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Consumer Defensive Sector Quarterly Credit Trend and Spread Chartbook

Morningstar Credit Ratings, LLC
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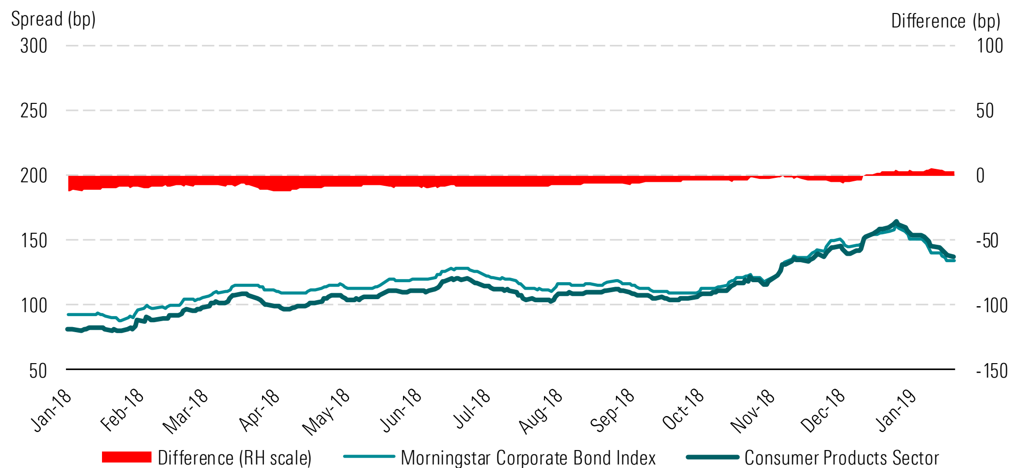
Executive Summary

Since the last chartbook publication in October 2018, the average credit spread for the highlighted bonds of investment-grade consumer defensive companies covered by Morningstar Credit Ratings, LLC has widened 32 basis point to +138 basis points over Treasuries. Over the same period, the Morningstar Corporate Bond Index widened 25 basis points to +134 basis points.

During the period, MCR upgraded one firm and affirmed the ratings of eight companies. Excluding firms that have engaged in leveraging mergers or acquisitions within the past 18 months, which is more than 50% of the portfolio, MCR expects credit quality to improve modestly for the consumer defensive sector in the near term , driven mainly by operating earnings and cash flow growth and to a lesser extent debt reduction. Companies that have consummated sizable acquisitions are likely to take two to three years to restore their credit measures. Should top-line growth, operating earnings, and cash flow fail to be generated as projected, credit quality for many firms in the sector will decline.

Exhibit 1 Morningstar, Inc. Corporate Bond Index Versus Consumer Defensive Sector (Trailing 12 Months)

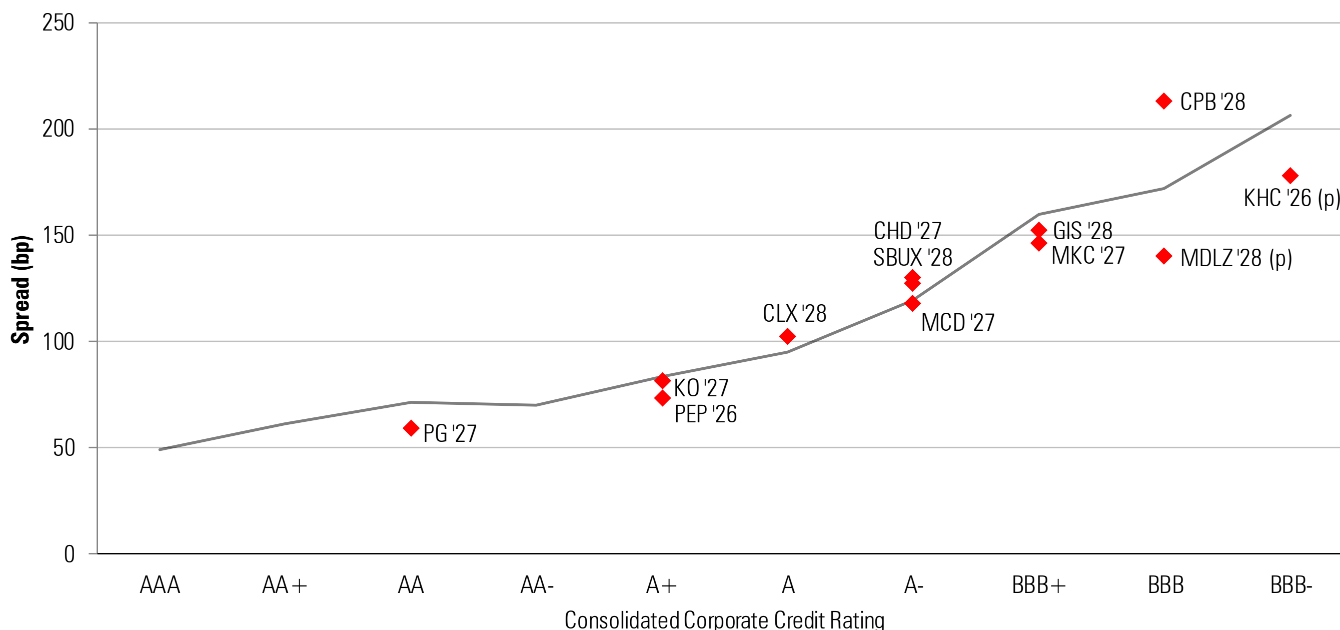


Source: Morningstar, Inc. Data as of Jan. 29, 2019.

Spread Charts by Consumer Defensive Sector

Packaged Foods, Restaurants, Nonalcoholic Beverages and Consumer Products

Exhibit 2 Packaged-Foods, Restaurants, Nonalcoholic Beverages, and Consumer Products Subsectors Versus Morningstar Industrials Index



Source: Morningstar Credit Ratings, LLC, Morningstar, Inc., and Interactive Data as of Jan. 29, 2019.
UR = rating under review / (p) = positive outlook / (n) = negative outlook

Exhibit 3 Investment-Grade Packaged-Foods, Consumer Product, and Nonalcoholic Beverages Pricing and Spreads

Issuer	Ticker	Credit Rating	Rating Outlook	Economic Moat*	Coupon	Maturity	Price	Yield to Worst	Spread to Treasury	Change
Procter & Gamble	PG	AA	Stable	Wide	2.85%	8/11/2027	96.87	3.27%	59	10
Coca Cola Co	KO	A+	Stable	Wide	2.90%	5/25/2027	95.78	3.49%	81	17
PepsiCo Inc.	PEP	A+	Stable	Wide	2.85%	2/24/2026	96.79	3.36%	73	13
Clorox Company	CLX	A	Stable	Wide	3.90%	5/15/2028	101.33	3.72%	102	14
Church & Dwight Co. Inc.	CHD	A-	Stable	None	3.15%	8/1/2027	94.01	3.99%	130	26
McDonald's Corp	MCD	A-	Stable	Wide	3.50%	3/1/2027	97.57	3.85%	118	28
Starbucks Corp	SBUX	A-	Stable	Wide	3.50%	3/1/2028	96.41	3.98%	127	30
McCormick & Co. Inc.	MKC	BBB+	Stable	Wide	3.40%	8/15/2027	94.66	4.15%	146	44
General Mills Inc.	GIS	BBB+	Stable	Wide	4.20%	4/17/2028	99.77	4.23%	152	15
Mondelez International Inc.	MDLZ	BBB	Positive	Wide	4.13%	5/7/2028	100.18	4.10%	140	34
Campbell Soup Co.	CPB	BBB	Stable	Wide	4.15%	3/15/2028	95.00	4.83%	213	36
Kraft Heinz Co.	KHC	BBB-	Positive	None	3.00%	6/1/2026	91.19	4.42%	178	36

Source: Morningstar Credit Ratings, LLC, Morningstar, Inc., and Interactive Data as of Jan. 29, 2019.
* Denotes data provided by Morningstar, Inc. and licensed by Morningstar credit Ratings, LLC
UR = rating under review / (p) = positive outlook / (n) = negative outlook

Spreads and Credit Trends: Packaged Foods and Nonalcoholic Beverages

Credit spreads for the consumer defensive firms have increased significantly, widening the most for McCormick & Company (BBB+, stable), +44 basis points over Treasuries, and Campbell Soup Company (BBB, stable) and Kraft Heinz Company (BBB-, positive), each +36 basis points over Treasuries. These firms' spreads were well above the average of 25 basis points for the group. McCormick's widening spreads maybe contributed to the company recently reporting that sales slowed to 2% in the fourth quarter of 2018 versus the prior-year quarter. The slowdown was mainly the result of an inventory reduction by certain customers. We trust that this is a transitory issue and that with its strong cash flow generation and commitment to reducing debt, McCormick will deleverage and reach its targeted leverage goal of 3 times by the end of fiscal 2020. We believe Campbell's spreads weakened greater than the average for the group because of pressure from activist investor Third Point LLC to restructure the company or sell itself. Campbell reached a settlement in November that included adding two new independent directors to the board from Third Point. As for Kraft Heinz, its ongoing top-line disappointment and recent lower earnings, overshadow its industry-leading operating margins and may have contributed to its spread expansion.

Operating earnings improvement has slowed for most packaged-foods firms that Morningstar covers, as benefits of extensive restructuring programs and cost-saving initiatives, which have generally resulted in greater profitability, are being absorbed by higher packaging and distribution costs and incremental brand investment. However, we expect the higher costs to be passed to consumers and heightened research and development and marketing investments to provide a longer-term benefit. With few exceptions, nearly every firm in the consumer defensive sector has recently engaged in mergers or acquisitions, ranging from small bolt-on to strategic acquisitions. Although leverage is expected to improve, it remains high for most firms.

Packaged-Foods Issuer Highlights

- Campbell Soup reported net sales of $2.7 billion for the first quarter ended Oct. 28, 2018, of fiscal 2019, an increase of 25% reflecting acquisitions. Organic sales declined 3%, which was attributed to lower volume and mix, and heightened promotional spending in the company's meals and beverage segment. Adjusted EBIT declined 10% to $369 million. As a testimony to its renewed focus, management indicated improving trends in the company's U.S. soup business, sales growth in its V8 business, and a strong performance in its snack business. Campbell's leverage is high because of its $6.2 billion debt-financed acquisition of Snyder's-Lance Inc., a leading U.S. snackmaker, that pushed pro forma leverage up to 4.8 times. While the acquisition is viewed as a strategic positive, pro forma debt/EBITDA more than doubled and execution risk remains high as Campbell integrates Snyder's-Lance and pursues additional cost savings of $500 million between fiscal 2019 and 2022. Although Campbell's credit pillars have weakened, it has low Business Risk and a moderate Solvency Score and Distance to Default score. Our rating incorporates management's stated intent to deleverage, with excess cash flow and divestiture proceeds from the sale of Campbell International and Campbell Fresh businesses, and the expected restoration of credit measures to levels appropriate for the BBB rating category. Leverage is projected to gradually decline to below 3.5 times. We forecast a slight contraction in organic revenue growth in the near term and very low-single-digit growth thereafter and a step-down in operating margins to 15%.

Free cash flow (cash flow from operations less capital expenditure and dividends) is projected to average $600 million annually, which should provide funds for Campbell to meet its leverage target of approximately 3.0 times by fiscal 2022.

- Kraft Heinz's credit rating reflects improvements in the company's credit measures and pillar scores during the past two years. Our positive outlook incorporates that the company will continue to deleverage, which could result in an upgrade in the next year or two. Kraft Heinz exceeded its cost-savings target of $1.7 billion and continues to generate industry-leading adjusted operating margins that surpass 20%. However, organic revenue growth for Kraft Heinz continues to remain a challenge, given continued volume and product mix pressures and its cash flow has been impaired by integration and restructuring cost. The company’s recent focus on marketing and brand investment, which has been lower than its peers for several years, should stimulate the company's top line. An upgrade would be impeded by a large debt-financed acquisition, and it is common knowledge that Kraft Heinz was seeking one that provides it with access to faster-growing international regions. Though debt/adjusted EBITDA, for the latest 12 months ended Sept. 30, 2018, has weakened to 4.4 times, it is expected to improve after the integration and restructuring.
- General Mills' (BBB+, stable). For the second quarter ended Nov. 25, 2018, of fiscal 2019, General Mills reported a 1% decline in organic revenue resulting from lower volume, partially offset by positive net price realization and mix benefit across all segments. The company's $8.0 billion strategic acquisition of Blue Buffalo is still viewed positively, as it broadens General Mills to the natural pet food category, which is growing faster and has stronger profit margins than many packaged-food categories. Blue Buffalo, which generates $1.3 billion of revenue and $319 million of EBITDA, is expected to grow revenue in the midsingle digits, which is meaningfully faster than the company's base business. Cost savings and synergies estimated at $50 million continue to be on track, and thus for the second quarter ended Nov. 25, 2018, operating margins expanded by 40 basis points compared with the prior-year period. General Mills' debt/adjusted EBITDA was 4.5 times as of quarter ended Nov. 27, 2018. The company repaid $280 million of debt during the quarter and remains on course to lower its leverage to 3.5 times by fiscal 2020. General Mills placed a moratorium on share repurchases following the acquisition of Blue Buffalo and will use its free cash flow, which MCR forecasts will average $1.0 billion annually, to deleverage.
- Mondelez’s (BBB, positive) credit rating was affirmed Jan. 29, 2019, and its outlook maintained. Mondelez's rating is based on the cash flow generated by the global leadership in its confectionary and biscuit businesses and balanced by above-average leverage. Mondelez benefits from low Business Risk and a strong Distance to Default score, which offset weakness in its Cash Flow Cushion from substantial five-year and shorter debt maturities and low returns on invested capital, which constrain its Solvency Score. We expect Mondelez to maintain the improvements in operating margins and cash flows resulting from the achievement of $1.5 billion in supply chain productivity and overhead cost-reduction. The company indicated that further cost savings were to come and will be used to fuel its top-line growth. Barring a sizable acquisition, we forecast that Mondelez will grow its top line at a low single-digit rate on an organic basis, maintain adjusted operating margins to 17%-18% and generate free cash flow in excess of $1 billion. Leverage should gradually improve, with debt declining to below 4.0 times of adjusted EBITDA and interest coverage expanding to the low double digits

Spreads and Credit Trends: Restaurants

After mid- to high-single-digit growth for the past few years, same-restaurant sales growth has slowed for restaurant companies we cover. Operating margins have remained strong due to structural improvements such has refranchising and cost-saving measures. From a macroeconomic perspective, food consumed away from home has increased from an expanding economy, lower unemployment, and higher real wages. As a result, we anticipate continued increased spending on travel and leisure, with foodservice and restaurants benefiting. On the operational side of the restaurant business, commodity costs excluding protein and labor costs, while rising, are manageable. We expect value-menu food and beverages, as well as inexpensive indulgence-menu items, to benefit in this economic environment. Credit trends for the firms in this subsector are stable, but they depend highly on the aggressiveness of companies' capital-allocation policies.

Restaurants Issuer Highlights

- Starbucks' (A-, stable) credit rating was downgraded on June 25, 2018, after the company announced that it will increase its fiscal 2018-20 cash return to shareholders program to $25 billion from $20 billion. Starbucks increased the program to $20 billion in May 2018 from $15 billion in November 2017, following its announcement of a global coffee alliance with Nestle and its receipt of a pretax upfront payment $7.15 billion, which would be used for share repurchases. In September 2018, the company entered into accelerated share repurchase agreement of around $5 billion, which it expects to complete by February 2019. The additional net increase in Starbucks' cash return to shareholders will be debt-financed, which is expected to weaken the company's credit pillars. We believe that Starbucks' core operations are strong and that the brand's growing ubiquity in the beverage industry still supports our low Business Risk assessment. However, Starbucks' higher debt levels and reliance on capital markets will eventually weaken its strong Solvency Score and moderate Cash Flow Cushion. Starbucks' alliance with Nestle is expected to accelerate its global growth. We forecast comparable-store sales at approximately 3%, the low end of the company's reduced guidance, operating margins at 18%, and maintenance of its commitment to lease-adjusted leverage of below 3.0 times. We are projecting that Starbucks' lease-adjusted leverage (based on 8 times rent expense) will remain around 3.2 times in fiscal 2019, given incremental debt for share repurchases and that its lease-adjusted coverage ratio will decline to 8.0 times from 10 times. Starbucks indicated that it is committed to maintaining lease-adjusted leverage below 3.0 times.
- McDonald's (A-, stable) has successfully turned around its operations, which is exemplified by the strength of its systemwide sales, comparable-store sales, operating margins, cash flows, and reflected in its credit pillar. McDonald's has introduced new and enhanced menu items, generated mid-single-digit global comparative sales for the past 14 quarters, accelerated the pace of refranchising, and saved costs through global restructuring. While we expect the growth rate to moderate, the company refranchising will result in lower capital expenditures after its current heightened cycle and increase the predictability of its operating earnings, margins, and cash flow. We believe leverage has plateaued, with debt/adjusted EBITDAR of just under 4.0 times, and the company's improving fundamentals will support its leveraged capital structure. McDonald's current three-year (period ending 2019) target cash return of $25 billion to shareholders in the form of dividends and share repurchases is manageable, given its cash flow generation, refranchising proceeds, and initiatives to increase comparative store and systemwide

sales. Although debt levels are likely to increase, leverage is expected to remain steady. Given McDonald's aggressive cash return to shareholders and elevated capital expenditures, failure to continue to maintain a high level of operating performance could lead to a stagnation of operating earnings, cash flow, and weaken its credit profile.

Spreads and Credit Trends: Consumer Products

The consumer products subsector consists of companies that provide household and personal-care products. Our coverage consists of one of the global players—Procter & Gamble (AA, stable), which is highly rated and fairly positioned in the rating category, and two much smaller regional firms—Clorox Company (A, stable), and Church & Dwight (A-, stable), with competitive or leadership positions in smaller categories. The products of household and personal-care firms have strong demand characteristics and generate considerable operating earnings and excess free cash flow. The credit trends are influenced more by management financial policies regarding capital allocation than by near-term fundamentals. These firms tend to be more disciplined from a credit perspective by simultaneously focusing on growth and cost reduction and reducing debt with free cash flow after acquisitions.

In the near term, higher transportation, commodity, and packaging costs will likely erode some of the cost-saving benefits, and we believe that acquisitions will lead to temporary increases in leverage. The smaller firms are benefiting from diversifying and expanding their product portfolios and the growth of the U.S. economy. We expect most companies in the subsector to maintain their capital allocation policies within the rating ranges. However, activist investors, such as Nelson Peltz, who gained a seat on Procter & Gamble's board of directors, typically call for leverage to increase and greater shareholder remuneration, which could weaken the sector's credit measures.

Consumer Products Issuer Highlights

- Church & Dwight's rating was affirmed on Dec. 18, 2018, and is supported by good returns on invested capital in the low teens, solid free cash flow generation, and moderate leverage, which has resulted in a strong Solvency Score and a very strong Distance to Default. Church & Dwight continues to generate 3%-4% organic revenue growth and EBITDA margins in excess of 20%. Higher commodities and transportation cost negatively affected gross margins in the recent period. For the latest 12-month period ending Sept. 30, 2018, adjusted debt/EBITDA was 2.2 times and EBITDA/interest at 12 times. Leverage is in line with the rating category. Free cash flow (cash flow from operation less capital expenditure and dividends) generation is excellent and expected to be sustained at above $400 million, or 10% of revenue, throughout our forecast period. Acquisitions remain a key element of Church & Dwight's growth strategy; as a result, we anticipate periodic increases in leverage, but we expect the company to return to its natural leverage level of 2.0 times within 12-24 months.
- Clorox's rating was affirmed on Dec. 18, 2018, based on its moderate use of leverage and the stability of its operating earnings and cash flow, which supports our assessment of its Business Risk as minimal. The strength of the company’s intangible asset has resulted in exceptional returns on invested capital that are in the mid-20s. These returns are generated by Clorox's strong brand equity, which is evidenced by its leading market shares. Through acquisitions, Clorox continues to build out its personal-care and healthcare segment, which provides the company with greater diversification into the high-growth

consumer personal-care category. Clorox acquired Nutranext, LLC in April 2018 for $700 million. Nutranext is a leading manufacturer and marketer of dietary supplement brands that generated sales of about $200 million in 2017. Clorox has a nominal amount of debt and maintains a healthy balance sheet with strong liquidity. The company's debt/adjusted EBITDA has been consistently maintained at a little less than 2 times, below management's target leverage ratio of 2-2.5 times. We expect healthy free cash flow (cash flow from operation less capital expenditures and dividends), to exceed $300 million annually throughout our five-year forecast. Clorox continues to exhibit financial discipline regarding capital allocation, which has provided it with headroom at its current rating level. We forecast steady financial performance and credit metrics over our five-year forecast period.

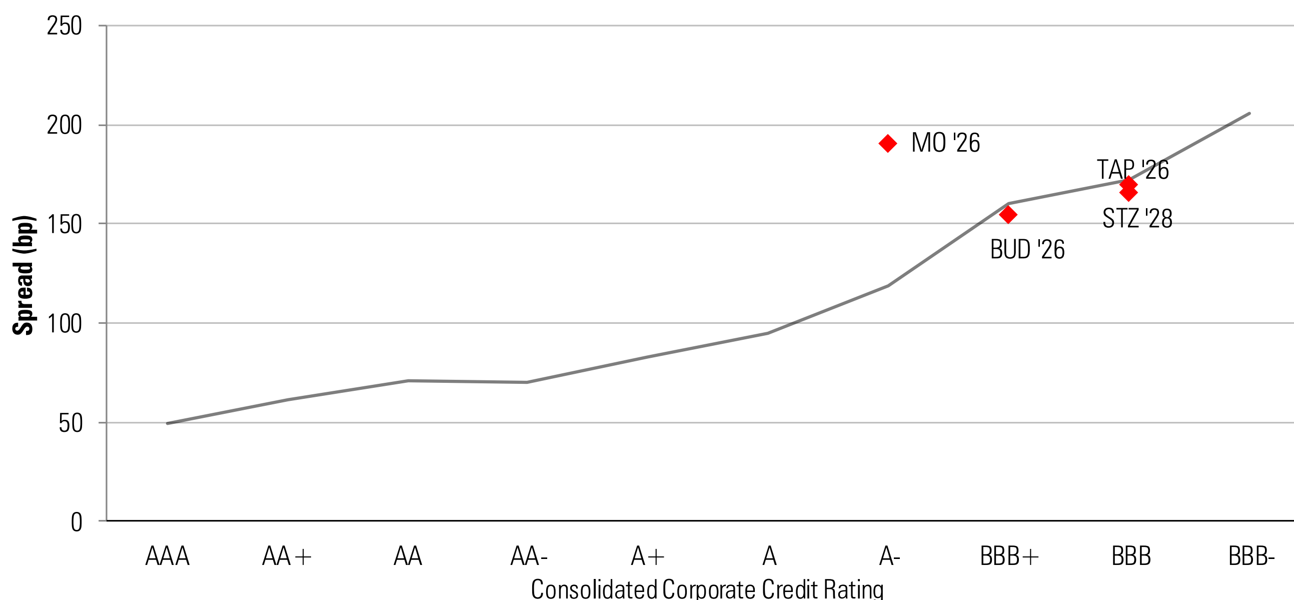
Exhibit 4 Packaged Foods, Consumer Products, and Nonalcoholic Beverages Financial Summary

	Procter & Gamble	**PepsiCo**	**Coca-Cola**	**Clorox**	**Starbucks**	**McDonald's**	**Church Dwight**	**General Mills**	**McCormick**	**Mondelez**	**Campbell's**	**Kraft Heinz**
Reporting Period	12/31/2018	9/8/2018	9/30/2018	9/30/2018	9/30/2018	9/30/2018	9/30/2018	11/25/2018	11/30/2018	9/30/2018	10/28/2018	9/30/2018
Ticker	**PG**	**PEP**	**KO**	**CLX**	**SBUX**	**MCD**	**CHD**	**GIS**	**MKC**	**MDLZ**	**CPB**	**KHC**
MCR Credit Ratings/Outlook:	**AA/Stable**	**A+/Stable**	**A+/Stable**	**A/Stable**	**A-/Stable**	**A-/Stable**	**A-/Stable**	**BBB+/Stable**	**BBB+/Stable**	**BBB/Positive**	**BBB/Stable**	**BBB-/Positive**
Pillars:*												
Business Risk	2	2	2	2	4	4	5	2	3	3	4	4
Cash Flow Cushion	6	7	7	7	6	8	6	7	7	7	8	7
Solvency	3	3	4	4	4	4	4	6	7	7	6	7
Distance to Default	2	2	2	2	2	2	2	4	3	2	5	4
Raw Data Score	51.5	54.5	65	65	77	85	91	93	108	104.5	118.5	119.5
Business Risk Composition:												
Size	10	10	10	7	9	9	6	9	7	10	8	10
Economic Moat Rating†	10	10	10	10	10	10	1	10	10	10	10	1
Uncertainty Rating	10	10	10	10	7.5	7.5	7.5	10	10	7.5	7.5	7.5
Product/Customer Concentration	5	5	5	4	2	4	4	5	2	3	3	5
Management Score	4	3	3	4	2	2	4	3	3	2	3	2
Dependence on Capital Markets	3	3	4	2	3	1	2	3	2	2	1	3
Cyclicality of Operations	5	5	5	5	3	4	4	5	5	4	5	5
(LTM) $ in millions except as noted												
Revenues	66,912	64,663	32,310	6,187	24,720	21,202	4,105	16,278	5,409	26,131	9,218	26,245
Adj. EBITDAR	17,609	13,930	11,284	1,385	6,964	11,638	979	3,497	1,123	4,845	1,568	7,215
Adj.EBITDA	17,255	13,188	11,108	1,298	5,338	9,993	954	3,307	1,065	4,561	1,494	7,032
EBIT	13,423	10,482	8,385	1,128	3,883	8,967	812	2,302	903	3,316	407	5,520
Adj. EBITDAR Margin	26.3%	21.5%	34.9%	22.4%	28.2%	54.9%	23.8%	21.5%	20.8%	18.5%	17.0%	27.5%
Adj. EBITDA Margin	25.8%	20.4%	34.4%	21.0%	21.6%	47.1%	23.2%	20.3%	19.7%	17.5%	16.2%	26.8%
Adj. EBIT Margin	20.1%	16.2%	26.0%	18.2%	15.7%	42.3%	19.8%	14.1%	16.7%	12.7%	4.4%	21.0%
FCF Margin	6.2%	1.3%	-4.1%	5.3%	33.2%	4.2%	13.7%	5.5%	7.0%	4.9%	5.1%	-9.9%
Cash & Short-term Investments	12,117	13,898	18,847	162	8,938	2,575	188	533	97	1,373	205	1,366
Committed Credit Facility (Avail)	3,200	7,500	8,925	1,100	3,000	2,500	997	3,300	1,000	6,000	0	3,029
Total liquidity	15,317	21,398	27,772	1,262	11,938	5,075	1,185	3,833	1,097	7,373	205	4,395
Total Debt	33,627	35,117	49,437	2,565	9,440	31,895	2,105	15,256	4,696	20,064	9,846	32,376
Total Adj Debt	43,791	45,053	50,845	3,257	22,442	45,055	2,305	16,776	5,288	24,005	10,435	33,840
CFFO	15,126	8,664	6,557	975	11,938	6,565	825	2,671	821	3,681	1,348	1,410
CAPEX	(3,598)	(3,073)	(1,398)	(181)	(1,976)	(2,508)	(55)	(617)	(169)	(1,103)	(460)	(855)
Dividends	(7,377)	(4,769)	(6,476)	(464)	(1,743)	(3,166)	(207)	(1,164)	(273)	(1,309)	(422)	(3,148)
Free Cash Flow	4,151	822	(1,317)	330	8,218	891	564	891	379	1,269	466	(2,593)
Share Repurchases	(4,754)	(1,978)	(2,191)	(303)	(6,980)	(4,710)	(238)	(1)	16	(2,038)	-	-
FCF Net of Share Repurchases	(603)	(1,156)	(3,508)	27	1,238	(3,819)	326	889	395	(769)	466	(2,593)
Market Capitalization	225,820	154,170	200,310	19,400	79,750	139,620	16,590	25,640	18,480	62,570	10,770	57,410
Enterprise Value	259,447	189,287	249,747	21,965	89,190	171,515	18,695	40,896	23,176	82,634	20,616	89,786
Enterprise Value/EBITDA (X)	15.0	14.4	22.5	16.9	16.7	17.2	19.6	12.4	21.8	18.1	13.8	12.8
Enterprise Value/Debt (X)	7.7	5.4	5.1	8.6	9.4	5.4	8.9	2.7	4.9	4.1	2.1	2.8
Total Debt/Adj. EBITDA (X)	1.9	2.7	4.5	2.0	1.8	3.2	2.2	4.6	4.4	4.4	6.6	4.6
Net Debt/Adj. EBITDA (X)	1.2	2.0	3.3	1.9	0.7	3.0	2.1	4.5	4.4	4.2	6.5	4.5
Total Adjusted debt/EBITDAR (X)	2.5	3.2	4.5	2.4	3.2	3.9	2.4	4.8	4.7	5.0	6.7	4.7
CFFO/Total Debt	45%	25%	13%	38%	126%	21%	39%	18%	17%	18%	14%	4%
FCF/Total Debt	12%	2%	-3%	13%	87%	3%	27%	6%	8%	6%	5%	-8%
Adj. EBIT/ Int. Exp. (X)	25.0	8.3	9.5	12.8	22.8	9.3	10.4	4.7	5.2	6.2	1.5	4.3
Adj. EBITDA/ Int. Exp. (X)	32.2	10.4	12.5	14.8	31.3	10.4	12.2	6.7	6.1	8.7	5.7	5.5
Adj. EBITDAR/ (Int. Exp+ 1/3 Rent	27.0	9.2	11.9	11.9	9.8	7.7	11.3	6.3	5.8	7.9	5.4	5.4

Source: Morningstar Credit Ratings, LLC , * See Appendix for Descriptors. †Determined by Morningstar Equity Research Group.

Alcoholic Beverages and Tobacco

Exhibit 5 Alcoholic Beverage and Tobacco Subsectors Versus Morningstar Industrials Index



Source: Morningstar Credit Ratings, LLC, Morningstar, Inc., and Interactive Data as of Jan 29, 2019
UR = rating under review/(p) = positive outlook/(n) = negative outlook

Exhibit 6 Alcoholic Beverages and Tobacco Subsector Versus Morningstar Industrials Index

Issuer	Ticker	Credit Rating	Rating Outlook	Economic Moat*	Coupon	Maturity	Price	Yield to Worst	Spread to Treasury	Change
Altria Group Inc.	MO	A-	Stable	Wide	2.63%	9/16/2026	87.63	4.56%	191	94
Anheuser-Busch Inbev SA/NV	BUD	BBB+	Stable	Wide	3.65%	2/1/2026	96.78	4.19%	155	36
Molson Coors Brewing Co.	TAP	BBB	Stable	Narrow	3.00%	7/15/2026	91.72	4.31%	166	19
Constellation Brands, Inc.	STZ	BBB	Stable	Narrow	3.60%	2/15/2028	94.10	4.40%	170	30

Source: Morningstar Credit Ratings, LLC, Morningstar, Inc., and Interactive Data as of Jan. 29, 2019
* Denotes data provided by Morningstar, Inc. and licensed by Morningstar credit Ratings, LLC
UR = rating under review/(p) = positive outlook/(n) = negative outlook

Spreads and Credit Trends

The average credit spreads for the alcoholic beverage and tobacco companies subsector widened +45 basis points since the October chartbook, which was also wider than the average of +32 basis points for the consumer defensive sector as a whole. With the exception of Anheuser-Busch InBev SA/NV (BBB+, stable), we attribute the widening spreads to heighted M&A and the possibility of increased regulation for the tobacco industry. Altria Group Inc.'s (A-, stable) spreads increased +94 basis points over Treasuries, leading the group, and we believe it was due to the company's $14.6 billion increase in debt to fund its $12.8 billion investment of Juul Labs Inc.,—the dominant player in the e-vapor cigarette category, and its $1.8 billion investment in Cronos Group Inc., a Canadian group that owns several firms

that produce cannabis-based products. Recreational use of cannabis was made federally legal in Canada on Oct. 17, 2018. The possibility of additional regulatory restrictions on vaping and menthol cigarettes is likely to have also affected Altria's spreads.

For Anheuser-Busch InBev and Molson Coors (BBB, Stable), we expect credit measures to gradually improve, as these companies are focused on reducing debt after the last round of the industry's consolidation. Anheuser-Busch's credit profile is improving as the company announced in October that it would cut its dividend in half, which is in excess of $9 billion annually, to reduce debt. However, the company's continued growth challenges in the U.S., and poor performance in Brazil, one of its largest markets, maybe the reasons for Anheuser-Busch's spreads widening. The surprise weakness of Constellation Brands Inc.'s (BBB, stable) wine business and its substantial investment in Canada's leading cannabis products producer could be the cause of its widening spread. Molson Coors formed a joint venture with The Hydropothecary Corporation (HEXO) to pursue opportunities to develop nonalcoholic, cannabis-infused beverages for the Canadian market.

Morningstar's tobacco coverage consists of the largest U.S. producers, whose primary business is manufacturing and marketing cigarettes, which is highly lucrative and one of the most profitable businesses among the consumer defensive subsectors. Tobacco firms generate tremendous operating earnings and free cash flow. In developed economies, cigarette consumption has been declining for decades, and the industry has consolidated and restructured. Companies have offset volume declines by raising prices and reducing their cost structures, resulting in an overall increase in profitability. These elements, combined with debt reduction and the refinancing of high coupon debt, have improved the credit profile for Altria, until its recent acquisition of Juul.

Alcoholic Beverages and Tobacco Issuer Highlights

- Constellation Brands' rating was upgraded October 2018, and its outlook was revised to stable from positive. The rating upgrade is supported by the strength, predictability, and growth of its operating earnings and cash flow that is driven by the company’s beer business and balanced by its moderate use of leverage. Constellation's exceptional operating results are derived from its ownership and management of five of the top 15 best-selling import beer brands in the United States, including Corona and Modelo, which has resulted in a strong intangible asset that generated excess returns on invested capital and has earned the firm a narrow economic moat rating from Morningstar's Equity Research Group. Our rating also incorporates Constellation’s debt-financed investment of approximately $4 billion in Canopy Growth Corporation, which is a global leader in cannabis production, branding, intellectual property, and retailing. We don't anticipate any meaningful contribution to the company’s results from this investment in the near term. We assess Constellation’s Business Risk as low, which is balanced by its weak Cash Flow Cushion due to the company's high forecast debt maturities and expansive capital expenditures, and a moderate Solvency Score that reflect Constellation’s Canopy investment. Canopy had sales of CAD 77.9 million and generated an operating loss of CAD 82 million for its fiscal year ended March 31, 2018. This investment will bring Constellation's ownership of Canopy up to approximately 38% from 9.9%. We forecast high-single-digit revenue growth in fiscal 2019 and mid- to high single digits thereafter, with operating margins exceeding 30% by fiscal 2019 and increasing 100 to 200 basis

points thereafter. We expect free cash flow in excess of dividends in fiscal 2019 of $500 million to grow to $900 million by fiscal 2021, as the company's heightened capital expenditures abates. Pro forma debt/adjusted EBITDA is 4.9 times, which is high for the rating level compared with 3.6 times at Aug. 31, 2018. Constellation placed a moratorium on mergers, acquisitions, and share repurchases until it reduces leverage to its target of 3.5 times. Given the current momentum of Constellation's beer business and its free cash flow generative ability, we forecast restoration of the company's credit measures by fiscal 2022.

- Altria Group's corporate credit rating was affirmed and its outlook changed to stable from positive on Dec. 27, 2018, after the company announced that it invested $12.8 billion in Juul Labs, Inc. The affirmation reflected Altria's moderate leverage, substantial cash flow generation, and low Business Risk, which is driven by Altria's leading market position in the U.S. tobacco industry, most notably in cigarettes. It is further supported by the strength of Altria's intangible brand assets, which provides pricing power and generates industry-leading profit margins. This is demonstrated by the 40%-plus market share of Marlboro, which is owned by Philip Morris USA, Altria's wholly owned subsidiary. Given the tobacco industry's high barriers to entry, including substantial regulation, Altria's leading market position is expected to support excess ROICs over the next 20 years and will continue to support its strong, albeit slightly weaker Solvency Score. Financing for the Juul investment and Altria's $1.8 billion acquisition of a 45% interest in Cronos Group Inc., a Canadian cannabis firm, was provided by the company's $14.6 billion term loan facility, which matures Dec. 19, 2019. While the Juul investment places the company at the forefront of the fast-growing vaping category, the Cronos investment provides Altria with an entrance into the cannabis industry, which is in its infancy. Neither investment is expected to meaningfully contribute to Altria's earnings and cash flow in the near to intermediate term, yet they position the company for the possibility of longer-term growth. Altria's pro forma debt is $29 billion, and its cash balance was $2.3 billion at quarter-end Sept. 30, 2018. We forecast that the company will refinance at least 75% of its $14.6 billion term loan facility beyond our five-year projection period. Altria's pro forma leverage was 2.9 times, which is slightly high for the rating category, but it is expected to improve to 2.4 times during the intermediate term. M

Exhibit 7 Tobacco and Alcoholic Beverages Financial Summary

	Altria Group Inc.	Anheuser-Busch InBev	Constellation Brands	Molson Coors
Reporting Period	9/30/2018	6/30/2018	11/30/2018	9/30/2018
Ticker	**MO**	**BUD**	**STZ**	**TAP**
MCR: Credit Rating/Outlook	**A-/Stable**	**BBB+/Stable**	**BBB/Stable**	**BBB/Stable**
Pillars:*				
Business Risk	4	2	5	4
Cash Flow Cushion	8	8	8	7
Solvency	3	8	5	6
Distance to Default	2	4	3	6
Raw Data Score	81.5	122	108	116
Business Risk Composition:				
Size	9	10	8	8
Economic Moat Rating†	10	10	5	5
Uncertainty Rating	10	10	7.5	7.5
Product/Customer Concentration	1	4	3	3
Management Score	3	3	2	3
Dependence on Capital Markets	2	2	1	3
Cyclicality of Operations	5	5	5	5
(LTM) $ in millions except as noted.				
Revenues	25,351	56,427	8,118	13,525
Adj. EBITDAR	9,875	22,546	2,873	2,724
Adj.EBITDA	9,832	22,239	2,814	2,660
EBIT	9,534	17,340	2,463	1,807
Adj. EBITDAR Margin	39.0%	40.0%	35.4%	20.1%
Adj. EBITDA Margin	38.8%	39.4%	34.7%	19.7%
Adj. EBIT Margin	37.6%	30.7%	30.3%	13.4%
FCF Margin	7.8%	-0.8%	11.7%	11.3%
Cash & Short-Term Investments	2,393	7,970	131	750
Committed Credit Facility (Avail)	3,000	9,000	1,373	1,500
Total Liquidity	5,393	16,970	1,503	2,250
Total Debt	13,903	116,923	13,570	10,572
Total Adj Debt	14,247	119,379	14,042	11,085
CFFO	7,323	14,634	2,437	2,512
CAPEX	(180)	(5,145)	(972)	(625)
Dividends	(5,172)	(9,932)	(517)	(354)
Free Cash Flow	1,971	(443)	948	1,534
Share Repurchases	(1,875)	-	(1,304)	-
FCF Net of Share Repurchases	96	(443)	(356)	1,534
Market Capitalization	86,270	144,360	30,400	13,990
Enterprise Value	100,173	261,283	43,970	24,562
Enterprise Value/EBITDA	10.2	11.7	15.6	9.2
Enterprise Value/Debt	7.2	2.2	3.2	2.3
Credit Measures				
Total Debt/AdjustedBITDA	1.4	5.3	4.8	4.0
Net Debt/Adjusted EBITDA	1.2	4.9	4.8	3.7
Total Adjusted Debt/EBITDAR	1.4	5.3	4.9	4.1
CFFO/Total Debt	53%	13%	18%	24%
FCF/Total Debt	14%	0%	7%	15%
Adj. EBIT/ Interest Expense	14.0	2.6	7.0	5.8
Adj. EBITDA/ Interest Expense	14.4	3.3	8.2	8.5
Adj. EBITDAR/ (Interest Expense+ (1/3)Rent	14.2	3.3	7.9	8.2

Source: Morningstar Credit Ratings, LLC , *See Appendix for Descriptors. †Determined by Morningstar Equity Research Group.

Appendix

Exhibit 8 Morningstar Credit Ratings Sector Coverage Consumer Defensive:

Issuer	Ticker	Corporate Rating	Rating Outlook	Moat*	Moat Trend*	Rating Action	Date
Packaged Foods							
Campbell Soup Co	CPB	BBB	Stable	Wide	Negative	Downgraded	4/6/2018
General Mills Inc.	GIS	BBB+	Stable	Wide	Negative	Affirmed	3/9/2018
Kraft Heinz Co (The)	KHC	BBB-	Positive	None	Negative	Affirmed	2/28/2018
McCormick & Co Inc.	MKC	BBB+	Stable	Wide	Stable	Affirmed	9/27/2018
Mondelez International Inc.	MDLZ	BBB	Positive	Wide	Stable	Affirmed	1/29/2019
Restaurants							
McDonald's Corp	MCD	A-	Stable	Wide	Negative	Affirmed	1/29/2019
Starbucks Corp	SBUX	A-	Stable	Wide	Positive	Downgraded	6/25/2018
Yum Brands Inc.	YUM	BB	Positive	Wide	Negative	Affirmed	4/24/2018
Beverages							
Anheuser-Busch InBev SA/NV	BUD	BBB+	Stable	Wide	Stable	Affirmed	10/29/2018
Brown-Forman Corp	BF.B	A+	Stable	Wide	Stable	Affirmed	8/30/2018
Coca-Cola Co (The)	KO	A+	Stable	Wide	Stable	Affirmed	6/21/2018
Constellation Brands Inc.	STZ	BBB	Stable	Narrow	Stable	Upgraded	10/29/2018
Molson Coors Brewing Co	TAP	BBB	Stable	Narrow	Stable	Affirmed	10/26/2018
PepsiCo Inc.	PEP	A+	Stable	Wide	Stable	Affirmed	6/21/2018
Tobacco							
Altria Group Inc.	MO	A-	Stable	Wide	Negative	Affirmed	12/27/2018
Consumer Products							
Church & Dwight Co Inc.	CHD	A-	Stable	None	Positive	Affirmed	12/18/2018
Clorox Co	CLX	A	Stable	Wide	Stable	Affirmed	12/18/2018
Procter & Gamble Co	PG	AA	Stable	Wide	Stable	Affirmed	12/18/2018

* Denotes data provided by Morningstar, Inc. and licensed by Morningstar Credit Ratings, LLC.
Information as of Jan. 29, 2019. Source: Morningstar Credit Ratings, LLC and Morningstar Inc.

Descriptors for Pillar Analysis

		Rating Pillars			
Score Range		**Business Risk**	**Cash Flow Cushion**	**Solvency Score**	**Distance to Default**
Strongest	1-2	Minimal	Very Strong	Very Strong	Very Strong
	3-4	Low	Strong	Strong	Strong
	5-6	Moderate	Moderate	Moderate	Moderate
	7-8	High	Weak	Weak	Weak
Weakest	9-10	Very High	Very Weak	Very Weak	Very Weak

Business Risk Pillar Components

Country Risk (10% of Business Risk Score)

Weakest	Very High Risk
	High Risk
	Moderate Risk
Strongest	Low Risk

Company Risk (90% of Business Risk Score)

	Size	Economic Moat	or Sustainable Competitive Advantage	Uncertainty
Weakest	Very Small	None	None	Extreme
	Small			Very High
	Moderate	Narrow	Moderate	High
	Large			Medium
Strongest	Very Large	Wide	Substantial	Low

	Product/Customer Concentration	Management	Dependence on Capital Markets	Cyclicality
Weakest	Highly Concentrated	Aggressive	Extremely Dependent	Highly Cyclical
	Concentrated	Fairly Aggressive	Highly Dependent	Cyclical
	Neutral	Neutral	Dependent	Average Cyclicality
	Diversified	Fairly Conservative	Low Dependence	Mild Cyclicality
Strongest	Highly Diversified	Conservative	Very Low Dependence	Non-Cyclical

Business Risk		
	Range/Score*	**Descriptor**
Country Risk (10%)	<11	Very High Risk
	11-15	High Risk
	16-20	Moderate Risk
	21-25	Low Risk
Company Risk (90%)		
Economic Moat	1	None
	5	Narrow
	10	Wide
Sustainable Competitive Advantage	1	None
	5	Moderate
	10	Substantial
Uncertainity	1	Extreme
	2.5	Very High
	5	High
	7.5	Medium
	10	Low
Size	1-2	Very Small
	3-4	Small
	5-6	Moderate
	7-8	Large
	9-10	Very Large
Product and Customer Concentration	1	Highly Concentrated
	2	Concentrated
	3	Neutral
	4	Diversified
	5	Highly Diversified
Business Risk		
	Range/Score*	**Descriptor**
Management	1	Aggressive
	2	Fairly Aggressive
	3	Neutral
	4	Fairly Conservative
	5	Conservative
Dependence on Capital Markets	1	Extremely dependent
	2	Highly Dependent
	3	Dependent
	4	Low Dependence
	5	Very Low Dependence
Cyclicality of Operations	1	Highly Cyclical
	2	Cyclical
	3	Medium Cyclicality
	4	Mild Cyclicality
	5	Non-Cyclical

About Morningstar® Credit Research

Morningstar Credit Research provides independent, fundamental equity research differentiated by a consistent focus on sustainable competitive advantages.

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