenges. Input and freight costs have risen dramatically, shipping volumes have surged creating bottlenecks, and lead times for manufactured goods have worsened. For medical technology equipment, services, and consumables, which are not sold though long-term contracts or reimbursement schemes, we assume a gradual pass through over the next 12 months as prices are adjusted to reflect the new input costs. For Philips, we expect the scarcity of certain key components, most importantly semiconductors, to persist through 2022. However, we think that higher demand and operating leverage will offset negative impacts and lead to a higher level of profitability from 2022.

We expect Philips' 2021 profitability will be hit by the performance of its connected care segment, which includes respiratory care devices. Despite expected lower profit margins in 2021, we believe that Philips will be able to offset the known short-term financial effects and potential further charges related to its respiratory care devices product family to a material extent via forecast continued positive FOCF and current financial flexibility. After the closing of the domestic appliances disposal, at the end of third-quarter 2021, Philips had more than €4 billion cash on balance sheet. This will reduce toward the year-end due to share buyback purchases and forward settlements. We expect Philips to continue its financial policy and keep adjusted leverage at 2x-3x.

Outlook: Stable

The stable outlook reflects our expectation that, despite some near-term challenges from the pandemic and product recalls, Philips' resilient business model should continue to support the current rating level. Continued strong FOCF and financial flexibility should allow adjusted leverage to remain at 2x-3x over the next 24 months, below the 3x threshold for the current rating.

Upside scenario

We could raise the long-term rating on Philips if:

- We see continued strong improvements in profitability, especially in the diagnosis and treatment and connected care segments, supported by market share gains; or
- Adjusted leverage is kept sustainably below 2.0x, supported by a financial policy that is compatible with a higher rating, notably regarding debt-financed acquisitions and shareholder distributions.

Downside scenario

We could lower our ratings on Philips if it can't keep adjusted leverage below 3x on a sustainable basis. The most likely causes of deteriorated metrics would be:

- Large, or a series of midsize, debt-funded acquisitions that lead to elevated leverage levels;
- Increased shareholder returns above our base case;
- Lower operating cash flow caused by a sustained margin decrease, which we consider unlikely; or
- Significant widening of respiratory care devices quality issues and related costs.

Our Base-Case Scenario

Assumptions

- Because Philips is a provider of predominantly medical equipment and services, we see a low correlation to economic cycles and GDP growth.
- Stable to low-single-digit revenue growth in 2021 on a comparable basis post disposals, led by growth in diagnosis and treatment, and personal health, and offset by a connected care segment sales decline--the latter caused by the respiratory devices recall. Sales growth of 4%-6% thereafter.
- A contraction in adjusted EBITDA margin in 2021 as a result of low connected care segment profitability amid the product recalls. That said, we estimate margin expansion to be beyond 2020 levels from 2022 with positive development under all segments, along with lower restructuring costs.
- No meaningful widening of product recall costs from the current levels or major litigation-related expenses.
- Unchanged investments into research and development (R&D) and capital expenditure (capex).
- Unchanged shareholder returns and financial policy in the long term.
- No large acquisitions above the average cash spend of €500 million per year, although the company does not exclude a more active approach in the future.

Key metrics

Koninklijke Philips N.V.--Key Metrics

	2020a*	2021e	2022e	2023e
Revenue (bil. €)	19.5	17.7	18.6	19.6
Adjusted EBITDA (bil. €)	2.9	2.2	3.0	3.2
Debt to EBITDA (x)	1.3	2.5	2.0	2.0

*2020 metrics not adjusted for the domestic appliances disposal. a--Actual. e--Estimate.

Company Description

Founded in 1891 and headquartered in the Netherlands, Philips is a global diversified health technology group. Adjusted to the disposal of domestic appliances, the group generated revenue of €17.3 billion in 2020 and company-adjusted EBITA margin of 13.2%.

Philips operates in three major segments:

- Diagnosis and treatment (approximately 50% of current group sales). Products include: diagnostics imaging and ultrasound, digital and computational pathology, informatics for radiology, oncology, and cardiology, interventional imaging, navigation, and devices;
- Connected care (30% of sales). Products include: telehealth, patient monitoring and analytics, hospital and clinical informatics platforms, emergency care and resuscitation, sleep, breathing, and respiratory care devices; and
- Personal health (20% of sales). The product range includes: oral care, mother and child care products, male grooming and skin care, and so on.

The group has a presence in 100 countries, and its largest markets are North America (49% of revenue in 2020), Asia (30%), and Western Europe (21%). Philips employs more than 78,000 staff globally.

Peer Comparison

Table 1

Koninklijke Philips N.V.--Peer Comparison

Industry sector: Health care equipment

	Koninklijke Philips N.V.	Medtronic PLC	Baxter International Inc.	Becton Dickinson & Co.	Siemens AG
Ratings as of Nov. 18, 2021	BBB+/Stable/A-2	A/Stable/A-1	A-/Watch Neg/A-2	BBB/Stable/A-2	A+/Stable/A-1+
			--Fiscal year ended--		
	Dec. 31, 2020	April 30, 2021	Dec. 31, 2020	Sept. 30, 2020	Sept. 30, 2020
(Mil. $ or €)	€	$	$	$	€
Revenue	19,535.0	30,117.0	11,673.0	17,117.0	56,472.0
EBITDA	2,927.0	7,819.0	2,693.0	4,753.0	7,784.0
Funds from operations (FFO)	2,385.0	5,964.5	2,284.5	3,667.3	5,897.9
Interest expense	173.0	947.5	175.5	580.7	494.7
Cash interest paid	148.0	604.5	159.5	567.7	417.7
Cash flow from operations	2,472.0	6,433.5	1,943.5	3,617.3	6,292.0
Capital expenditure	637.0	1,355.0	700.0	767.0	1,112.0
Free operating cash flow (FOCF)	1,835.0	5,078.5	1,243.5	2,850.3	5,180.0
Discretionary cash flow (DCF)	1,489.0	1,306.5	270.5	1,824.3	281.0
Cash and short-term investments	3,226.0	10,817.0	3,730.0	2,845.0	15,297.0
Debt	3,693.0	19,130.9	5,096.0	18,582.6	12,389.4
Equity	11,901.0	51,602.0	8,726.0	23,765.0	37,151.0
Adjusted ratios					
EBITDA margin (%)	15.0	26.0	23.1	27.8	13.8
Return on capital (%)	8.3	7.0	12.6	5.3	8.3
EBITDA interest coverage (x)	16.9	8.3	15.3	8.2	15.7
FFO cash interest coverage (x)	17.1	10.9	15.3	7.5	15.1
Debt/EBITDA (x)	1.3	2.4	1.9	3.9	1.6
FFO/debt (%)	64.6	31.2	44.8	19.7	47.6
Cash flow from operations/debt (%)	66.9	33.6	38.1	19.5	50.8
FOCF/debt (%)	49.7	26.5	24.4	15.3	41.8
DCF/debt (%)	40.3	6.8	5.3	9.8	2.3

*Philips 2020 figures not restated for the domestic appliances disposal.

Business Risk: Strong

Connected, integrated, and AI-enabled medical equipment delivering rapid and predictive diagnosis will drive market growth. Philips' business standing is supported by its leading positions and strong profitability in personal health, ultrasound, image-guided therapy, and patient monitoring, which we expect will continue to support growing revenue. We view the group's strong pricing power--which stems from its innovation capabilities, large intellectual property portfolio, and strong brand among consumers and health professionals--as supportive of the rating. Earnings visibility and stability are supported by the group's growing order book, as well as its increasing level of recurring revenue and sales from integrated solutions between systems, devices, and services.

The global medical equipment market should continue to expand by roughly 5% per year, with the Asia-Pacific region driving the growth, although the U.S. will remain the largest market. Like the wider medical equipment industry, the risk of product recalls is prominent. With an increasing focus on digital and data use, cybersecurity and software have become key areas of growth development.

Philips competes in the large and broad health technology market that displays positive underlying trends including an ageing population, the increasing prevalence of chronic diseases, and the need for better and faster diagnostics and treatment, although constrained health care budgets continue to weigh on pricing. The industry is fast evolving, with outcome-oriented payment models taken up by health care providers, and the accelerating adoption of digital technology focused on telehealth, connectivity, AI, and workflow informatics. The fast-developing technology landscape increases the need for R&D investment and the risk of certain types of technology becoming outdated or obsolete. In this regard, we view positively Philips' ability to innovate and its investments in software, which is the fastest growing area in the health care space.

Via its diagnostics and treatment segment, Philips' focus is on integrated diagnostics, minimally invasive procedures to optimize productivity, and outcomes. It benefits from a leadership position in ultrasound and image-guided therapy, while in - diagnostics imaging it ranks behind GE Healthcare and Siemens Healthineers. Philips' connected care is centered around telehealth, with leading positions in patient monitoring, respiratory and sleep care. Philips' monitoring solutions range from continuous to central patient monitoring, with data integration and connectivity. The group's respiratory and sleep care leadership position is supported by a broad portfolio of ventilators for both hospital and domestic settings, with interoperability and connectivity features. In all these fields, Philips is among the global leaders. Personal health includes oral health, male grooming, beauty, and mother and child care--businesses in which Philips can take advantage of its health care expertise. Philips maintains the No. 1 market share in male grooming and reusable baby bottles in North America. The decision to completely divest the domestic appliance segment further strengthens the company's focus in its health equipment and personal care business.

Financial Risk: Intermediate

Philips' financial position remains primarily supported by its FOCF base, which we forecast to be about €1 billion-€2 billion annually over the next two years. We believe cash flow growth should mostly be driven by the growth and improvements in profitability in all segments. Philips should be able to continue reducing working capital and maintain stable capex spending at about 5% of revenue.

We believe management will continue to pursue a consistent approach toward debt-financed acquisitions and shareholder remuneration. We see Philips remaining acquisitive as it seeks to increase its presence in the fast-growing segments of diagnosis and treatment or connected care. We have assumed €500 million annually on acquisitions, but would not close our larger acquisitions should an opportunity to strengthen the portfolio toward faster growth and higher margins arise. Regarding shareholder remuneration, we assume a stable dividend payout ratio (40% to 50% of adjusted income from continuing operations attributable to shareholders) and the continuation of the share repurchase program. We do not see a material refinancing risk for Philips, and its pension liabilities have reduced greatly, limiting the risk of a widening net pension deficit in the next few years. Overall, we expect Philips to maintain adjusted leverage at 2x-3x over the coming years supported by unchanged financial policy and strong cash flow.

Financial summary

Table 2

Koninklijke Philips N.V.--Financial Summary					
Industry sector: Healthcare equipment					
	--Fiscal year ended Dec. 31--				
	2020	**2019**	**2018**	**2017**	**2016**
(Mil. €)					
Revenue	19,535.0	19,482.0	18,121.0	17,780.0	17,422.0
EBITDA	2,927.0	2,850.0	2,745.0	2,525.5	2,424.0
Funds from operations (FFO)	2,385.0	2,315.0	2,231.9	1,979.8	1,781.6
Interest expense	173.0	195.0	230.1	276.7	405.4
Cash interest paid	148.0	172.0	212.1	261.7	347.4
Cash flow from operations	2,472.0	1,693.0	1,616.9	1,684.8	1,035.6
Capital expenditure	637.0	675.0	548.0	521.0	438.0
Free operating cash flow (FOCF)	1,835.0	1,018.0	1,068.9	1,163.8	597.6
Discretionary cash flow (DCF)	1,489.0	(813.0)	(377.1)	135.8	(340.4)
Cash and short-term investments	3,226.0	1,426.0	1,688.0	1,939.0	2,334.0
Gross available cash	3,226.0	1,426.0	1,688.0	1,988.0	2,370.0
Debt	3,693.0	4,976.0	4,401.3	4,351.5	5,743.9
Equity	11,901.0	12,625.0	12,117.0	12,023.0	13,453.0
Adjusted ratios					
EBITDA margin (%)	15.0	14.6	15.1	14.2	13.9
Return on capital (%)	8.3	9.1	10.0	8.1	7.6
EBITDA interest coverage (x)	16.9	14.6	11.9	9.1	6.0
FFO cash interest coverage (x)	17.1	14.5	11.5	8.6	6.1
Debt/EBITDA (x)	1.3	1.7	1.6	1.7	2.4
FFO/debt (%)	64.6	46.5	50.7	45.5	31.0
Cash flow from operations/debt (%)	66.9	34.0	36.7	38.7	18.0
FOCF/debt (%)	49.7	20.5	24.3	26.7	10.4
DCF/debt (%)	40.3	(16.3)	(8.6)	3.1	(5.9)

Reconciliation

Table 3

Koninklijke Philips N.V.--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. €)

	--Fiscal year ended Dec. 31, 2020--							
Koninklijke Philips N.V. reported amounts								
	Debt	**Shareholders' equity**	**EBITDA**	**Operating income**	**Interest expense**	**S&P Global Ratings' adjusted EBITDA**	**Cash flow from operations**	**Capital expenditure**
Reported	4,737.0	11,870.0	3,206.0	1,542.0	160.0	2,927.0	2,777.0	942.0
S&P Global Ratings' adjustments								
Cash taxes paid	--	--	--	--	--	(394.0)	--	--
Cash interest paid	--	--	--	--	--	(148.0)	--	--
Reported lease liabilities	1,215.0	--	--	--	--	--	--	--
Postretirement benefit obligations/deferred compensation	597.0	--	--	--	13.0	--	--	--
Accessible cash and liquid investments	(3,226.0)	--	--	--	--	--	--	--
Capitalized development costs	--	--	(305.0)	(84.0)	--	--	(305.0)	(305.0)
Share-based compensation expense	--	--	115.0	--	--	--	--	--
Dividends received from equity investments	--	--	4.0	--	--	--	--	--
Nonoperating income (expense)	--	--	--	9.0	--	--	--	--
Noncontrolling interest/minority interest	--	31.0	--	--	--	--	--	--
Debt: Derivatives	52.0	--	--	--	--	--	--	--
Debt: Contingent considerations	318.0	--	--	--	--	--	--	--
EBITDA: Gain/(loss) on disposals of PP&E	--	--	(2.0)	(2.0)	--	--	--	--
EBITDA: Other	--	--	(91.0)	(91.0)	--	--	--	--
Total adjustments	(1,044.0)	31.0	(279.0)	(168.0)	13.0	(542.0)	(305.0)	(305.0)
S&P Global Ratings' adjusted amounts								
	Debt	**Equity**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**	**Capital expenditure**
Adjusted	3,693.0	11,901.0	2,927.0	1,374.0	173.0	2,385.0	2,472.0	637.0

Liquidity: Strong

We view Philips' liquidity as strong and project that its liquidity sources will cover uses more than 1.5x over the next 12 months from Sept. 30, 2021, and more than 1.0x for the 12 months thereafter. There are no financial covenants on the debt. We believe that Philips retains access to a diversified pool of lenders and to international capital markets.

Principal liquidity sources include:	Principal liquidity uses include:
• Estimated available cash and cash equivalents of €3.8 billion; • Forecast cash funds from operations of about €2.4 billion-€2.8 billion per year over the next 24 months; and • Undrawn committed credit lines of €1 billion maturing in 2024.	• An estimated €1.5 billion of short- and long-term debt due in the next 24 months; • Working capital outflows of €300 million per year over the next 24 months; • Our forecast of total capex of about €1.0 billion per year for the next 24 months; • Our forecast of cash dividends of about €400 million-€500 million annually; and • Share repurchases according to the financial policy.

Environmental, Social, And Governance

Philips has one of the highest environmental standards across its value chain in the medical equipment industry. The company distinguishes itself in the management of its indirect environmental impact, which we view as more material. While many industry peers have general commitments to improve the environmental footprint of their products, Philips has the infrastructure to regularly track, report, and set quantitative targets. Philips may face challenges to maintain high environmental standards as it expands to regions with lower environmental regulations, such as China.

Philips is well positioned to provide access to medical care to customers and communities because of its diversified regional footprint and portfolio of products and services. Its business model, based on providing integrated and customized solutions to hospitals--from manufacturing equipment, to providing software and services such as data analytics--will continue to support customer retention and satisfaction, in our view. The connected nature of Philips' products and services has also supported its penetration in markets with limited health care infrastructure and a growing middle-class, such as India and Indonesia.

Cybersecurity is increasingly material, given the company's reliance on sophisticated information technology, sensitive data on patients' health, and connection to the IT infrastructure of customers, such as hospitals. Product safety remains an important social risk factor, as is the case for other medical device manufacturers, as demonstrated by the recent events around its sleep apnea and ventilator devices, which had to be recalled and could lead to a meaningful negative financial impact for the group. Over the past few years, Philips has demonstrated sound decision making and strategic choices, especially regarding the company's transition to a focused global medical technology group.

Issue Ratings - Subordination Risk Analysis

Capital structure

Most of the debt is senior unsecured and issued directly by Koninklijke Philips N.V., the group's top holding company.

Analytical conclusions

All the long-term senior unsecured notes are rated 'BBB+', in line with our issuer credit rating on Philips.

Ratings Score Snapshot

Issuer Credit Rating

BBB+/Stable/A-2

Business risk: Strong

- **Country risk:** Low
- **Industry risk:** Low

- **Competitive position:** Strong

Financial risk: Intermediate

- **Cash flow/leverage:** Intermediate

Anchor: bbb+

Modifiers

- **Diversification/portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Strong (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

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
- 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, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	**Intermediate**	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	**a-/bbb+**	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of December 1, 2021)*

Koninklijke Philips N.V.		
Issuer Credit Rating		BBB+/Stable/A-2
Senior Unsecured		BBB+
Issuer Credit Ratings History		
28-Jul-2015	*Foreign Currency*	BBB+/Stable/A-2
02-Oct-2014		A-/Negative/A-2
24-Jul-2013		A-/Stable/A-2
28-Jul-2015	*Local Currency*	BBB+/Stable/A-2
02-Oct-2014		A-/Negative/A-2
24-Jul-2013		A-/Stable/A-2

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

Additional Contact:
Industrial Ratings Europe; Corporate_Admin_London@spglobal.com