# Morningstar Corporate Credit Research Highlights

## CVS Megadeal Weighs on Investment-Grade Corporate Bonds

**Morningstar Credit Ratings, LLC**
12 March 2018

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### Credit Rating Actions

- Rating Changes

| Issuer/Ticker | Current Issuer Credit Rating | Previous Issuer Credit Rating |
|---|---|---|
| United Continental **UAL** | BB+ | BB |
| Teva Pharmaceutical **TEVA** | BB | BBB- |

- Rating Affirmations

| Issuer/Ticker | Current Issuer Credit Rating | Previous Issuer Credit Rating |
|---|---|---|
| Southwest Airlines **LUV** | BBB+ | BBB+ |
| United Parcel Service **UPS** | A+ | A+ |
| American International Group **AIG** | BBB | BBB |
| Chubb **CB** | A- | A- |
| General Mills **GIS** | BBB+ | BBB+ |

### Recent Notes Published by Credit Analysts

- **CVS** (BBB+/UR-) Issuing New Debt to Prefund Pending Aetna Merger
- **Teva** (BB, Stable) Issuing New Debt to Refinance Term Loans and 2018 Debt Maturity
- **Rolls-Royce** (A-, Negative) Ends 2017 on Solid Ground and Provides 2018 Guidance
- **Zimmer Biomet** (BBB, Stable) Issuing New Notes to Redeem Existing Debt

## Credit Market Insights

### CVS Megadeal Weighs on Investment-Grade Corporate Bonds

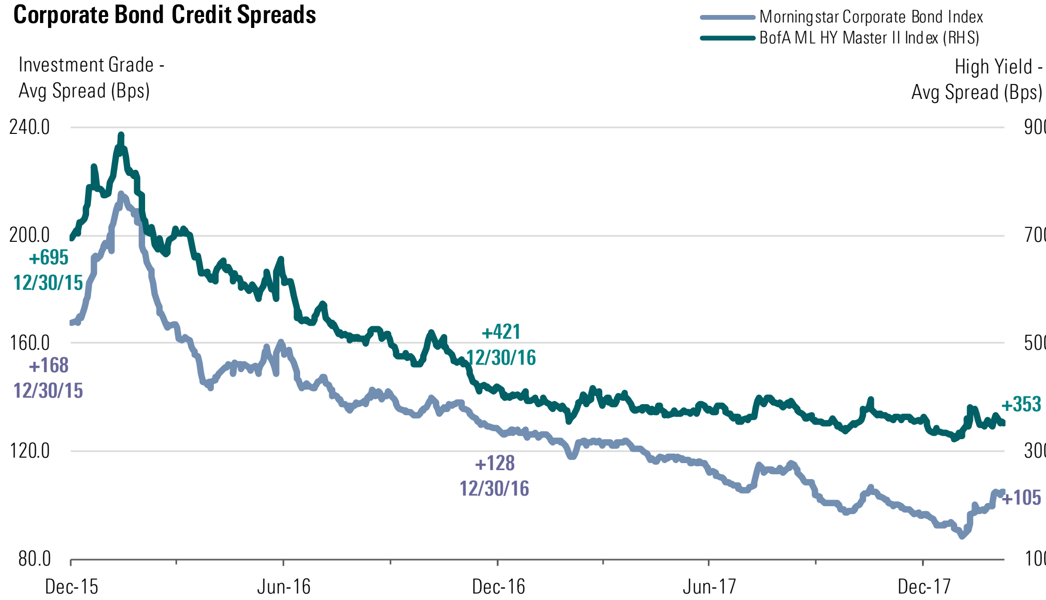
The extremely strong employment report released Friday morning overwhelmed any lingering negative investor sentiment from the tariff debates and the resignation of Gary Cohn as director of the National Economic Council. Risk assets traded fairly well through most of the week, but equities soared Friday after it was reported that jobs jumped by 313,000 in February. The S&P 500 rose 3.54% for the week, but half of that increase came on Friday alone, when the index jumped 1.74%. Even though most classes of risk assets rose last week, credit spreads in the investment-grade corporate bond market languished and were generally unchanged as bond investors suffered a little indigestion from the monster $40 billion CVS Health (BBB+/UR-) deal.

This transaction from CVS was the third-largest single-borrower transaction in the history of the corporate bond market. The largest transaction was the $49 billion Verizon (BBB, stable) deal in 2013, in which the proceeds were used to finance the company's wireless assets. The second largest occurred in 2016, when Anheuser-Busch InBev (BBB+, stable) priced $46 billion to fund the purchase of SABMiller. CVS plans to use the proceeds from this transaction to fund its acquisition of Aetna, which is expected to close in late 2018. We placed our rating for CVS under review with negative implications when the acquisition was first announced, as we expect the debt leverage of the combined company will increase to over 4 times.

Given the size of the CVS issuance, corporate credit spreads in the investment-grade market were under pressure as the market digested this new supply. Compounding the overhang on the investment-grade market, other issuers that came to market had to pay greater-than-average new issue concessions to attract new investors to price their deals. Between the new supply and the wider-than-usual new issue concessions, investors have little reason to bid up prices on other bonds until this abundant supply is put away in long-term hands. In addition, investors are increasingly leery that the re-emergence of large debt-funded acquisitions will drive credit spreads wider for those companies. It appears that the appetite for acquisitions in the healthcare industry is not over, as Cigna (BBB/UR-) on Thursday announced its bid to purchase Express Scripts (A-/UR-).

The average spread of the Morningstar Corporate Bond Index (our proxy for the investment-grade bond market) ended the week unchanged at +105. Credit spreads in the investment-grade market languished as the CVS deal cast a shadow across trading desks, while in the high-yield market, the BofA Merrill Lynch High Yield Master Index tightened 12 basis points to +353. There has been a record-setting eight consecutive weeks of outflows among high-yield open-end mutual funds and exchange-traded funds; however, the positive sentiment from the stunning jobs number more than offset the pall from continued redemptions.

**Corporate Bond Credit Spreads**




Source: Morningstar,Inc., BofA Merrill Lynch Global Indexes. Data as of 3/9/2018.

Interest rates rose 2 basis points across the yield curve in a parallel shift upward. The 2-year Treasury note ended the week at 2.26%, its highest yield since September 2008. The yield on the 2-year has risen in lockstep with the expected increase in the federal-funds rate. Between the jump in employment and strong readings across other economic metrics such as the PMI and ISM indexes, investors are pricing in increasingly higher probabilities that strong economic growth will prompt the Federal Reserve to raise short-term rates even more than originally expected at the beginning of the year.

According to the CME FedWatch Tool, the probability that the federal-funds rate at the end of 2018 will be greater than 1.75% is 95%, the probability that the fed-funds rate will be 2% or higher is 73%, and the probability that the rate will be 2.25% or higher (representing four rate hikes) is now 34%. At the beginning of the year, those probabilities were 79%, 44%, and 13%, respectively. In the near term, the probability that the Fed will lift rates to 1.50%-1.75% after the Federal Open Market Committee meetings March 20-21 is almost a foregone conclusion at 89%.

In conjunction with the March meeting, the Fed will release an updated summary of its economic projections, which will be scrutinized for any change in the dot plot graph that details FOMC participants' assessment of the midpoint of the target range for the federal-funds rate at the end of 2018. At the Fed's December 2017 meeting, the average projected federal-funds rate of the board members was 2%, 2.70%, and 3% for years ended 2018, 2019, and 2020. In addition, Fed Chairman Jerome Powell will conduct a press conference to make a statement and answer questions.

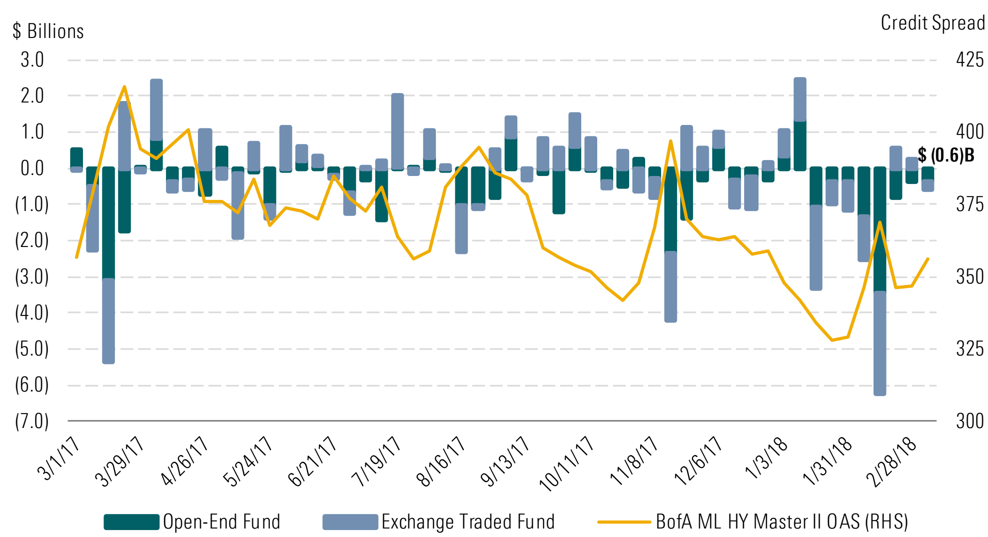
Across the rest of the yield curve, the 5-year Treasury note rose to 2.65%, the 10-year Treasury bond increased to 2.89%, and the 30-year Treasury bond ended the week at 3.16%. The spread between the yield on the 2-year and the 10-year Treasury was unchanged at 63 basis points.

### High-Yield Outflows Continue to Set Records

Outflows in the high-yield asset class just would not stop; for the eighth consecutive week, high-yield open-end mutual funds and exchange-traded funds registered outflows. The prior record for consecutive weekly outflows was six weeks, which occurred in December 2014 through January 2015 and again in July through August 2015. Net outflows last week increased to $0.6 billion from $0.1 billion the prior week, with $0.4 billion of outflows among the open-end mutual funds and $0.2 billion of net unit redemptions across the ETFs.

There has been a total of $15.1 billion of outflows over the past eight weeks. This is also a new record for the amount of outflows occurring over a period of consecutive weekly outflows. The second-greatest amount of outflows that occurred over a period of consecutive weekly outflows was $12.3 billion over five weeks in mid-2014, and the third-greatest amount was $12.1 billion over five weeks in spring 2013.

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




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

**Exhibit 1** Morningstar Credit New Issue Monitor

Week ended March 9, 2018

(000,000s $ unless otherwise noted)

| Issuer | | | Issue | | | | |
|---|---|---|---|---|---|---|---|
| Name | Ticker | Morningstar Corporate Rating[1] | Size | Coupon | Description | Maturity | Approx Spread to US Treasuries |
| Analog Devices | ADI | A | $300 | 2.85% | Senior Unsecured | 2020 | +70 |
| Analog Devices | ADI | A | $450 | 2.95% | Senior Unsecured | 2021 | +70 |
| CVS Health | CVS | BBB+/UR- | $2,000 | 3.125% | Senior Unsecured | 2020 | +90 |
| CVS Health | CVS | BBB+/UR- | $1,000 | L+63 | Senior Unsecured | 2020 | NA |
| CVS Health | CVS | BBB+/UR- | $3,000 | 3.35% | Senior Unsecured | 2021 | +95 |
| CVS Health | CVS | BBB+/UR- | $1,000 | L+72 | Senior Unsecured | 2021 | NA |
| CVS Health | CVS | BBB+/UR- | $6,000 | 3.70% | Senior Unsecured | 2023 | +125 |
| CVS Health | CVS | BBB+/UR- | $5,000 | 4.10% | Senior Unsecured | 2025 | +145 |
| CVS Health | CVS | BBB+/UR- | $9,000 | 4.30% | Senior Unsecured | 2028 | +160 |
| CVS Health | CVS | BBB+/UR- | $5,000 | 4.78% | Senior Unsecured | 2038 | +180 |
| CVS Health | CVS | BBB+/UR- | $8,000 | 5.05% | Senior Unsecured | 2048 | +195 |
| Frontier Communications | FTR | B | $1,600 | 8.50% | Senior Unsecured | 2026 | +566 |
| John Deere Capital | DE | A[1] | $500 | L+24 | Senior Unsecured | 2021 | NA |
| John Deere Capital | DE | A[1] | $400 | 2.875% | Senior Unsecured | 2021 | +48 |
| John Deere Capital | DE | A[1] | $600 | 3.45% | Senior Unsecured | 2025 | +67 |
| Mondelez International | MDLZ | BBB | CAD 600 | 3.25% | Senior Unsecured | 2025 | +119[2] |
| Sysco | SYY | A- | $500 | 3.55% | Senior Unsecured | 2025 | +85 |
| Sysco | SYY | A- | $500 | 4.45% | Senior Unsecured | 2048 | +135 |
| Teva Pharmaceutical Finance BV | TEVA | BB[1] | € 700 | 3.25% | Senior Unsecured | 2022 | +342[3] |
| Teva Pharmaceutical Finance BV | TEVA | BB[1] | € 900 | 4.50% | Senior Unsecured | 2025 | +420[3] |
| Teva Pharmaceutical Industries | TEVA | BB | $1,250 | 6.00% | Senior Unsecured | 2024 | +328 |
| Teva Pharmaceutical Industries | TEVA | BB | $1,250 | 6.75% | Senior Unsecured | 2028 | +388 |
| Zimmer Biomet | ZBH | BBB | $450 | L+75 | Senior Unsecured | 2021 | NA |
| Zimmer Biomet | ZBH | BBB+ | $300 | 3.70% | Senior Unsecured | 2023 | +110 |

Source: Bloomberg, company Securities and Exchange Commission filings.

(1) Morningstar's issuer credit rating is assigned at the holding company level.

(2) Spread over Canadian Treasuries.

(3) Spread over German Treasuries.

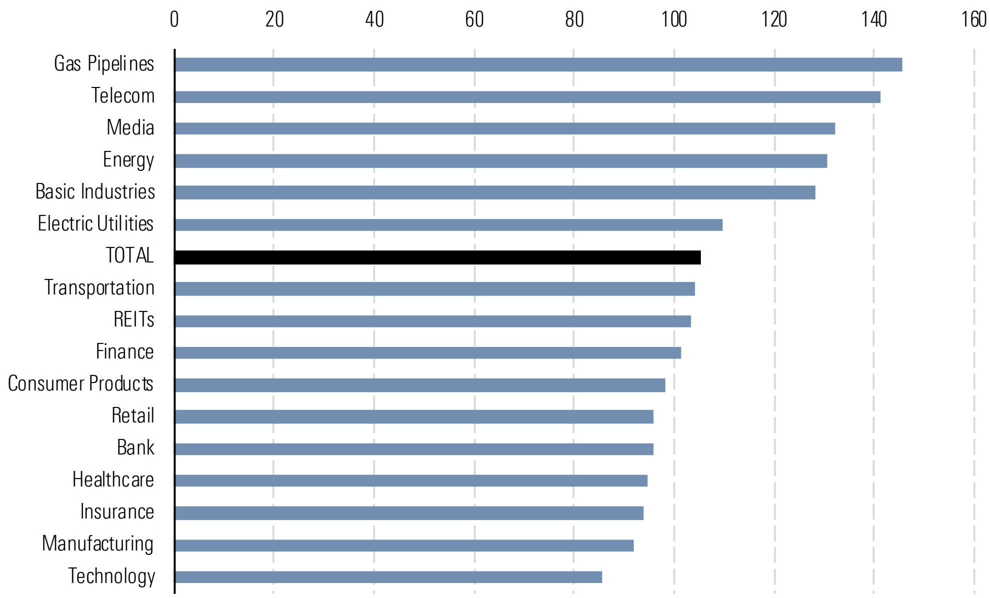
**Exhibit 2** Morningstar Corporate Bond Index Sector Summary

| 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-** | **4,987** | **6.9** | **105** | **5** | **9** | **(0.37)** | **(2.82)** |
| **FINANCIAL** | **A-** | **1,486** | **5.3** | **97** | **4** | **13** | **(0.26)** | **(2.37)** |
| Bank | A- | 905 | 4.9 | 96 | 5 | 15 | (0.25) | (2.15) |
| Finance | A | 271 | 5.5 | 101 | 4 | 14 | (0.25) | (2.77) |
| Insurance | A | 217 | 7.7 | 94 | 4 | 8 | (0.39) | (3.18) |
| REITs | BBB+ | 85 | 6.0 | 104 | (1) | (1) | (0.27) | (2.21) |
| **INDUSTRIAL** | **A-** | **2,892** | **7.6** | **108** | **5** | **7** | **(0.40)** | **(3.03)** |
| Basic Industries | BBB | 242 | 7.7 | 128 | 5 | (1) | (0.49) | (2.67) |
| Consumer Products | A- | 323 | 7.5 | 98 | 5 | 14 | (0.46) | (3.54) |
| Energy | A- | 412 | 7.3 | 130 | 7 | 8 | (0.36) | (2.70) |
| Healthcare | A- | 401 | 7.8 | 95 | 5 | 6 | (0.46) | (3.55) |
| Manufacturing | A- | 459 | 6.1 | 92 | 5 | 11 | (0.35) | (2.62) |
| Media | BBB+ | 188 | 8.4 | 132 | 6 | 3 | (0.56) | (3.22) |
| Retail | A- | 160 | 7.6 | 96 | 4 | 9 | (0.47) | (3.42) |
| Technology | A+ | 355 | 7.3 | 86 | 2 | 8 | (0.22) | (2.93) |
| Telecom | BBB+ | 146 | 9.2 | 141 | 3 | (2) | (0.48) | (2.47) |
| Transportation | BBB+ | 153 | 8.9 | 104 | 4 | 6 | (0.49) | (3.71) |
| **UTILITY** | **BBB+** | **570** | **8.6** | **125** | **5** | **5** | **(0.56)** | **(3.31)** |
| Electric Utilities | A- | 330 | 9.1 | 110 | 4 | 6 | (0.51) | (3.73) |
| Gas Pipelines | BBB | 228 | 7.8 | 146 | 6 | 2 | (0.63) | (2.65) |
| **Rating Bucket** | | | | | | | | |
| AAA Bucket | | 112 | 8.2 | 53 | 2 | 5 | (0.28) | (3.31) |
| AA Bucket | | 473 | 5.6 | 65 | 3 | 7 | (0.20) | (2.26) |
| A Bucket | | 1,941 | 6.8 | 86 | 4 | 13 | (0.34) | (3.03) |
| BBB Bucket | | 2,461 | 7.2 | 133 | 5 | 6 | (0.43) | (2.73) |
| **Term Bucket** | | | | | | | | |
| 1-4 | A- | 1,592 | 2.3 | 70 | 4 | 13 | (0.02) | (0.65) |
| 4-7 | A- | 1,163 | 4.7 | 91 | 5 | 11 | (0.15) | (1.86) |
| 7-10 | A- | 927 | 7.0 | 116 | 6 | 10 | (0.37) | (3.19) |
| 10PLUS | A- | 1,305 | 13.7 | 148 | 4 | 4 | (0.92) | (5.62) |

*Data as of 03/09/2018*

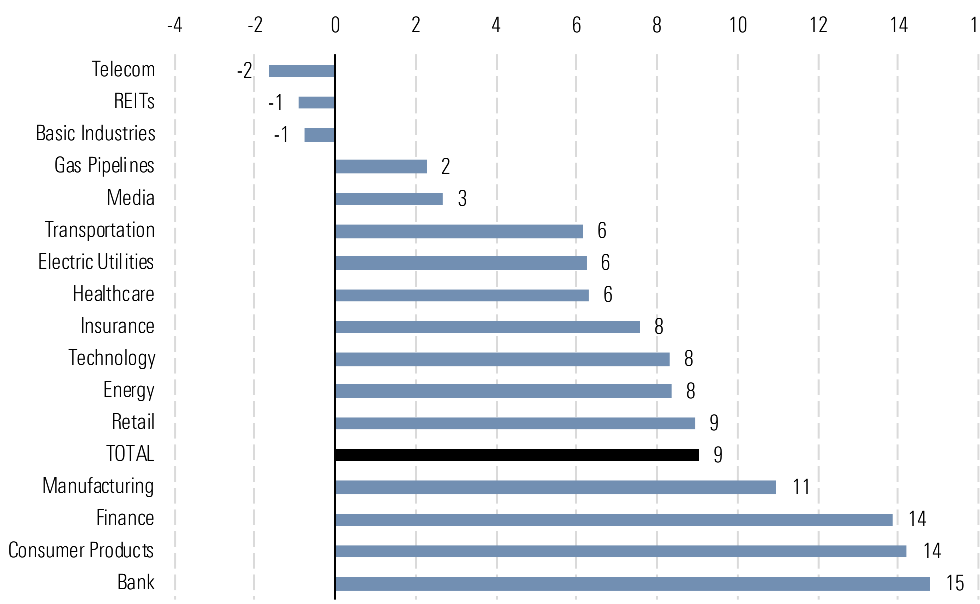
Source: Morningstar, Inc.

**Exhibit 3** Morningstar Corporate Bond Index Spread by Sector



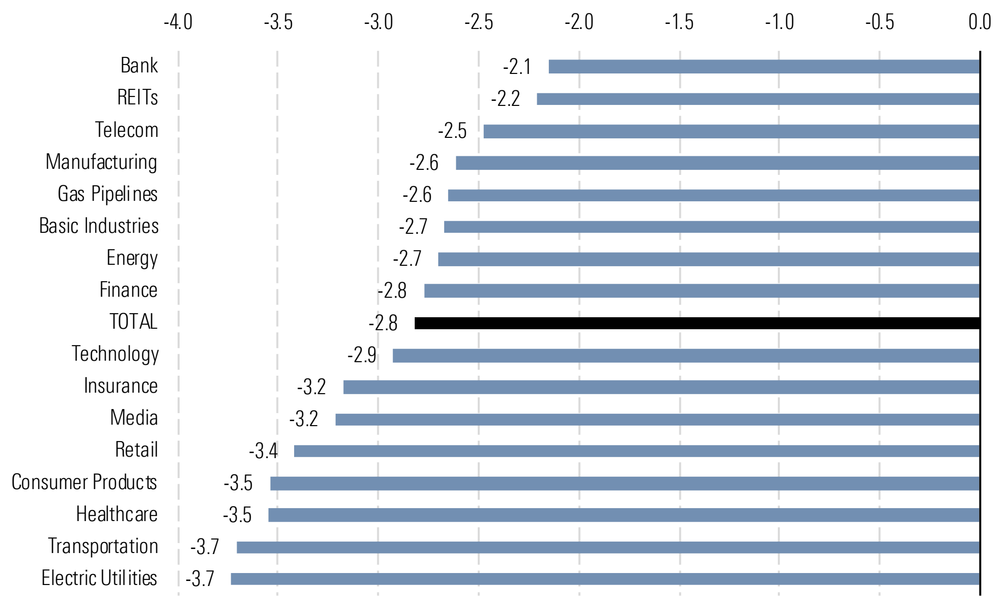

Source: Morningstar, Inc.

**Exhibit 4** Morningstar Corporate Bond Index YTD Spread Change




Source: Morningstar, Inc.

**Exhibit 5** Morningstar Corporate Bond Index YTD Return




Source: Morningstar, Inc.

## Credit Rating Actions

### Rating Changes

| Issuer/Ticker | Current Issuer Credit Rating | Previous Issuer Credit Rating |
|---|---|---|
| United Continental **UAL** | BB+ | BB |
| Teva Pharmaceutical **TEVA** | BB | BBB- |

### Rating Affirmations

| Issuer/Ticker | Current Issuer Credit Rating | Previous Issuer Credit Rating |
|---|---|---|
| Southwest Airlines **LUV** | BBB+ | BBB+ |
| United Parcel Service **UPS** | A+ | A+ |
| American International Group **AIG** | BBB | BBB |
| Chubb **CB** | A- | A- |
| General Mills **GIS** | BBB+ | BBB+ |

**United Continental's Rating Upgraded One Notch to BB+ and Stable Outlook Assigned**

Morningstar Credit Ratings, LLC is upgrading our corporate credit rating on United Continental Holdings Inc. one notch to BB+ to account for our view of the company's permanently stronger credit profile. The beginning of 2017 started to trend ahead of our projections, but since the summer season, things have hit bumpier skies. Competition has intensified and lowered prices while fuel prices rose. So, while United delivered a less lucrative 2017 than previously anticipated, we still believe that the company's overall credit profile is strong enough to warrant an upgrade to BB+. That said, we believe that United is destined to remain below investment-grade territory at this juncture, which is also corroborated by management's recent commentary. As such, we are assigning United a stable outlook.

Our rating for United Continental incorporates our weak view of the industry, United's competitive position, and its high leverage. United is one of the world's largest airlines, and its revenue base helps support its moderate Business Risk score. Although consolidation has added some much-needed discipline in the industry, low barriers to entry and high exit barriers have historically kept any sustained profitability at bay. This has resulted in Morningstar's Equity Research Group assigning a no-moat assessment to United that constrains its Business Risk score. The Business Risk pillar does benefit slightly from our view of the company's neutral product and customer concentration and average cyclicality rankings. Returns on invested capital and interest coverage have improved recently, too, but the company's high total liabilities/total assets and low quick ratio result in a moderate Solvency Score. We project that United will generate average operating cash flow of $4.9 billion per year, but its Cash Flow Cushion score is affected by meaningful capital expenditures ($3.2 billion per year), resulting in average annual free cash flow of $1.8 billion per year during our forecast period. United also faces average debt maturities of $1.3 billion per year through 2022.

At this point, we have assigned United a stable outlook, and we think the company is likely to remain just below investment-grade territory. Our view is corroborated by management commentary in October indicating that the company will not strive toward an investment-grade rating. In part, we believe that United's rating is constrained by its moderate Business Risk pillar. Should we gain more confidence in the firm's ability to sustain a competitive advantage, then we would expect a possible uplift to the

Business Risk pillar could result in a ratings upgrade. We also think that further deleveraging could improve the Solvency Score and Cash Flow Cushion pillars that could also lend support to a possible upgrade. However, should United return more cash to shareholders combined with a collapse in profitability due to industry pressures, then we could envision a possible downgrade.

### Teva's Credit Rating Downgraded to BB; Rating Outlook Stable

Morningstar Credit Ratings, LLC is downgrading Teva's credit rating to BB from BBB-, reflecting the firm's difficult path ahead as it tries to reverse declining operational performance while handcuffed by high financial leverage. Our stable outlook is informed by our expectations of success for the firm's operating strategy, which is meant to stabilize operational deterioration while strengthening its balance sheet. This action resolves the under review negative status originally placed on the credit rating on Dec. 19, 2017, shortly after the announcement of the new operating strategy.

Teva's new CEO has instituted a strategy intended to stabilize operational deterioration by trimming its cost structure, streamlining its organizational infrastructure, and reducing elevated debt leverage. Specific actions include removing $3 billion in operating expenses (from a $16 billion cost base) by 2019, suspending the common dividend, prioritizing cash for debt reduction, and emphasizing specialty medicines. While uncertainty has risen in light of Teva's recovery, we still see benefits provided by the firm's scale, geographic reach, and breadth of its generic drug offering, which supports our Business Risk pillar. Still, this pillar is weighed down by Morningstar Equity Group's consideration that the generic drug industry is predominantly a no-moat industry, given low barriers to entry, highly commoditized products, and a fragmented industry despite past consolidation. We recognize that the organizational revamp may have negative repercussions on revenue and earnings over the next few years, complicated by increasing generic competition to its bestseller Copaxone (multiple sclerosis), which represents about 15% of overall sales. The current rating incorporates pressure on our Cash Flow Cushion, Solvency Score, and Distance to Default pillars in connection with withering operational output over the course of 2017. Over the next five years, we expect revenue and EBITDA to decline in the low single digits compounded annually, assuming solid execution for its restructuring plan and successful commercialization of novel medicines. Recovery of top-line growth in the intermediate term may be helped by strong uptake of specialty drug Austedo for Huntington's disease and tardive dyskinesia, and the near-term U.S. launch of migraine drug candidate fremanezumab. Our modestly declining forecast, along with an expectation of material debt reduction, would help decrease inflated leverage enough to hold our current leverage-based pillars, which informs our stable outlook.

Teva has worked diligently to reduce its heavy debt load since the highly leveraging acquisition of Actavis in August 2016. At the end of 2017, the firm owed $32.5 billion in unsecured notes and term loans, or gross debt leverage of 5.3 times, compared with a debt balance of $35.8 billion in 2016 for total leverage of 5.8 times. Considering modest cash and investments of $963 million on Dec. 31, 2017, net leverage stood at 5.2 times. Teva still has a long road to reach its current net leverage target of below 4 times EBITDA by 2020, which is part of its new operating strategy. Achieving the firm's leverage expectation would require a combination of significant debt reduction and increasing profitability that depends on solid execution for its restructuring program, together with successful commercialization of new products. Along these lines, the firm anticipates reducing gross debt by $3.5 billion in 2018, funded in part with asset sale proceeds and free cash flow generation. Teva has some financial flexibility to address its debt burden, with free cash flow averaging around $3 billion annually, in our estimation; this fully covers long-term debt maturities over the next five years, which presently total around $13 billion, adjusting for present refinancing activities. We view Teva's elimination of its dividend as a credit positive, as it preserves more than $1.3 billion of cash per year that can be directed to debt reduction. We recognize that management had already taken steps to preserve cash flow for debt reduction, including stopping share repurchases and curtailing larger M&A actions. In addition, recent actions to strengthen its precarious financial position have given the firm time to return to operational growth, including relaxing a maximum leverage covenant in its credit facilities and currently refinancing nearing debt maturities, effectively extending more than $3 billion of aging debt into 2022 and beyond.

Our stable rating outlook incorporates Teva's solid execution of its operating strategy, most notably its success in extracting operating expenses through 2019, in driving strong uptake of Austedo, commercializing fremanezumab in the near term, and strengthening its balance sheet. Any hiccups during the firm's recovery in the next two years, including delayed debt reduction and failure to reverse underwhelming operational performance, such that we expect any one of our leverage-based pillars to deteriorate from its current level, could result in a downgrade. In addition, aggressive capital deployment, such as leveraging M&A or significant shareholder returns before Teva's balance sheet is repaired, could pressure the rating downward. While positive rating action is highly unlikely, substantial leverage improvement for a sustained period that strengthens our leverage-sensitive pillars, coupled with stabilized operational performance, could result in positive rating action.

**Southwest Airlines' Rating Affirmed at BBB+ With Stable Outlook**

Morningstar Credit Ratings, LLC is affirming its BBB+ credit rating and stable outlook on Southwest Airlines Co. Our credit rating considers Southwest's marked improvement in profitability and cash flow generation, but also contemplates its mixed competitive position and generous policy of returning cash to shareholders. Although there have been some recent indications that industry capacity expansion could hurt profitability, we believe that overall industry fundamentals should help Southwest's results over the next few years.

Our BBB+ issuer rating blends Southwest Airlines' mixed competitive position with its strong financial profile. The company has an entrenched position in the domestic market with 24% share, based on domestic originating passengers boarded and leading positions in several metropolitan areas, such as Las Vegas and Denver. Southwest arguably has a lower cost structure than its peers, but the airline industry is challenged to the extent that no company can reliably sustain returns above invested capital for an extended period. Morningstar's Equity Research Group has assigned Southwest an economic moat rating of none, which detracts from its Business Risk pillar. Nevertheless, industry consolidation has enabled all players to benefit from solid profitability gains, with Southwest delivering strong profitability metrics and interest coverage ratios, two things that bolster its Solvency Score. Profitability helps its Cash Flow Cushion, but the score is weakened by returning cash to shareholders—$4.5 billion in share repurchases over the past three years and $850 million remaining on its current authorization as of Jan. 31, 2018—a substantial rise in its dividend, and average debt maturities of $480 million due over the next five years, versus average free cash flow of $2.6 billion.

We expect that our Southwest rating will remain at the current level as we think increased shareholder distributions will accompany further profitability growth, which is reflected in our stable outlook. However, we could upgrade our rating if Southwest experiences a meaningfully higher increase in profitability than we currently forecast. Also, a reduction in leverage could help improve both the Solvency Score and Cash Flow Cushion enough to upgrade. Lastly, an improvement in the company's Business Risk pillar, based on an improvement of its competitive position, could also result in an upgrade. Our credit rating could come under pressure if Southwest abandons its cost discipline to capture further market share in a prolonged fare war or if the company decides to add incremental debt to return more cash to shareholders, which would constrain the aforementioned pillars.

**UPS' Rating Affirmed at A+, but Outlook Reduced to Negative on a Worsening Credit Profile**
Morningstar Credit Ratings, LLC is affirming its A+ credit rating on United Parcel Service Inc. Our rating reflects the company's strong competitive position offset by moderately high adjusted leverage for the rating category, which is exacerbated by its unfunded pension liabilities and operating leases. UPS delivered strong 2017 results, driven by a 4.5% increase in volume. However, profitability has suffered as the massive volume surge has forced UPS to keep increasing its capital spending. In total, that higher capital spending, financed by incremental debt, has weakened the company's creditworthiness such that we are now assigning it a negative outlook. Should UPS deliver results along the same route in the next year or so, then we could downgrade our rating.

UPS has developed a massive, integrated global shipping network with breadth that is almost impossible to replicate. The resulting competitive position has enabled UPS to garner a wide economic moat from Morningstar's Equity Research Group, which supports its Business Risk pillar. This pillar score is also boosted by UPS' medium uncertainty around cash flows, a diverse customer base, and relatively stable business conditions. UPS has monetized this competitive advantage into returns on invested capital of around 15% per year and interest coverage of nearly 10 times, bolstering its Solvency Score. However, leverage has increased to 2.3 times, as the company raised debt to fund capital spending and contribute to its underfunded pension—$5.2 billion as of December 2017. As a result, the company has a high total liabilities/total assets ratio that slightly detracts from the Solvency Score. We project UPS will generate $10 billion per year in annual operating cash flow, but capital spending will reach around $7 billion per year over the next few years before tapering to $5 billion by 2022. In total, we project average annual free cash flow of around $4 billion during the next five years. Shareholder-friendly policies, annual debt maturities of $2.1 billion per year, and $1.4 billion in projected annual operating leases and pension contributions constrain the Cash Flow Cushion.

We are assigning UPS a negative outlook to account for the worsening financial health of UPS over the past year. Revenue growth was strong in 2017, but UPS had to spend considerably to keep pace with e-commerce growth. For example, capital spending grew to $5.2 billion in 2017 from $2.4 billion in 2015 and is projected to increase to $6.8 billion in 2018. All the while, reported operating margins contracted to 11.6% from 13.3%. As a result, debt/EBITDA has increased to 2.3 times from 1.6 times, as the company borrowed money to fund that capital spending and $7.8 billion in 2017 pension payments, $5.1 billion more than in 2016. If this deterioration continues and things do not improve, we could downgrade our rating on a weakening Solvency Score. If UPS were to repay debt and profitability improves, we could foresee our rating stabilizing or even increasing eventually.

**AIG's Rating Affirmed at BBB; Outlook Revised to Stable**

Morningstar Credit Ratings, LLC is affirming American International Group, Inc.'s credit rating at BBB. We have revised the outlook to stable from negative.

Our BBB credit rating for AIG reflects the significant size and global reach of the company's insurance business, as AIG is one of the world's largest insurers. We have revised the outlook to stable despite the company's poor bottom-line performance in 2017, as underlying operating and underwriting results and the company's reserve position show signs of material improvement, and AIG discontinued its $25 billion capital return plan. With the announced acquisition of Validus Re in January, AIG is following through on its plans to pursue growth opportunities while shedding unprofitable commercial policies.

AIG reported poor 2017 results due to high natural catastrophe losses, lower but still material adverse reserve developments, and a large tax charge linked to revaluing the company's deferred tax assets (the balance of which was built up in the aftermath of the financial crisis). Underwriting results were weak, with AIG reporting a full-year 2017 combined ratio at 117.3%, with catastrophe losses and reserve development adding 16.0 points and 5.6 points to the combined ratio, respectively. Combined with a $6.7 billion fourth-quarter tax charge, the insurer reported a negative $6.1 billion full-year loss. Positively, AIG's underlying results improved year over year, with the combined ratio excluding natural catastrophes and reserve development improving to 95.6% from 96.8% in the prior year. Pretax operating income (EBIT less realized gains/losses) also grew 52% to $2.8 billion from $1.9 billion in 2016, aided by a 40-basis-point increase in the company's investment yield to 3.8%. Most important, the insurer's reserve position finally looks as though it's stabilized, as adverse development decreased to $1.5 billion from $5.4 billion in 2016 and $4.0 billion in 2015, with the majority of development occurring in the third quarter as opposed to the fourth quarter, as in prior years.

The company is also less focused on capital return, choosing instead to reinvest in its business particularly through smaller, bolt-on acquisitions of established, profitable insurance companies. The acquisition of Validus Re, announced in January and expected to close in the second or third quarter of 2018, is a prime example. As we wrote in a Jan. 22 credit note, "AIG's Strategic Acquisition of Validus Anticipated to Be Mutually Beneficial," the deal is expected to be a positive for both insurers. Validus should contribute moderately to AIG's underwriting profitability on a long-term basis, averaging out years with significant catastrophe activity, while AIG offers Validus greater global reach, an expanded distribution network, and the expertise of CEO Brian Duperreault, who has extensive experience in the Bermuda market.

AIG does not have an economic moat, according to Morningstar's Equity Research Group, despite the insurer's size and global network. As AIG writes business in almost every major product line in multiple geographic locations, this diversification makes it difficult to consistently beat industry returns in the long term, as gains in one area are diluted by losses in another. The lack of a moat factors unfavorably in our credit risk assessment, as opposed to the narrow moat ratings of higher-rated peers Chubb Ltd. (A-, positive) and Travelers Companies, Inc. (A-, stable).

Our credit risk assessment for AIG considers four key components, or pillars, that factor heavily in the credit rating. AIG scores worse in our assessment than other rated property-casualty peers particularly due to its Debt Cushion score, as its poor profitability and greater debt balance run counter to peer assessments. The Business Risk pillar is considered good due to the company's large size, above-average management grade and a medium uncertainty score. AIG reports moderately high financial leverage at 33% debt/capital and high reserve leverage at 2.7 times due to longer-tail commercial line business and its life operations, offset by low operating leverage at 0.3 times, resulting in a fair Financial Risk pillar. The company also scores very well under the Distance to Default pillar.

Key factors that could lead to a rating upgrade include sustained stabilization of the commercial reserve position as demonstrated by a material reduction in reported adverse development and a sustained improvement in profitability with return on equity at 8%-10%. A decrease in leverage to levels more consistent with a primary property/casualty insurer, as well as a decrease in financial leverage to 20%, could also lead to an upgrade. Further large material reserve charges, profit deterioration in underlying results of property/casualty lines, or a material weakening in the performance of life operations could also lead to a downgrade. Financial leverage increasing to 35% and an increase in reserve or asset leverage metrics that are more consistent with a life insurance company would also likely lead to a downgrade.

**Chubb's Rating Affirmed at A-; Outlook Remains Positive**
Morningstar Credit Ratings, LLC is affirming Chubb Ltd.'s A- credit rating and maintaining a positive outlook on the rating.

Chubb's A- credit rating considers the insurer's strong underwriting profile, conservative balance sheet, and narrow economic moat assigned by Morningstar's Equity Research Group. We are maintaining a positive outlook given the company's solid operating performance and stronger credit profile following the merger of ACE and Chubb, offset by the insurer's below-average results in 2017 due to outsize catastrophe losses. Specializing in middle and large commercial market accounts, Chubb is one of the most consistent and profitable underwriters in both Morningstar Credit Ratings, LLC's rated universe and in the wider primary property/casualty industry. Chubb provides insurance solutions to members of the Fortune 1000 that have diverse risks throughout the globe, with strong relationships that allow the company cross-selling opportunities and high customer retention rates. For example, the largest portion of intangible assets acquired in the merger is allocated to agency distribution relationships and renewal rights ($3.15 billion out of $7.7 billion).

According to Morningstar's Equity Research Group, Chubb's narrow moat stems from its commercial and personal lines of business. Before the ACE/Chubb merger in 2016, ACE primarily wrote business on large commercial accounts while Chubb's main client base was middle-market commercial accounts. Both companies were able to carve out profitable niches in their respective market segments given their size, network capabilities and strong brands, which have carried over into the combined company. While most insurers are not able to achieve a moat around their personal line segments, Chubb's focus on high-net-worth clients affords the company the ability to write unique specialty risks and retain customers. As a result, the company is able to attain a narrow moat.

Catastrophe losses added 11.5 points to Chubb's 2017 consolidated combined ratio, the highest amount in the past 10 years on both a pre- and post-merger basis. As a result, the 2017 combined ratio deteriorated 6 points to 94.7%, and ROE decreased nearly 3 points to 7.8% despite a $450 million fourth-quarter tax benefit from revaluation of deferred tax liabilities. Positively, though, underlying underwriting results (excluding natural catastrophes and prior-year reserve development) were strong, with Chubb reporting improvement in its underlying combined ratio at 87.1% in 2017 versus 89.3% in the prior year. We also expect Chubb to benefit from modest rate increases on its renewal business in 2018, given the magnitude of industry losses from hurricanes and wildfires in the third and fourth quarters of 2017.

Our credit risk assessment considers four key components, known as pillars, that factor heavily in Chubb's credit rating. Chubb's model results are better than its rated property/casualty peers, primarily as a result of its Business and Financial Risk scores. The Business Risk pillar is considered good due to the company's large size, narrow moat rating, solid underwriting performance and low volatility in underwriting results, and a medium uncertainty score. Chubb's moderate financial leverage, with debt/capital reported at 20%, low operating leverage (net earned premiums/capital) at 0.4 times and reserve leverage at 1.0 times all contribute to a good Financial Risk pillar. The company also scores very well under the Debt Cushion and Distance to Default pillars.

While we believe 2017 was a subpar year given the high amount of natural catastrophe losses, should Chubb's underlying results remain consistent through 2018 we may consider upgrading the rating. Factors that could lead to a rating upgrade include continued strong underwriting performance as evidenced by sub-90% combined ratios in normalized catastrophe loss years, ROE sustained above 12%, and/or a reduction in debt/total capital to 15% or below. Key rating factors that could lead to a downgrade include debt/total capital at 35% or higher, a significant increase in leverage metrics driven by large reserve deficiencies, material goodwill impairments or a reduction in capital, or deterioration in underwriting performance as judged by sustained reported combined ratios above 100%.

**General Mills' BBB+ Rating Affirmed; Outlook Stable on Its Strong Free Cash Flow to Deleverage**
Morningstar Credit Ratings, LLC is affirming General Mills' BBB+ credit rating and maintaining a stable outlook. General Mills' rating is supported by its market leadership and competitiveness across multiple product categories, including cereal, yogurt, refrigerated baked goods, and grain-based snacks. The company recently signed an agreement to acquire Blue Buffalo Pet Products, Inc. for $8.0 billion, to be financed with $1.0 billion of equity, cash on hand, and debt. Blue Buffalo generates $1.3 billion of

revenue and $319 million of EBITDA annually. Cost savings and synergies are estimated at $50 million. The acquisition, which we view as a strategic positive, enhances the company's portfolio by broadening it to the natural pet food category, which is growing faster and has stronger profit margins than some packaged food categories. General Mills' rating is anchored by its low Business Risk, which is derived from its solid intangible assets, predictable operating earnings and cash flows, and cost advantage developed from economies of scale. These attributes have resulted in Morningstar's Equity Research Group assigning General Mills a wide economic moat. The company has a weak Cash Flow Cushion and a moderate Solvency Score, which are more sensitive to leverage, maturing debt relative to cash flows, and returns on invested capital.

Growth and pricing power have been elusive for General Mills and most packaged food firms. Retail channels have splintered, and changing consumption patterns toward organic, less processed foods with fewer additives have hurt the company's top line. We believe General Mills' lineup of new and organic products, particularly in cereal and yogurt, aligns well with consumer demand and will increase its competitiveness. General Mills' successful restructuring and redirecting a portion of its cost savings into high-growth areas, concurrent with bolt-on acquisitions that have strong growth trajectories, may be the company's best strategy to restore its long-term growth.

General Mills' total debt, including redeemable interest of $793 million, was $10.5 billion at Nov. 26, 2017. The company's cash balance was $898 million at period-end, which is held in foreign jurisdictions and expected to be used to fund foreign operations and acquisitions. General Mills' other debtlike obligations include the unfunded portion of its defined-benefit pension plan of $533 million reported at its fiscal year ended May 28, 2017, and its obligation under operating leases estimated at $1.5 billion. Commercial paper support, additional liquidity, and financial flexibility are provided by General Mills' committed credit facilities totaling $2.9 billion, composed of a $2.7 billion facility expiring in May 2022 and a $0.2 billion facility expiring in June 2019. General Mills also maintains uncommitted lines of $500 million. The committed credit facilities contain a financial covenant that requires the company to maintain a fixed-charge coverage ratio of at least 2.5 times, which we view as achievable. The company has a committed bridge facility for the acquisition of Blue Buffalo, which is expected to close during the second quarter.

We forecast very low-single-digit revenue growth, excluding acquisitions, operating margins averaging just under 18%, and free cash flow after dividends averaging $1.0 billion annually. General Mills' debt/adjusted EBITDA is expected to increase from 3.0 times for the latest 12 months ended Nov. 26, 2017, to 4.6 times on a pro forma basis. The interest coverage ratio for the period is expected to decline from approximately 11 times to 7. General Mills spent $1.8 billion on share repurchases during the latest 12-month period. However, the company indicated that it placed a moratorium on share repurchases following the acquisition of Blue Buffalo and will use its free cash flow to deleverage rapidly to below 3.5 times by fiscal 2020.

A stable outlook indicates that our rating is not likely to change during the next two years. However, a positive rating action could occur if General Mills deleverages, restores revenue growth, and maintains its operating margins and returns on invested capital, therefore improving its Cash Flow Cushion and Solvency Score. An extension of near-term maturities thereby reducing the company's reliance on short-term financing would also be positive for the rating. Conversely, a failure to reduce debt level or, a prolonged decline in revenue, operating margins, or cash flow could weaken the company's Cash Flow Cushion and Solvency Score and negatively affect the company's ratings.

**Recent Notes Published by Credit Analysts**

**CVS (BBB+/UR-) Issuing New Debt to Prefund Pending Aetna Merger**

*Market Data*

CVS Health Corp (BBB+/UR-) has filed to issue new senior notes with maturities of 2 (fixed and floating), 3 (fixed and floating), 5, 7, 10, 20, and 30 years. According to regulatory filings dated March 6, proceeds will be used to fund part of the $48 billion cash portion of the pending Aetna Inc (not rated) merger. Previously, management discussed seeking about $45 billion in new debt financing, including potential term loan borrowings, to permanently fund the transaction. Notably, the merger has yet to gain shareholder or regulatory approval, and the organizations aim to close the transaction in late 2018. In the event the merger does not close, CVS aims to keep the new 30-year bonds outstanding and reallocate the proceeds for general corporate purposes, but it would need to redeem the remaining new issues at 101% of aggregate principal plus any accrued and unpaid interest.

We compare CVS' bonds with key pharmaceutical supply chain peers Express Scripts Holding Co (A-, negative) and Walgreens Boots Alliance Inc (BBB, stable). CVS' bonds due 2026 recently traded closest to the Morningstar Corporate Bond Index at BBB. All of the following bond data is sourced from Interactive Data as of March 5.

In the approximate 3-year area, spreads over the nearest Treasury from recent trades can be seen as follows:
CVS's 2.13% notes due 2021 at +91 basis points.
Express Scripts' 3.30% notes due 2021 at +86 basis points.
Walgreens' 3.30% notes due 2021 at +79 basis points.

In the approximate 10-year area, spreads over the nearest Treasury from recent trades can be seen as follows:
CVS' 2.88% notes due 2026 at +139 basis points.
Express Scripts' 3.40% notes due 2027 at +128 basis points.
Walgreens' 3.45% notes due 2026 at +143 basis points.
For comparison with the roughly 10-year maturities, the Morningstar Corporate Bond Index is at +125 basis points at BBB+, +132 basis points at BBB, and +155 basis points at BBB-.

In the approximate 30-year area, spreads over the nearest Treasury from recent trades can be seen as follows:
CVS' 5.13% notes due 2045 at +183 basis points.
Express Scripts' 4.80% notes due 2046 at +174 basis points.
Walgreens' 4.65% due 2046 at +180 basis points.

*MCR Credit Risk Assessment*

Our BBB+ credit rating for CVS remains under review with negative implications based on its planned leverage-increasing combination with managed-care organization Aetna, which is expected to close in late 2018. On a stand-alone basis and in the Aetna merger scenario, CVS's Business Risk pillar looks likely to remain in low-risk territory, influenced by Morningstar's Equity Research Group's wide moat assessment, along with its large size and predictable cash flows. CVS already operates as a top-tier pharmacy benefit manager and pharmacy retailer, which we view as an attractive combination of businesses. Adding a top-tier medical benefit manager like Aetna to the mix appears strategically compelling, in our view, and may also boost its diversification measure in this pillar.

However, leverage looks set to rise substantially due to this merger from an already elevated level. As of December, we estimate lease-adjusted debt/EBITDAR stood at 3.3 times, or above its previous 2.7 times target. That elevated leverage already pushed CVS to the weak end of BBB+ territory on a stand-alone basis. In December 2017, CVS announced plans to merge with Aetna, and that acquisition promises to boost pro forma gross leverage to the mid-4s if it closes as expected. Along with limited further acquisition activities, CVS plans to suspend its share-repurchase program and flat-line its dividend to enable deleveraging. Management aims to reduce gross leverage to the mid-3s in the two years after the transaction and to the low 3s in the long term. However, that projected leverage appears higher than the firm's previous goal, and the company's willingness to boost and keep leverage well above its previous target informs our under review negative status on CVS.

**Teva (BB, Stable) Issuing New Debt to Refinance Term Loans and 2018 Debt Maturity**
*Market Data*
Teva Pharmaceutical Industries Ltd. (BB, stable) is in the market with a proposed private offering of $2.25 billion in 6- and 10-year senior unsecured notes and EUR 1 billion in 4- and 7-year senior unsecured notes. According to Teva's press release Feb. 28, net proceeds will be used to repay approximately $2.3 billion of outstanding indebtedness under its U.S. dollar and yen term loans and to repay $1.5 billion of its 1.40% senior unsecured notes due 2018. The remainder of the net proceeds may be used for general corporate purposes.

We compare Teva's unsecured bonds with peers that are also rated in the general BB category in the healthcare industry, which includes dialysis provider DaVita Inc. (BB+, negative), healthcare provider HCA Healthcare Inc. (BB, stable), and specialty pharmaceutical firm Mallinckrodt PLC (BB-, stable). Teva's unsecured bonds due in 2026 recently traded wider than those at DaVita (due 2025) by about 50 basis points and those at HCA (due 2026) by 60 basis points. Its bonds also recently traded tighter than Mallinckrodt's 2025 bonds by around 335 basis points.

In the approximate 5-year maturity bucket, bonds from these firms recently traded near the following, according to Interactive Data:
Teva's 2.95% unsecured notes due in 2022 at 89.88, yield to maturity of 5.38%, and spread to maturity of +276 basis points.
HCA's 7.50% unsecured notes due in 2022 at 110.50, yield to maturity of 4.55%, and spread to maturity of +199 basis points.
Mallinckrodt's 5.75% unsecured notes due in 2022 at 88.50, yield to maturity of 8.97%, and spread to maturity of +639 basis points.

For comparison, the BofA Merrill Lynch High Yield BB Rated Index is at a 4.96% yield with a +228 spread.

In the approximate 10-year maturity bucket, bonds from these firms recently traded near the following according to Interactive Data:
Teva's 3.15% unsecured notes due in 2026 at 81.16, yield to maturity of 5.99%, and spread to maturity of +315 basis points.
DaVita's 5.00% unsecured notes due in 2025 at 97.45, yield to maturity of 5.43%, and spread to maturity of +263 basis points.
HCA's 5.88% unsecured notes due in 2026 at 103.13, yield to worst (2025 call date) of 5.36%, and spread to worst of +255 basis points.
Mallinckrodt's 5.50% unsecured notes due in 2025 at 80.50, yield to maturity of 9.31% and spread to maturity of +651 basis points.

*MCR Credit Risk Assessment*
We recently downgraded Teva's credit rating to BB, reflecting the firm's difficult path ahead as it tries to reverse declining operational performance while handcuffed by high financial leverage. Teva's new CEO has instituted a strategy meant to stabilize deterioration by trimming its cost structure, streamlining its organizational infrastructure, and reducing elevated debt leverage. Specific actions include removing $3 billion in operating expenses (from a $16 billion base) by 2019, suspending the common dividend, prioritizing cash for debt reduction, and emphasizing specialty medicines. While uncertainty has risen in light of Teva's recovery, we still see benefits provided by the firm's scale, its geographic reach, and the breadth of its generic drug offering, which supports our Business Risk pillar. We expect that the organizational revamp may have negative repercussions on revenue and earnings over the next few years, complicated by generic competition to its bestseller Copaxone (multiple sclerosis), which represents about 15% of total sales. The current rating incorporates pressure on our Cash Flow Cushion, Solvency Score, and Distance to Default pillars, resulting from withering operational output over the course of 2017. Over the next five years, we expect revenue and EBITDA to decline in the low single digits compounded annually, assuming solid execution of its restructuring plan and successful commercialization of novel medicines. Recovery of top-line growth in the intermediate term may be helped by strong uptake of specialty drug Austedo for Huntington's disease and tardive dyskinesia, and the near-term U.S. launch of migraine drug candidate fremanezumab. Our modest forecast, along with an expectation of material debt reduction, would help decrease inflated leverage enough to hold our current leverage-based pillars over the next year or so, which informs our stable outlook.

Teva has worked to reduce its heavy debt load since the highly leveraging acquisition of Actavis in August 2016. At the end of 2017, the firm owed $32.5 billion in unsecured notes and term loans, or gross debt leverage of 5.3 times, which compares with a debt balance of $35.8 billion in 2016 for total leverage of 5.8 times. Considering modest cash and investments of $963 million on Dec. 31, 2017, net leverage stood at 5.2 times. Teva still has a long road to reach its current net leverage target of below 4 times EBITDA by 2020, which is part of its new operating strategy. Achieving the firm's leverage expectation would require a combination of significant debt reduction and increasing profitability that depends on solid execution against its restructuring program together with successful commercialization of new products. Along these lines, the firm anticipates reducing gross debt by $3.5 billion in 2018, funded in part with asset sale proceeds and free cash flow generation. Teva has some financial flexibility to address its debt burden with free cash flow averaging around $3 billion annually, in our estimation; this fully covers long-term debt maturities over the next five years, which presently total around $13 billion, adjusting for present refinancing activities. We view Teva's elimination of its dividend as a credit positive, as it preserves more than $1.3 billion of cash per year that can be directed to debt reduction. We recognize that management had already taken steps to preserve cash flow for debt reduction, including stopping share repurchases and curtailing larger M&A actions. In addition, recent actions to strengthen its precarious financial position has granted time to the firm to return to operational growth, including relaxing a maximum leverage covenant in its credit facilities and currently refinancing nearing debt maturities, which effectively extends more than $3 billion of aging debt into 2022 and beyond.

**Rolls-Royce (A-, Negative) Ends 2017 on Solid Ground and Provides 2018 Guidance**
*MCR Credit Risk Assessment*
Rolls-Royce Holdings PLC (A-, negative) finished 2017 with strong results that were ahead of management's expectations. Organic revenue increased by midsingle digits versus 2016, driving better profitability and free cash flow generation. Management provided initial guidance for 2018, expecting another year of mid-single-digit revenue growth that should result in free cash flow of GBP 350 million-550 million, up from GBP 273 million in 2017.

Reported revenue grew 9.0% compared with the year-ago period, as organic results, which strip out currency, grew 6%. The strength was led by civil aerospace (49.2% of revenue). Revenue in this segment grew 14% due to a 35% increase in large engine deliveries and a 12% increase in wide-body flying hours. Despite the strong revenue performance, reported gross margins decreased 70 basis points to 19.7%, in part due to higher maintenance costs on its newer engines (Trent 1000 and Trent 900) and lower spares volume in its defense aerospace segment (14.0% of revenue). Rolls-Royce benefited from aftermarket growth and improved working capital management, helping it produce GBP 273 million in free cash flow, up from GBP 100 million last year. The company paid annual dividends of GBP 214 million, nearly 30% lower than 2016's payment since it cut the dividend for the first time in 25 years. Rolls-Royce ended the quarter with cash of nearly GBP 3 billion compared with debt of GBP 3.5 billion, resulting in gross and net leverage of 1.7 times and 0.3 times, respectively.

We compare Rolls-Royce with other similar-rated aerospace/defense companies Northrop Grumman Corp (A-/UR-) and Lockheed Martin Corp (A-, stable). As with Rolls-Royce, Northrop Grumman's Business Risk benefits from its narrow economic moat from Morningstar's Equity Research Group, although Rolls-Royce operates with a better leverage profile—1.7 times gross leverage versus 3.4 times for Northrop pro forma for its pending acquisition of Orbital ATK. Lockheed Martin's Business Risk receives a higher boost than Rolls-Royce does because Morningstar's Equity Research Group awards Lockheed Martin a wide economic moat, but Lockheed's credit profile includes somewhat higher leverage than Rolls-Royce's at 2.0 times.

*Market Data*

According to pricing service Interactive Data, bonds with similar maturities for Rolls-Royce and key comparables are indicated over the nearest Treasury as follows:
The Rolls-Royce 3.625% notes due 2025 are indicated at +77 basis points.
The Northrop Grumman 3.20% notes due 2027 are indicated at +93 basis points.
The Lockheed Martin 3.55% notes due 2026 are indicated at +80 basis points.
The A- Morningstar Corporate Bond Index is at +94 basis points in comparison.

**Zimmer Biomet (BBB, Stable) Issuing New Notes to Redeem Existing Debt**

*Market Data*

Zimmer Biomet Holdings Inc (BBB, stable) is in the market issuing new 3-year floating-rate notes and 5-year fixed-rate notes. According to a regulatory filing on March 8, Zimmer intends to use the proceeds from this new issuance to help redeem bonds coming due April 1, which have $1.15 billion of principal outstanding.

From a credit perspective, Zimmer's closest comparables are similar-rated firms in the medical technology sector, Boston Scientific Corp (BBB, positive) and Becton, Dickinson and Co (BBB, stable). All the following bond data is sourced from Interactive Data.

In the approximate five-year area, bonds from these issuers recently traded over the nearest Treasury as follows:
Zimmer Biomet's 3.15% notes due 2022 at +103 basis points.
Boston Scientific's 3.38% notes due 2022 at +89 basis points.
Becton Dickinson's 2.89% notes due 2022 at +108 basis points.

*MCR Credit Risk Assessment*

Our BBB credit rating on Zimmer Biomet reflects its substantial competitive advantages in orthopedic devices, along with its elevated leverage, which has been exacerbated by Zimmer's own capital-allocation activities and operational missteps since the merger of Zimmer and Biomet in mid-2015. Positively for its Business Risk pillar, we think Zimmer Biomet enhanced its competitive advantages and scale by combining the two organizations. Market share in orthopedic devices typically stays steady over time, which we believe stems from the substantial switching costs for surgeons associated with orthopedic tool sets. This dynamic has helped top-tier orthopedic firms like Zimmer Biomet dig wide moats, according to Morningstar's Equity Research Group. However, key peer Stryker appears to be stealing some market share in knees with its new robotic system. Combining that competitive dynamic with ongoing supply-chain problems, we believe Zimmer will have a tough time increasing its profits and cash flows significantly in the near future.

Those factors, along with the company's elevated leverage, cut into Zimmer's Solvency Score pillar enough for us to downgrade the rating one notch in January 2018. As of December, debt stood at $10.1 billion, down slightly from the end of the third quarter. However with profit growth stuck in neutral, gross leverage remained around 3.5 times by our estimates. While Zimmer's new management team has not addressed its previous gross leverage target of 2.5 times by the end of 2018, we do not expect the company will be able to deleverage to that previously expressed target by the end of this year, which informed our recent downgrade.

For comparison, Boston Scientific's gross leverage stood at 2.4 times at the end of 2017, excluding ongoing legal and tax liabilities that are worth about half a turn of leverage by our estimates. Boston's management team has highlighted that it intends to eliminate most of those legal and tax obligations in 2018, and those actions should grant Boston Scientific significantly more financial flexibility in the near future, which supports our positive outlook on its rating. For another comparison, Becton Dickinson's gross leverage after the recently completed Bard acquisition stood at 4.7 times on a pro forma basis at the end of 2017. BD plans to reduce its leverage to below 3.0 times within a few years of this combination.

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