



Rating Action: Moody's downgrades 3M's senior unsecured ratings to A2; outlook negative

23 Jun 2023

New York, June 23, 2023 -- Moody's Investors Service (Moody's) downgraded the senior unsecured ratings of 3M Company's ("3M") to A2 from A1. Moody's also affirmed the company's commercial paper ratings at Prime-1. The outlook is negative.

The ratings downgrade was prompted by 3M's announcement on June 22, 2023[1] that it has agreed to a proposed class-action settlement to resolve a wide range of drinking water claims by public water systems in the US regarding PFAS. This settlement will be subject to court approval initially and require a sufficient level of participation from the public water systems. Under the agreement, 3M will pay between \$10.5 billion and \$12.5 billion over a 13-year period. The payments associated with this settlement will create a sizable liability for 3M. This will result in a significant increase in adjusted debt that will elevate leverage well above current levels for several years. The company will take a \$10.3 billion pre-tax charge associated with this liability in the second quarter of 2023.

"While the proposed settlement on an important class of PFAS claimants represents a key milestone for 3M as it navigates these liabilities, it will nonetheless result in increased leverage while constraining cash flow for years to come" said Moody's Senior Vice President, David Berge. "Future potential settlements related to either PFAS or Combat Arms will further stress 3M's financial strength."

Affirmations:

..Issuer: 3M Company

.... Commercial Paper, Affirmed P-1

Downgrades:

..Issuer: 3M Company

....Senior Unsecured Medium-Term Note Program, Downgraded to (P)A2 from (P)A1

....Senior Unsecured Regular Bond/Debenture, Downgraded to A2 from A1

Outlook Actions:

..Issuer: 3M Company

....Outlook, Remains Negative

RATINGS RATIONALE

The downgrade reflects Moody's expectation that debt-to-EBITDA will increase to well over 3x as the result of the proposed settlement, based on a present valuation of the announced settlement's payments. In its initial assessment, Moody's believes that 3M would be able to cover these payments through cash reserves as well as free cash generated over the term of the payments. Moody's assumes that the company will continue to engage in conservative financial policies, foregoing substantial share repurchases and preserving the approximately \$7 billion in proceeds from the spinoff of its Health Care segment later this year. Although this settlement represents a major milestone that crystalizes much of 3M's PFAS exposure, Moody's recognizes that the company has yet to resolve further liabilities related to PFAS that will likely materialize over the next few years. These include potential settlements relating to US states seeking compensation for other PFAS-related damages as well as personal injury claims related to firefighting foam (AFFF). Moreover, 3M will need to resolve what could be a multibillion settlement for product liability litigation (Combat Arms), which Moody's believes could occur as early as 2023. Aggregate payments associated with the combination of these claims would further increase leverage over a long period, put pressure on liquidity, and restrict the company's ability to deploy capital toward business growth, debt repayment or shareholder returns.

Environmental and social risks were drivers of this rating action. PFAS related liabilities present high environmental risks related to water pollution. Also, demographic and societal trends pose high social risk as legal and regulatory actions will curtail the manufacturing and sale of PFAS products while the public perception of these ubiquitous "forever chemicals" declines.

The negative outlook reflects Moody's expectation that payments relating to PFAS claims beyond the 2023 public water systems settlement, along with sizable resolutions in the Combat Arms litigation, will accumulate over the next few years. This will further increase adjusted debt and leverage while restricting the company's ability to deploy capital productively.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

The ratings could be upgraded if 3M can reach a final settlement with Combat Arms claimants for an amount close to the \$1 billion that it originally planned, while concurrently achieving a significant reduction in exposure to environmental liabilities with no material effect on the capital structure. An upgrade would also be supported by the consistent practice of conservative financial policies, allowing the company to substantially repay debt after the spinoff of the Health Care segment, resulting in debt-to-EBITDA sustained below 2.5x.

Ratings could be downgraded if Combat Arms or any other product litigation settlement exceeds the company's current plans, or if longer term regulatory and litigation risks increase. Ratings could also be downgraded if the company undertakes further corporate restructuring, such as the separation of additional businesses, which will reduce 3M's revenue diversity. As well, a substantial increase in funded debt to cover cash shortfalls possibly caused by increased settlement payments could also prompt a downgrade.

Headquartered in Saint Paul, Minnesota, 3M Company is a diversified global manufacturer, technology innovator and marketer of a wide variety of products and services. The company maintains operations in more than 70 countries, with nearly 60% of revenue realized outside of the US. 3M operates under four business segments: Safety & Industrial, Transportation & Electronics, Health Care (to be spun off in 2023) and Consumer. Revenue is approximately \$34 billion.

The principal methodology used in these ratings was Manufacturing published in September 2021 and available at <https://ratings.moodys.com/rmc-documents/74970>. Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on <https://ratings.moodys.com/rating-definitions>.

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Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://ratings.moodys.com/documents/PBC_1288235.

At least one ESG consideration was material to the credit rating action(s) announced and described above.

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REFERENCES/CITATIONS

[1] The company's 8-K: <https://pro.edgar-online.com/DisplayFilingInfo.aspx?TabIndex=2&FilingID=16746507&companyid=5248&ppu=>

Please see <https://ratings.moodys.com> for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

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