Morningstar Corporate Credit Research Highlights

In Tale of Two Bond Markets, Investment Grade Struggles While High Yield Strengthens

Morningstar Credit Ratings, LLC
18 June 2018

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Issuer/Ticker	Current Issuer Credit Rating	Previous Issuer Credit Rating
Union Pacific **UNP**	A-	A
National Retail Properties **NNN**	BBB+	NA
Bayer **BAYRY**	BBB+	A-

- Rating Affirmations

Issuer/Ticker	Current Issuer Credit Rating	Previous Issuer Credit Rating
Dr Pepper Snapple **DPS**	A-/UR-	A-/UR-
Rockwell Collins **COL**	BBB/UR+	BBB/UR+
United Technologies **UTX**	A/UR-	A/UR-
AbbVie **ABBV**	BBB+	BBB+

Recent Notes Published by Credit Analysts

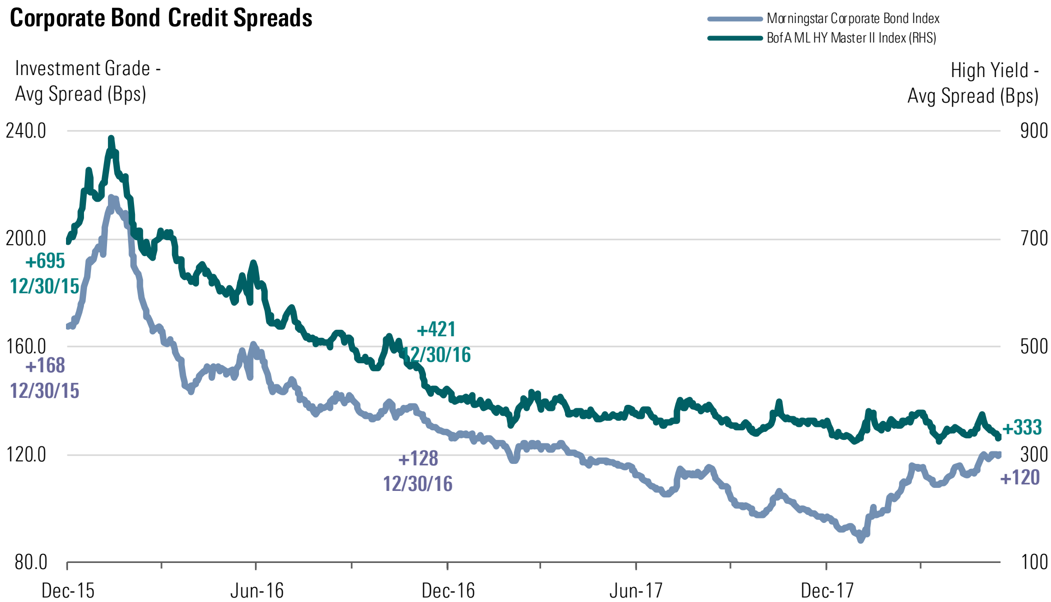
- Prologis (A-, Stable) Issues New Unsecured 10-Year and 30-Year Notes to Pay Down Existing Debt
- Sanofi (AA-/UR-) Issues Unsecured Notes to Potentially Refinance Existing Notes
- Alexandria Real Estate Equities (BBB+, Stable) Issues Unsecured 5-Year and 12-Year Green Notes
- Concho Resources (BBB-, Positive) Issuing New Senior Unsecured 10- and 30-Year Notes
- MGM Resorts International (BB-, Positive) Offering New $500 Million 7-Year Bonds

Credit Market Insights

In Tale of Two Bond Markets, Investment Grade Struggles While High Yield Strengthens

It's been a tale of two corporate bond markets thus far this year. Year to date, the Morningstar Corporate Bond Index (our proxy for the investment-grade market) has lost 3.14%, whereas the BofA Merrill Lynch High Yield Master Index has risen 0.66%. Since the beginning of the year, credit spreads have widened 24 basis points in the investment-grade market but tightened 30 basis points in the high-yield market. The average credit spread in the investment-grade market remains near its widest level thus far this year and is as high as it was this time last year. In contrast, the average credit spread of the high-yield index has rallied to its tightest level since before the 2008-09 credit crisis. To put into context just how tight spreads in the high-yield market are, since the beginning of 2000, the high-yield index has traded below the current level less than 9% of the time. Compounding the loss in the investment-grade market, with its longer duration, the investment-grade bond index is more sensitive to rising interest rates than the high-yield index. Since the end of last year, interest rates have risen significantly as the 2-year, 5-year, 10-year, and 30-year bonds have risen 67, 59, 51, and 31 basis points, respectively.

Corporate Bond Credit Spreads



Source: Morningstar,Inc., BofA Merrill Lynch Global Indexes. Data as of 6/15/2018.

While a multitude of concerns have kept investors at bay in the investment-grade market, the most recent is the expectation that large-scale mergers and acquisitions will re-emerge in the near term. Last week, a court ruled against the Department of Justice's attempt to block the proposed merger between AT&T and Time Warner. This was a closely watched case, and this precedent is expected to open the floodgates to a deluge of M&A across the telecom and media sectors. As soon as the DOJ announcement was made, Comcast commenced a bidding war by offering to acquire certain assets from Fox for which Disney had made a prior offer. The loss by the DOJ is likely to affect other industries as well. Many rumored mergers contemplated over the past few years never came to fruition as management teams had assumed that the deals would not pass antitrust regulators. With the approval of the AT&T-Time Warner merger, many of these plans may be dusted off and brought to bear.

Historically, investment-grade bonds have been more negatively affected by M&A than high yield. Mergers and acquisitions are typically funded with significant amounts of newly issued debt, which often leads to downgrades. However, more often than not, high-yield companies are purchased by larger, investment-grade companies, and the outstanding debt of those acquired high-yield companies is upgraded to the same rating as the acquirer.

Thus far this year, the high-yield market has been the beneficiary of an acceleration in economic activity. With economic metrics coming in stronger than expected, as of June 14, the Federal Reserve Bank of Atlanta increased its GDPNow estimate for second-quarter GDP growth to 4.8%. This would be the second-strongest quarterly rate over the past four years, surpassed only by the third quarter of 2014. This added economic growth would be a tailwind to the credit metrics of more economically sensitive companies.

Following the hike to the federal-funds rate to 1.75%-2.00%, short-term rates continued their march higher. However, long-term rates have remained stubbornly flat, which has led to a further flattening of the yield curve. On the shorter end of the curve, the yield on the 2-year Treasury bond rose 5 basis points to 2.55%, matching the highest yield this year and the highest yield the 2-year has registered since mid-2008. Along the longer end of the curve, after breaking above the 3% psychological barrier a few weeks ago, the 10-year has rallied once again, sinking below that threshold and ending the week at 2.92%. The spread between the 2-year and 10-year Treasury has tightened to 37 basis points, representing the flattest the yield curve has been since fall 2007.

10-Year Treasury Constant Maturity Minus 2-Year Treasury Constant Maturity

The yield curve has been on a multiyear flattening trend since the Federal Reserve began to raise short-term rates in its aim to normalize monetary policy. As short-term rates have risen faster than long-term rates, the steepness of the yield curve has flattened to its lowest level since before the 2008-09 credit crisis. In the past, when the yield curve has been flattening, it has often been an indicator of a weakening economy and in many cases an impending recession. This time around, this signal may not be foreshadowing a near-term recession risk, as it is being heavily influenced by global central bank actions and current economic activity hasn't shown any indications of slowing. In fact, as an indication of the current economic strength, the Atlanta Fed's GDPNow forecast of 4.8% for second-quarter real GDP growth would be a strong acceleration from 2.3% growth in the first quarter and the strongest quarterly growth rate since the third quarter of 2014.

In the short end of the curve, interest rates have been rising in connection with the hikes that the Fed has conducted this year, with the market pricing in an additional two rate hikes before year-end. According to the CME FedWatch Tool, the futures market is pricing in probabilities of 94% that the federal-funds rate will end the year at 200 basis points or higher and 55% that the fed-funds rate will end the year at 225 basis points or higher.

While the Fed's monetary policy actions have been directly affecting short-term rates in the United States, rates in other developed markets continue to be influenced by their central bank interventions. For example, at its most recent press conference, the European Central Bank disclosed its plans to keep its deposit rate at a negative yield of 0.40% through the summer of 2019. Furthermore, although the ECB announced that it will begin to taper its asset purchases this fall, it will continue to purchase EUR 30 billion of debt securities per month through September and then reduce the purchases to EUR 15 billion per month until the end of the year. Even though the 10-year U.S. Treasury is yielding only 2.92%, that yield has been attractive to global bond investors as the yield on Germany's 10-year bond is 0.40%, and the yield on Japan's 10-year bond is 0.04%.

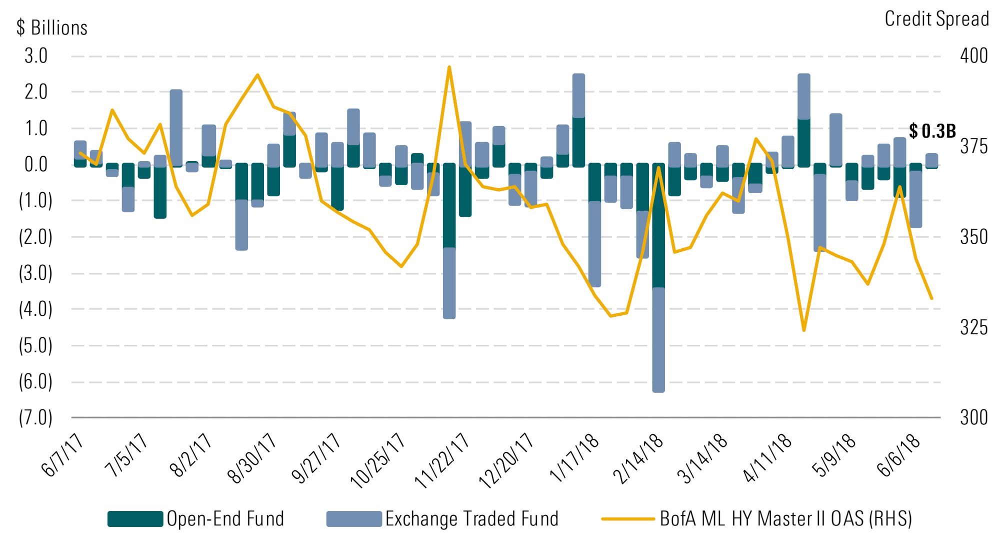
June OPEC Meeting to Weigh Production Increases vs. Price Stability

Media reports indicate that Saudi Arabia and Russia have already agreed to increase oil output ahead of a much-anticipated discussion about the oil production cut agreement at the regularly scheduled OPEC meeting June 22. The question is how much. An opening of the spigots by the cartel and other participants—an expectation that has caused the Brent-basis oil price to decline to $73 per barrel from an interim peak of about $80 in May—would probably hamper further near-term pricing gains and have significant fiscal implications for export-oriented oil countries. According to the International Monetary Fund, Saudi Arabia needs the oil price to average near $88 this year to balance its state budget. The fiscal break-even oil price seems to provide Saudi Arabia and other export-oriented producers an incentive to carefully consider the merits of loosening curbs on production, lest a meaningful portion of pricing gains for the past 18 months be lost. — *Contributed by Andrew O'Conor*

Weekly High-Yield Fund Flows

Fund flows in the high-yield asset class registered a small net inflow of $0.3 billion last week. This was driven by net unit creation among exchange-traded funds as the amount of flows across high-yield open-end mutual funds was essentially unchanged. Year to date through June 13, there has been a total of $14.1 billion of outflows across the high-yield sector. Net fund flows have consisted of $9.7 billion of outflows among open-end high-yield mutual funds but only $4.4 billion of net unit redemptions among high-yield ETFs. Historically, open-end mutual funds have been viewed as a proxy for retail investors, while ETFs are considered a proxy for institutional investors.

Estimated Weekly High-Yield Bond Fund Flows and High Yield Credit Spreads



Source: Morningstar, Inc. and BofA Merrill Lynch Global Indexes.

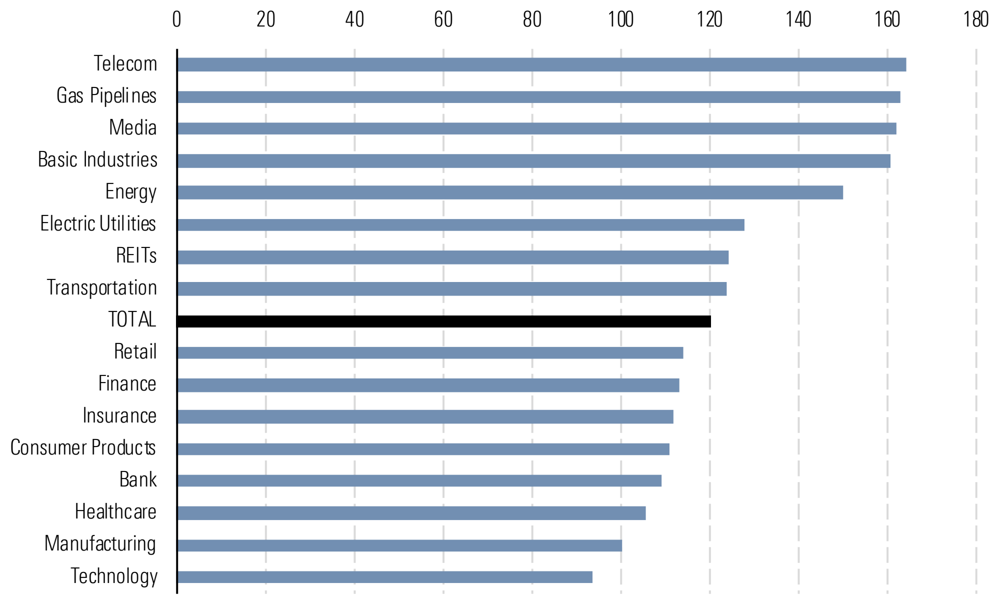
Exhibit 1 Morningstar Corporate Bond Index Sector Summary

Sector	Average Rating	Number of Issues	Modified Duration	Spread (bps)	MTD Spread Chg (bps)	YTD Spread Chg (bps)	MTD Total Return (%)	YTD Total Return (%)
TOTAL	**A-**	**5,048**	**6.9**	**120**	**0**	**24**	**(0.34)**	**(3.14)**
FINANCIAL	**A-**	**1,488**	**5.3**	**110**	**(1)**	**27**	**(0.22)**	**(2.66)**
Bank	A-	902	4.8	109	(1)	28	(0.19)	(2.47)
Finance	A	271	5.6	113	0	26	(0.30)	(2.89)
Insurance	A	220	8.0	112	1	26	(0.31)	(3.53)
REITs	BBB+	86	5.8	124	(0)	20	(0.30)	(2.72)
INDUSTRIAL	**A-**	**2,930**	**7.5**	**123**	**0**	**22**	**(0.37)**	**(3.36)**
Basic Industries	BBB	238	7.6	161	2	32	(0.48)	(4.03)
Consumer Products	BBB+	351	7.5	111	0	27	(0.30)	(3.81)
Energy	A-	406	7.3	150	3	28	(0.66)	(3.25)
Healthcare	A-	402	7.8	106	(0)	17	(0.25)	(3.49)
Manufacturing	A-	470	6.0	100	(1)	19	(0.21)	(2.60)
Media	BBB+	188	8.3	162	4	33	(0.64)	(4.77)
Retail	A-	162	7.8	114	(0)	27	(0.20)	(3.40)
Technology	A+	354	7.2	93	0	16	(0.31)	(2.76)
Telecom	BBB+	145	9.0	164	(1)	21	(0.35)	(2.95)
Transportation	BBB+	160	8.9	124	2	26	(0.42)	(4.23)
UTILITY	**BBB+**	**592**	**8.6**	**143**	**2**	**23**	**(0.52)**	**(3.71)**
Electric Utilities	A-	341	9.2	128	1	24	(0.49)	(4.12)
Gas Pipelines	BBB	236	7.8	163	3	20	(0.56)	(3.05)
Rating Bucket								
AAA Bucket		111	8.1	56	(1)	8	(0.25)	(2.78)
AA Bucket		463	5.7	71	1	12	(0.26)	(2.03)
A Bucket		1,994	6.8	97	(0)	23	(0.33)	(3.18)
BBB Bucket		2,480	7.1	155	1	28	(0.36)	(3.35)
Term Bucket								
1-4	A-	1,629	2.3	74	0	17	(0.15)	(0.37)
4-7	A-	1,162	4.7	109	2	29	(0.36)	(2.13)
7-10	A-	921	7.0	136	(0)	30	(0.34)	(3.67)
10PLUS	A-	1,336	13.6	172	1	27	(0.52)	(6.51)

Data as of 06/15/2018

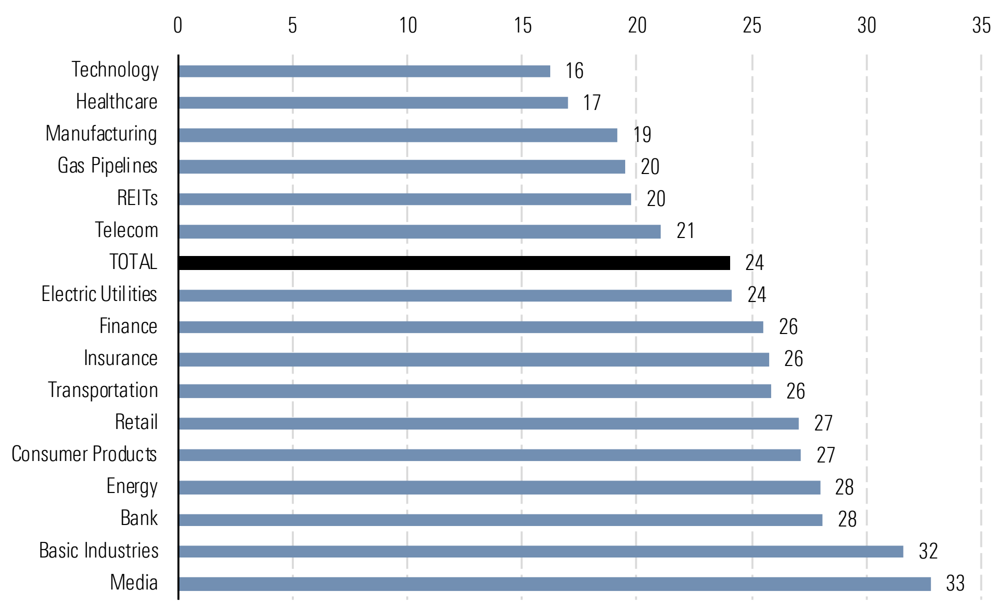
Source: Morningstar, Inc.

Exhibit 2 Morningstar Corporate Bond Index Spread by Sector



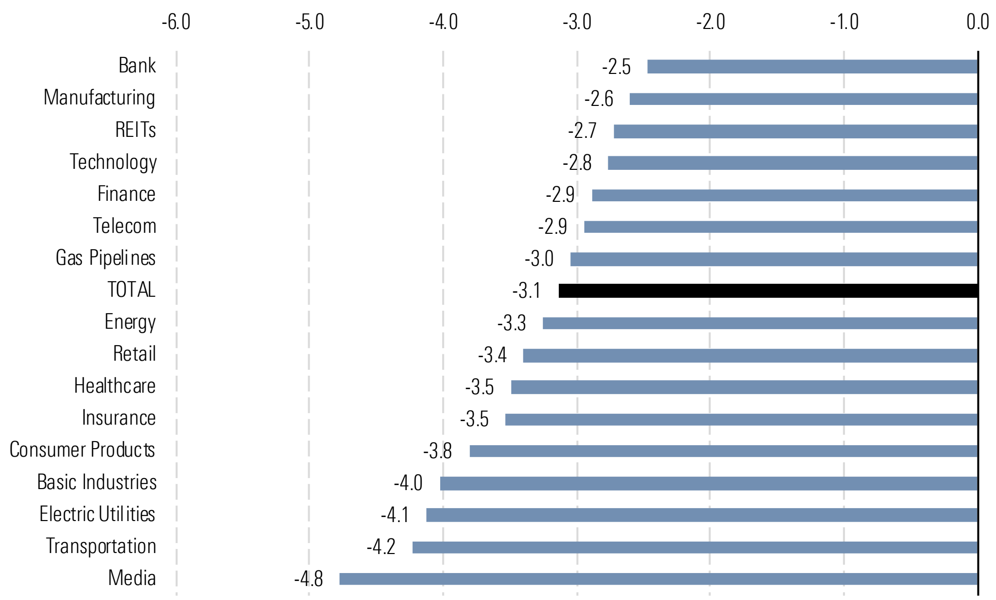
Source: Morningstar, Inc.

Exhibit 3 Morningstar Corporate Bond Index YTD Spread Change



Source: Morningstar, Inc.

Exhibit 4 Morningstar Corporate Bond Index YTD Return



Source: Morningstar, Inc.

Credit Rating Actions

▶ Rating Changes

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Bayer **BAYRY**	BBB+	A-

▶ Rating Affirmations

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Rockwell Collins **COL**	BBB/UR+	BBB/UR+
United Technologies **UTX**	A/UR-	A/UR-
AbbVie **ABBV**	BBB+	BBB+

Union Pacific's Rating Downgraded One Notch to A- on New Capital-Allocation Plans

Morningstar Credit Ratings, LLC is downgrading our corporate credit rating on Union Pacific Corporation one notch to A- to account for management's new capital-allocation strategy. This new policy includes increasing the rent-adjusted leverage target to 2.7 times from up to 2.0 times. In total, management is looking to reward shareholders by repurchasing $20 billion worth of shares by 2020, a move that will necessitate a total of at least $8 billion of incremental debt by our calculation. Management is also keen on further rewarding shareholders by raising its target dividend payout ratio to 40%-45% from historical levels of around 35%. These decisions had the largest effect on our Cash Flow Cushion score and have resulted in the downgrade. The rating outlook is stable.

Our rating reflects Union Pacific's strong competitive position offset by its leverage aspirations and generous shareholder payments. Union Pacific owns assets that are difficult to reproduce and are the basis for Morningstar's Equity Research Group's wide economic moat, which is the cornerstone for its low Business Risk score. Union Pacific serves a multitude of industries and customers, which bolsters the customer concentration and cyclicality components of the score. Union Pacific has leveraged its competitive position into midteens returns on invested capital and solid interest coverage ratios that underpin its strong Solvency Score, although the additional debt will elevate the financial leverage component of the forward-looking score. Union Pacific has a weak Cash Flow Cushion. Over the next five years, we project that the company will generate average annual operating cash flow of $9.5 billion and reinvest $3.8 billion per year in the business. Incorporating management's new payout ratio translates into a nearly 50% increase in the company's $2 billion annual dividend during this span. Management will repurchase $20 billion worth of shares by 2020. In total, this will consume more than all of its available cash flow. Union Pacific also has a meaningful debt maturity schedule, with average maturities of $1 billion due per year over the next five years.

At this rate, we doubt that management will perform a volte-face and unwind its new capital-allocation strategy, which would cause us to possibly upgrade our rating, so we expect that our rating will remain at the current level over the next few years. Despite the increase in leverage, management is guiding toward improved profitability metrics and targeting a 60% operating ratio by 2020 along with reaffirming its long-run aspirations for a 55% operating ratio. However, should financial results underwhelm and thus cause leverage to increase further, we would expect both the Solvency Score and Cash Flow Cushion to weaken enough to cause another possible rating downgrade.

National Retail Properties' Credit Rating Initiated at BBB+; Outlook Stable

Morningstar Credit Ratings, LLC is assigning National Retail Properties, Inc. a corporate credit rating of BBB+. The outlook is stable. The rating reflects National Retail's moderate Business Risk, supported by high-quality portfolio of single-tenant net lease properties in a wide range of markets in 48 states, with more than 400 tenants in 37 lines of trade, good interest coverage and leverage metrics, and highly experienced management team. The rating also considers National Retail's moderate Cash Flow Cushion and Solvency Score, which are both likely to remain steady between now and 2020 despite a modest net increase in debt. We expect leverage remain at or slightly above 5 times and interest coverage to remain in the area of mid-4 times. Since 2014, debt levels have increased in proportion to the growth of the company and its property portfolio. In recent years, the company has used very little secured debt, which was down to just $13 million at year-end 2017.

National Retail owns gross real estate assets in excess of $7.3 billion, among the larger net lease real estate investment trust portfolios. Although the retail industry has endured months of negative headlines due to bankruptcies and store closings, the net lease REIT peer group average occupancy remained near 99% throughout 2017 and has exceeded 98% each quarter since 2013. Demand for store space remains better than adequate, as many stores vacated due to bankruptcy were leased to new tenants in 2017. National Retail has had occupancy at or close to 99% since 2015, in part because of its success at finding replacements for terminated tenants, including 12 Gander Mountain stores in 2017. We expect that new store openings should continue to outpace store closings in the National Retail portfolio for the foreseeable future. Based on this outlook, we anticipate that demand for single-tenant properties will be sufficient for the company to maintain occupancy and replace failed tenants as necessary.

We view the company's credit metrics as somewhat better than peers, with forecast year-end 2018 debt/EBITDA at 5.3 times compared with peer average of 6.0 times and 2018 EBITDA interest coverage of 4.4 times, compared with the peer average of 3.8 times. We anticipate that the company will source sufficient capital from debt, equity, and dispositions financing to fund debt maturities averaging $149 million over the next five years (though almost all occur in 2021 and 2022), other obligations and acquisitions based on our operating forecast of average adjusted funds from operations of $502 million per year from 2018 through 2022. This flexibility, along with a meaningfully unencumbered portfolio, supports the company's moderate Cash Flow Cushion. We continue to expect National Retail to maintain high occupancy rates and continue its focus on improving its portfolio through careful tenant analysis and strategic property acquisitions on a leverage-neutral basis. The commoditized nature of single-tenant retail properties and the large number of builders and owners prevent any clear sustainable competitive advantages to support material returns on investment above the cost of capital over the long term for National Retail.

Our rating assumes that National Retail Properties will maintain leverage at or close to current levels over time with an efficient senior unsecured debt structure. We may consider an upgrade if National Retail can weather the headwinds that are causing some tenants to vacate stores or abandon expansion plans, as other retailers thrive and expand, including restaurants and other activities and services that can't be experienced on the Internet. In our view, this should support demand for single-tenant stores, drive modestly increasing rents, and boost margins, helping to improve Cash Flow Cushion and Solvency Score, permitting management of debt service and dividend payments without increasing leverage. On the other hand, we may consider a downgrade of the rating if a meaningful number of retailers become unable to grow and are forced to increase store closings to the extent that it results in more vacancies and lower levels of EBITDA for National Retail. In addition, such a scenario is likely to put downward pressure on the rating as a result of the negative impact on Cash Flow Cushion and Solvency Score.

Bayer's Rating Downgraded to BBB+ After Monsanto Merger; Stable Rating Outlook
Morningstar Credit Ratings, LLC is downgrading Bayer's credit rating to BBB+ from A-, reflecting significantly higher debt load following its acquisition of Monsanto for approximately $63 billion, and the potential challenges of successfully integrating the large entity over the next few years. This action resolves the under review negative that was placed on Sept. 19, 2016. The rating outlook is stable.

The addition of Monsanto's offering in seeds and genetic traits to Bayer's leading crop chemical portfolio has transformed the crop science division into the global leader in the agriculture industry. We see each company bringing strong competitive advantages to the combination that solidifies Bayer's leadership position in terms of breadth and depth of its product portfolio and technological capabilities. Enhanced scale of the research program of the new entity could offer integrated solutions that could bring novel solutions to address farmers' needs. However, we think this is a longer-term proposition that could take years to come to fruition. The transaction was completed June 7 and financed with equity, cash on hand, and debt funding. The resulting elevated debt load may keep gross leverage above 4 times EBITDA over the next few years, by our estimates, which weighs on a weak Cash Flow Cushion pillar.

Bayer's rating also reflects its diverse product portfolio that spans human and animal pharmaceutical industries, as well as agricultural markets, which favors our Business Risk pillar. Bayer's currently narrow moat as assigned by Morningstar's Equity Research Group is a composite of the wide-moat human drugs business, and the narrow moats in the consumer health and crop sciences divisions (now including wide-moat Monsanto), considering the recent full separation of the no-moat Covestro material sciences segment. Going forward, Bayer will be closely split between its healthcare businesses—pharmaceutical, consumer care and animal health—and the crop science segment including Monsanto. Collectively, we see Bayer increasing revenue in the high single digits and EBITDA in the low double digits (inclusive of synergies) compounded annually in 2018-22.

Bayer's credit profile has changed dramatically after its acquisition of Monsanto from incremental debt needed to complete the transaction. The firm's capital structure comprises a variety of securities, including floating- and fixed-rate unsecured notes that are yen-, euro-, and U.S.-dollar-denominated, as well as long-dated hybrid euro notes. The Monsanto transaction will initially be funded with borrowings against a $56.9 billion (EUR 46.2 billion) bridge loan facility, with incremental borrowings reduced in part by an equity investment by Singapore-based Temasek ($3.6 billion), as well as some proceeds from required crop science divestments and the Covestro separation (together about $12 billion). We expect incremental debt for the Monsanto acquisition to drive gross leverage above 4 times over the next few years, but we see leverage falling over the long term through a combination of debt reduction and operational improvement. Bayer has an opportunity to ease its elevated debt load with free cash flow that we anticipate averaging more than EUR 6 billion through 2022, which could help improve our Cash Flow Cushion and Solvency Score pillars.

In the context of the stable outlook, we see no immediate catalyst to change the BBB+ rating. However, Bayer's debt load and leverage are currently high for the current rating category, with the anticipation that both will fall over our rating horizon. If debt leverage remains high on a sustained basis, our Cash Flow Cushion and Solvency Score pillars could deteriorate and lead to a rating downgrade. On the flip side, if the firm can accelerate debt reduction and rapidly reduce leverage while successfully integrating Monsanto, such that our Cash Flow Cushion and Solvency Score pillars improve, then an upgrade may be appropriate.

Dr Pepper Snapple's A- Rating Under Review With Negative Implication Pending Merger
Morningstar Credit Ratings, LLC has affirmed Dr Pepper Snapple Group, Inc.'s A- rating and maintains its under review with negative implication status. Dr Pepper Snapple's rating was placed under review negative following its announcement in January that the company had entered into a definitive merger agreement with Keurig Green Mountain, Inc. Under the terms of the agreement, which was unanimously approved by Dr Pepper Snapple's board of directors, Dr Pepper Snapple's shareholders will receive $103.75 per share in a special cash dividend and own 13% of the combined company. JAB Holding Company, the current owner of Keurig Green Mountain, will own the remaining 87%. We estimate Dr Pepper Snapple's enterprise value at $23 billion and its enterprise value/EBITDA at 16.4 times. The combined company is expected to generate adjusted operating income of $3.1 billion inclusive of $600 million in synergies, which are expected to be realized annually by 2021.

While we do not anticipate a significant change to the Business Risk pillar because of the strategic fit of the acquisition, Dr Pepper Snapple other three pillars, which are influenced by leverage, are likely to weaken materially. We are estimating that total debt/EBITDA will be in excess of 5.5 times. Management indicated that it will accelerate deleveraging, with a net debt/EBITDA target of below 3.0 times (two to three years after the transaction closes), which is higher than our forecast of Dr Pepper Snapple's stand-alone leverage, which was trending toward 2.0 times. The combined entity credit measures will be weak for its current rating level. The combination is expected to increase the company's size, scale, and significantly increase its distribution capabilities. The transaction is subject to a vote by Dr Pepper Snapple shareholders and regulatory approval and expected to close by the end of the second quarter.

On a stand-alone basis, Dr Pepper Snapple's rating is supported by strong operating margins, high returns on invested capital, and moderate usage of debt, which has resulted in a strong Solvency Score and substantial free cash flow (cash flow from operation less capital expenditures and dividends) generation. Morningstar's Equity Research Group assigns Dr Pepper Snapple a wide economic moat due to its intangible brand assets and cost advantage, derived from its Rapid Continuous Improvement program and efficient DSD system. Although it is a distant third in the North American beverage industry behind Coca-Cola and PepsiCo, Dr Pepper Snapple benefits from a broad portfolio of impressive brands whose products are number one or two in their subcategories, including Dr Pepper, 7UP, A&W, Canada Dry, Sunkist Soda, Snapple, and Bai.

Dr Pepper Snapple's stand-alone debt balance including capital lease obligations was $4.5 billion at March 31, composed of current maturities of $383 million, including $120 million of commercial paper. Maturities of long-term debt are estimated as follows: $250 million in 2020, $500 million in 2021, and $3.2 billion thereafter. Dr Pepper Snapple's maturity schedule is manageable and well laddered, based on the company's financial flexibility, and its free cash flow generation that is in excess of $400 million annually, but it does constrain the company's Cash Flow Cushion as approximately 30% of its debt matures in five years. Liquidity is augmented by Dr Pepper Snapple's unused $500 million senior unsecured credit facility that expires March 2022, as its cash balance of $13 million, excluding $16 million of restricted cash is considerably low. The credit facility also provides financial flexibility and supports the company's commercial paper program. Borrowings under the revolving line of credit bear interest at a floating rate, which varies based upon the company's debt ratings. Aggregate commitments under the facility may be increased to a total not exceeding $250 million at the discretion of the lenders and upon the request of the company. The credit agreement includes a financial covenant that requires Dr Pepper Snapple to maintain a ratio of consolidated debt/EBITDA of no more than 3.5 times. This ratio may increase to 4.0 times for a 12-month period following an acquisition. However, upon the sale of the company, the revolver will be terminated as a result of change in control provision.

Dr Pepper Snapple's rating is under review negative and thus it is highly unlikely to be upgraded. The A-rating is likely to be lowered more than one notch based on the company's merger with Keurig Green Mountain, which will probably weaken its Cash Flow Cushion, Solvency Score, and Distance to Default once the deal closes in the first half of 2018.

Rockwell Collins Remains Under Review Positive on Pending Sale to United Technologies
Morningstar Credit Ratings, LLC is affirming its BBB corporate credit rating on Rockwell Collins and maintaining the under review positive status established in September 2017 as we await further regulatory approvals of its pending sale to United Technologies (A/UR-). The combination will result in a much bigger, broader, and more diversified entity than Rockwell is today, with moderately lower leverage. Pro forma leverage is expected to decline to 3.9 times in 2018 from a pro forma 4.4 times after the B/E Aerospace acquisition in April 2017. Further, we expect Morningstar's Equity Research Group to retain United Technologies' wide economic moat assessment, which compares with Rockwell's stand-alone assessment of narrow.

Our rating reflects a two-notch downgrade in April 2017 as we incorporated the $6.4 billion acquisition of B/E Aerospace. The acquisition boosted pro forma total debt to $8.1 billion from $2.3 billion. Gross leverage increased to 4.4 times from 1.8 times, and net leverage rose to 4.0 times from 1.6 times.

Rockwell's rating reflects its solid business position as a leading supplier of avionics, flight control, communication, and navigation systems. These products, which feed into the commercial, business jet, and defense sectors, typically enjoy high switching costs, strong margins, and solid returns on invested capital. The diversification of end-market users, including the more recent move into information management services, supports the firm's Business Risk score. Offsetting that is the firm's modest size relative to much larger customers as well as the cyclicality inherent in the industry.

Our rating is likely to increase if the deal with United Technologies closes as planned. If the deal does not close, we are likely to maintain our current rating. A rating decline would be subject to the deal not closing and Rockwell adding a material amount of new debt to the capital structure, which might be driven by a change in leverage targets or capital allocation plans.

United Technologies' A Rating Affirmed and Remains Under Review Negative
Morningstar Credit Ratings, LLC is affirming the A corporate credit rating and under review negative status on United Technologies Corp. Our review relates to United Technologies' September 2017 announced acquisition of aerospace supplier Rockwell Collins Inc (BBB/UR+) for an enterprise value of $30 billion. We expect that UTC will finance the $23 billion equity portion with $15 billion of cash, of which we expect $11.5 billion in incremental debt, as well as assume the $7.2 billion of Rockwell Collins' debt. In total, we estimate that proforma debt to increase to $46.1 billion from $27.3 billion predeal and raise leverage to 3.9 times from 2.9 times. The additional leverage will cause a meaningful deterioration in both the Solvency and Cash Flow Cushion scores, and we anticipate at least a one-notch downgrade in our rating.

Our rating reflects United Technologies' strong Business Risk offset by stress related to its elevated debt. UTC has an impressive portfolio of entrenched business units, such as Otis, Carrier, and Pratt & Whitney engines. These brand names and installed base create meaningful customer switching costs that contribute to its wide economic moat from Morningstar's Equity Research Group. UTC also benefits from aftermarket revenue, which represents approximately 40% of sales, that dampens cyclicality. These factors bolster its Business Risk score. UTC has historically monetized its competitive position into strong returns on invested capital and solid interest coverage ratios, which has helped its Solvency Score. However, we expect that the added leverage and increased invested capital from the deal will hurt all four components of the forward-looking Solvency Scores. We project that the combined UTC could generate $10 billion in free cash flow post integration. We expect that the company will grow its $2.3 billion dividend with earnings. We also estimate that debt maturities will be $12.3 billion over the next five years. These factors are likely to weigh down the company's Cash Flow Cushion score.

At this point, we are waiting for regulatory approvals and the combined company's capital structure. Recently, there has been further agitation by activist shareholders to compel UTC to breakup into three separate entities. Management has studied the issue and thinks a separation is unwise but has recently promised additional resources to review the cost benefit analysis underlining that previous assertion. Still, given our under review negative rating, we expect to downgrade our rating following the closing of the deal. The added leverage is likely to affect the stand-alone Solvency and Cash Flow Cushion scores.

AbbVie's Rating Affirmed at BBB+; Outlook Revised to Stable From Negative

Morningstar Credit Ratings, LLC is affirming AbbVie Inc.'s BBB+ rating reflecting strong cash-generating prospects of the firm's human drug portfolio balanced against heavy reliance on the world's top-selling drug, Humira, and stubbornly inflated leverage. Our expectation that the firm can overcome nearing biosimilar competition in Europe to Humira with newer oncology medicines and potential contribution from its late-stage research pipeline informs the revision in rating outlook to stable from negative.

Over the past year, AbbVie reached agreements to legal challenges regarding Humira's patent estate. Humira's composition-of-matter patents expired in the U.S. in December 2016 and will expire across Europe in October 2018. Generic competition poses a high risk as Humira sales represent around 60% of total revenue, which weighs on the firm's moderate Business Risk. These settlements ensure that market entry for two major competitors—Samsung Bioepis (not rated) and Amgen (A, stable)—is delayed in the important U.S. marketplace (around 64% of total Humira sales) until January 2023 at the earliest. Because of these agreements, we see more-certain growth rates for revenue in the midsingle digits and EBITDA in the low double digits compounded annually in 2017-22, which supports a moderate Cash Flow Cushion. Solid contributions from expanding clinical utility of AbbVie's oncology portfolio, specifically Venclexta and Imbruvica, along with potential near-term commercialization of novel late-stage drug candidates in women's health (elagolix) and immunology (risankizumab and upadacitinib), may serve to partially stem Humira erosion until U.S. competition intensifies in 2023. AbbVie aims to balance capital priorities between generous shareholder rewards and diversifying its product set via internal and external means to improve its growth prospects in light of the coming threat of Humira biosimilars, notably in the U.S.

AbbVie's debt load has jumped to $37.3 billion as of March 31 from $15.0 billion at the end of 2014 following active business development in 2015-16, when the firm acquired Pharmacyclics and Stemcentrx for nearly $27 billion. Outstanding debt consists entirely of unsecured notes with maturities ranging from this year to 2046 and $400 million in commercial paper borrowings. Gross leverage has moderately decreased to 2.9 times for the latest 12 months ended March 31 from 3.7 times at the end of 2015 after the $20.8 billion purchase of Pharmacyclics. Considering cash totaling $9.5 billion as of March 31, net leverage was 2.2 times for the trailing 12-month period. AbbVie has a prime opportunity to substantially decrease its debt burden this year, when $6 billion in unsecured notes mature, given cash on hand (plus $2 billion in long term investments) and solid free cash flow that we estimate averaging nearly $14 billion per year through 2022. This cash generation along with full availability under its $3 billion revolving credit facilities allows the firm to easily manage the 2018 maturities as well as $1.7 billion in notes due in 2019, $3.8 billion due in 2020, $1.8 billion due in 2021, and $4.1 billion due in 2022. But AbbVie traditionally prioritizes capital deployment for shareholder rewards, including annual increases to its large dividend and aggressive share repurchasing, which can consume most free cash flow and leave little remaining for debt reduction. For example, the firm's Dutch tender auction for $7.5 billion of shares completed in June and a 35% increase to dividends to about $6 billion will more than utilize our estimated free cash flow in 2018. As such, we anticipate that any improvement in debt leverage over the long term may stem mainly from operational improvement. We also expect AbbVie to continue to consummate further business development to establish new sources of earnings growth and bolster its research program, which could also jeopardize debt-reduction efforts, limiting improvement to our Cash Flow Cushion and Solvency Score pillars.

Management's ability to significantly reduce concentration on Humira revenue and earnings while refocusing capital deployment to debt reduction could help improve our Business Risk and Cash Flow Cushion pillars enough to create uplift to the current rating. We see lessened reliance on Humira potentially stemming from strong commercialization of the firm's current late-stage pipeline, but we think external means may be required to fully offset biosimilar erosion in the U.S. starting in 2023. On the other hand, in the case of a return of leveraging business development or substantial share repurchasing, such that the Cash Flow Cushion and Solvency Score pillars deteriorate from sustained elevated leverage and less financial flexibility, a downgrade may follow.

Recent Notes Published by Credit Analysts

Prologis (A-, Stable) Issues New Unsecured 10-Year and 30-Year Notes to Pay Down Existing Debt

Market Data

Prologis, Inc. (A-, stable) is reportedly in the market June 11 with 10-year and 30-year senior unsecured note offerings, the size of which have not been indicated as of this publication. The issuer is Prologis, LP. Net proceeds are expected to be used to pay down outstanding borrowings on the firm's $3.6 billion global revolving credit facilities, its Canadian term loan, and for general corporate purposes, according to the preliminary supplement to the prospectus dated March 7, 2017, filed by Prologis June 11.

Prologis' rated industrial peers are Duke Realty Corporation (BBB+, stable), Liberty Property Trust (BBB, stable), and First Industrial Realty Trust, Inc. (BBB, stable). The following data is from Interactive Data. In the 10-year area, spreads over the nearest Treasury from these issuers were as follows.
Prologis' $500 million 3.00% bonds due 2026 at +122 basis points.
Prologis' $750 million 3.75% bonds due 2025 at +91 basis points.
Duke Realty's $300 million 3.375% bonds due 2027 at +132 basis points.
Liberty Property's $400 million 3.25% bonds due 2026 at +133 basis points.
First Industrial's $100 million 7.15% bonds due 2027 at +169 basis points.
The A- Morningstar Corporate Bond Index is currently priced at +111 basis points.

MCR Credit Risk Assessment

Prologis reported solid first-quarter results, including strong same-store net operating income growth of 5.3% and an average cash basis rent increase of 9.2% on new and renewing leases. In its 2018 updated guidance, management indicated that it pushed its expected same-store NOI growth higher to 6.0% at the midpoint, again fueled by strong industrial rent growth. Prologis also anticipates midrange development starts of $2.35 billion and building acquisitions of $400 million. We project growth of revenue and total NOI of between 3.5% and 4.0% for 2018, with leverage remaining a little above 6.0 times and interest coverage slightly lower because of rising interest rates but still above 5.0 times.

Subsequent to the first-quarter earnings announcement, Prologis disclosed April 29 that it has entered into an agreement to acquire DCT Industrial Trust in a leverage-neutral all-stock transaction. In our view, the combination is highly complementary, as the large market presences in key distribution hubs enjoyed by Prologis will be expanded in most cases, especially in the Atlanta market. The purchase of DCT is expected to close in the third quarter and will add about 71 million square feet of distribution space to the firm's existing U.S. portfolio of 353 million square feet. Prologis expects to benefit from $80 million in immediate cost savings when the portfolios are combined. DCT will contribute most to Prologis' presence in the Southern California and Chicago markets. Amazon will continue to be the largest tenant, contributing 3.1% of rent in the combined portfolios.

Our rating assumes that Prologis will maintain low leverage over time and an efficient capital structure that supports unsecured creditors. We may consider an upgrade if Prologis can take advantage of the favorable market trends supporting demand for distribution space. In our view, this should drive increasing rents and improving margins, permitting management of debt service and dividend payments without incurring much new debt. We may consider a downgrade of the rating if forecasts of new additions to building inventory underestimate actual development, to the extent that it results in lower interest coverage and higher leverage. Problems integrating the acquisition of DCT could also put downward pressure on the rating.

Sanofi (AA-/UR-) Issues Unsecured Notes to Potentially Refinance Existing Notes

Market Data

Sanofi SA (AA-/UR-) is in the market with a proposed offering of senior unsecured notes maturing in 2023 and 2028. According to a preliminary prospectus filed June 12, net proceeds will be used for general corporate purposes, including the repayment of existing debt. The firm has EUR 750 million of 1.1% medium-term notes due in September.

For closest comparison for Sanofi's issues, we look to similar-rated companies Roche (AA-, stable), Pfizer (AA-, stable), and Bristol-Myers Squibb (AA-, stable). As Sanofi has few dollar-denominated securities, we look at its bonds due 2021 that trade closest with Roche's bonds, but wider than those of Pfizer and Bristol-Myers Squibb, according to Interactive Data.

In the approximate 5-year maturity bucket, bonds from these issuers recently traded over the nearest Treasury as follows.
Sanofi's 4.00% notes due 2021 at +44 basis points.
Roche's 1.75% notes due 2022 at +50 basis points.
Pfizer's 3.00% notes due 2023 at +49 basis points.
Bristol-Myers Squibb's 2.00% notes due 2022 at +37 basis points.

MCR Credit Risk Assessment

Sanofi's AA- rating reflects its diverse product portfolio balanced against its stretched balance sheet after recent business development activities. Bioverativ helps to further diversify Sanofi's drug portfolio as the firm contends with biosimilar and brand-name competition to its bestseller Lantus, representing about 11% of overall revenue. From a broader perspective, the firm's well-diversified product portfolio—spanning prescription pharmaceuticals, over-the-counter medicines, and human vaccines—supports minimal Business Risk. The addition of Bioverativ's leading hemophilia treatments, Eloctate and Alprolix, provides a steady source of revenue and cash flows. These medicines, along with seven novel therapies since 2014, including oral multiple sclerosis treatment Aubagio, next-generation insulin Toujeo, novel cholesterol-fighter Praluent, first-in-class atopic dermatitis drug Dupixent, and second-generation IL-6 receptor inhibitor Kevzara, may offset the current erosion of Lantus. Solid uptake of these promising therapies, along with a broader vaccine offering, may support revenue growth and EBITDA generation in the low single digits compounded annually through 2022. However, EBITDA growth may come in slightly behind sales growth due to increased research costs to shepherd promising drug and vaccine candidates through regulatory approval, moderated somewhat by cost-efficiency efforts.

Sanofi stretched its historically strong balance sheet with debt funding needed to consummate the recent acquisitions of Bioverativ and Ablynx. At the end of the first quarter of 2018, Sanofi owed EUR

26.9 billion in debt and held EUR 12.8 billion of cash and investments. Given this, gross debt leverage and net debt leverage jumped to 2.4 times and 1.3 times, respectively, for the latest 12 months at the end of the first quarter from 1.4 times and 0.5 times, respectively, in 2017. This gross leverage increase pressures our Cash Flow Cushion pillar. Sanofi has well-laddered debt maturities comprising EUR 750 million due in 2018, EUR 2.1 billion due in 2019, EUR 3.9 billion due in 2020, EUR 2.2 billion in 2021, and EUR 1.9 billion in 2022. The firm can readily manage this maturing debt, given our expectation of free cash flow averaging more than EUR 6.0 billion per year through 2022. The firm remains committed to its heavy dividend, which consumes around 60% of free cash flow, while it utilizes the remainder for opportunistic share repurchases or bolt-on acquisitions. We are cautious of the firm's capital deployment, as Sanofi thinks it still has flexibility to continue repurchasing shares (EUR 1.5 billion in shares by March 2019) while consummating tuck-in to midsize acquisitions to strengthen its key therapeutic areas.

Alexandria Real Estate Equities (BBB+, Stable) Issues Unsecured 5-Year and 12-Year Green Notes

Market Data

Alexandria Real Estate Equities, Inc. (BBB+, stable) is in the market June 12 with 5-year and 12-year senior unsecured note offerings, according to Bloomberg, the sizes of which have not been indicated as of this publication. The issuer is Alexandria Real Estate Equities, L.P. Net proceeds are expected to fund eligible green projects and for general corporate purposes, including paying down outstanding borrowings on the firm's $1.65 billion unsecured senior line of credit, according to the preliminary supplement to the prospectus dated Dec. 18, 2017, filed by Alexandria June 12.

Alexandria's rated office peers are Boston Properties, Inc. (A-, stable), Highwoods Properties, Inc. (BBB, stable), and Kilroy Realty Corporation (BBB, stable). The following data is from Interactive Data. In the 10-year area, spreads over the nearest Treasury from these issuers were as follows.
Alexandria's $425 million 3.95% bonds due 2028 at +151 basis points.
Boston Properties' $1.00 billion 2.75% bonds due 2026 at +131 basis points.
Highwoods' $350 million 4.125% bonds due 2028 at +151 basis points.
Kilroy's $400 million 4.25% bonds due 2029 at +159 basis points.
The BBB+ Morningstar Corporate Bond Index is currently priced at +149 basis points.

MCR Credit Risk Assessment

Alexandria reported solid increases in revenue and adjusted funds from operations in the first quarter, with year-over-year gains of 18.2% and 24.4%, respectively. Same-property net operating income was higher by 4.0% compared with last year's first quarter. In our view, Alexandria is the REIT industry's dominant player in life science properties, with its tenants predominantly in the fields of medicine, pharmaceutical research, biotechnology, and medical technology. Its properties are concentrated in clusters, which are common in the life sciences industries, developed around university campuses and government agencies associated with research and development.

The operating portfolio was 96.6% occupied as of March 31, with overall occupancy at 94.3%, down by 40 basis points from year-end and one year earlier. The REIT benefits from a high-quality and relatively diverse tenant roll, in our opinion. The 20 largest tenants provide 44.8% of annual in-place rent, none of which accounts for more than 4% of rent; Morningstar Credit Ratings has investment-grade ratings on eight of these tenants, which together contribute 20.5% of in-place rent. Moreover, the top 20 tenants have an average remaining lease term of 13.2 years, providing considerable stability to the tenant base.

We project revenue growth of 13.8% in 2018 because of the combination of strong rent increases and the large volume of new properties placed into service since the beginning of 2017. EBITDA growth is projected in a range of 4.5%-5.0% in 2018, with total debt/gross assets at 35% and interest coverage between 5.0 and 5.5 times, little changed from 2017.

Our rating assumes that Alexandria will maintain leverage in the mid-6.0 times range with a flexible and efficient capital structure. While we do not foresee ratings improvement in the foreseeable future, we may consider an upgrade if Alexandria can make a meaningful reduction in leverage below 6.0 times and improve its interest coverage, while continuing to increase rents. These developments would help improve our Cash Flow Cushion and Solvency Score pillar assessments. Meaningful growth, which brings further diversification, especially the addition of new market locales, would help support positive ratings momentum. On the other hand, we may consider a downgrade of the rating if market forces change the landscape such that Alexandria can no longer command the high quality of tenants and solid occupancy in its properties, and interest coverage suffers as a result. That would have a negative impact on Cash Flow Cushion and Solvency Score.

Concho Resources (BBB-, Positive) Issuing New Senior Unsecured 10- and 30-Year Notes

Market Data

Concho Resources (BBB-, positive) is in the market June 14 issuing 10- and 30-year senior unsecured notes. Following the closing of Concho's proposed acquisition of RSP Permian (not rated) through an all-stock transaction, the company intends to use the net proceeds from this offering to redeem, as previously announced, RSP Permian's 6.625% senior notes due 2022 and 5.25% senior notes due 2025 for approximately $1.2 billion and to repay a portion of the outstanding indebtedness under RSP's existing credit facility, under which RSP had outstanding borrowings of $445 million as of March 31.

If the RSP Acquisition is not completed on or before Dec. 31 or is terminated on or before completion, Concho will redeem all of the new senior unsecured notes at a price equal to 101% of the principal amount of the notes of the applicable series, plus accrued and unpaid interest to the redemption date. At the end of the March quarter, Concho had a negligible cash balance, total debt of $2.4 billion, and reported trailing 12-month adjusted EBITDAX of $2.0 billion.

From a credit perspective, Concho's comparables include Anadarko Petroleum (BBB-, stable), a larger, U.S.-centric exploration and production company, and Pioneer Natural Resources (BBB-, positive), which is a larger Texas Permian-focused E&P company. Concho's 3.75% 2027 senior notes recently traded wider than Pioneer's 4.45% 2026 bonds but slightly tighter than Anadarko's 5.55% 2026 bonds. All of the following bond data is sourced from Interactive Data.

In the approximate 10-year maturity bucket, bonds from these issuers recently traded over the nearest Treasury as follows.
Concho Resources' 3.75% notes due 2027 at +135 basis points.
Pioneer Natural Resources' 4.45% notes due 2026 at +108 basis points.
Anadarko Petroleum's 5.55% notes due 2026 at +142 basis points.

In the approximate 30-year maturity bucket:
Concho's 4.875% notes due 2047 at +179 basis points.
Anadarko's 6.60% notes due 2046 at +201 basis points.

MCR Credit Risk Assessment

On April 6, we affirmed our BBB- rating on Concho Resources and revised the outlook to positive from stable, related to Concho's agreement to purchase RSP Permian (not rated). The acquisition remains on track to close in the third quarter. Regarding regulatory review, early termination of Hart-Scott-Rodino was granted April 27. On closing, RSP shareholders will receive 0.320 share of Concho common stock for each share of RSP common stock and Concho will assume RSP's net debt, which amounted to $1.55 billion at the end of March.

Since its formation in 2006, Concho has helped to consolidate exploratory activity in the Permian Basin (Texas and New Mexico), focusing on horizontal unconventional acreage there, primarily in the Delaware portion. RSP is also a pure-play Permian Basin oil and gas producer, with acreage located contiguous or in close proximity to Concho's holdings. We believe Concho should benefit from the acquisition through operational synergies, shared infrastructure, and corporate-level savings.

Despite a negligible cash balance, we think Concho's liquidity on a stand-alone basis is very good, supported by full availability at the end of March on its $2 billion unsecured revolving credit facility that matures May 2022. Furthermore, assuming $2.0 billion in 2018 capital expenditures and $250 million net proceeds from noncore asset sales realized in the first quarter, we estimate $450 million in 2018 net cash flow, steadily increasing to about $1.5 billion in 2022. Therefore, we do not anticipate Concho needing to make a draw on its credit facility. Regarding leverage, Concho's total debt/trailing 12-month EBITDAX was 1.2 times at the end of March. Pro forma for the RSP acquisition and excluding any synergies, we estimate the company's gross leverage at March 31 would have been 1.4 times.

MGM Resorts International (BB-, Positive) Offering New $500 Million 7-Year Bonds

Market Data

MGM Resorts International (BB-, positive) is reportedly in the market with a new $500 million 7-year senior unsecured note offering. The new notes will be guaranteed on a senior basis by certain subsidiaries that guarantee the company's existing notes. The notes are effectively subordinated to the company's secured obligations, primarily consisting of its senior credit facility, and are also effectively junior to debt at the subsidiaries that do not guarantee the notes. The firm plans to use proceeds for general corporate purposes, including debt refinancing, acquisition funding, and shareholder dividends and share repurchases. MGM has filed a preliminary prospectus supplement to the prospectus dated March 1.

MGM Resorts is best compared with its nonrated peer Wynn Resorts, which also operates resorts in Macau and maintain a similar leverage profile. According to pricing service Interactive Data, MGM Resorts' $500 million 4.625% senior unsecured notes due 2026 recently traded at a yield of 5.56% and a spread of +264 basis points over the nearest Treasury, while Wynn Las Vegas, LLC's $1.8 billion 5.50% senior unsecured notes due in 2025 recently traded at a yield of 5.61% and a spread of +272 basis points.

MCR Credit Risk Assessment

MGM Resorts rating is based on the company's leading market positions, healthy profit improvement, strengthening free cash flow, and declining debt leverage. MGM is the leading operator in its domestic markets, including Las Vegas, Detroit, the Mississippi Gulf Coast, Maryland, and New Jersey. Las Vegas is the company's largest market, in which it holds over 40% share. Las Vegas fundamentals continue to improve, with occupancy rates on the Las Vegas strip at the highest level in 10 years at 93%, according to management. In addition, MGM and its peers continue investing to reposition Las Vegas as an entertainment destination, resulting in a more diversified revenue stream that is less reliant on gaming. Nongaming revenue in Las Vegas is at record levels following strong 4% average annual growth rates over the past 5 years led by increased sports and entertainment venues. MGM generates about 80% of its EBITDA from Las Vegas and U.S. regional markets, yet MGM is also firmly positioned in Macau, the largest gaming market in the world. MGM currently holds one of only six gaming licenses in Macau and thus enjoys high regulatory and land barriers. Macau continues to recover from a multiyear decline prompted by government enforcement on corruption, with gross gaming revenue accelerating to over 20% growth in each of the last four quarters.

Over the past several years MGM's credit profile has improved. The company exceeded its recently concluded three-year Profit Growth Plan, increasing incremental EBITDA by $400 million, ahead of its $300 million target. Adjusted EBITDA margins improved 450 basis points over this period to 27.2% in 2017. MGM's free cash flow is projected to substantially improve over the next three years as capital spending on recent new development is completed. MGM recently opened MGM National Harbor (December 2016) and MGM Cotai (February 2018) and is on track to open MGM Springfield (Massachusetts) in September. As such, over the next three years MGM is projected to generate cumulatively between $4.5 billion and $5.0 billion of free cash flow. While management expects to pay out 50%-65% of this free cash flow to shareholder via dividends and share repurchases, it targets net leverage to decline further, to 3.0-4.0 times by 2019. The positive outlook reflects the potential for the rating to be raised within the next couple of years with free cash flow growth and continued progress to lower debt leverage.

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