Corporate Credit Spread Chartbook
Consumer Defensive Sector

Morningstar Credit Ratings, LLC
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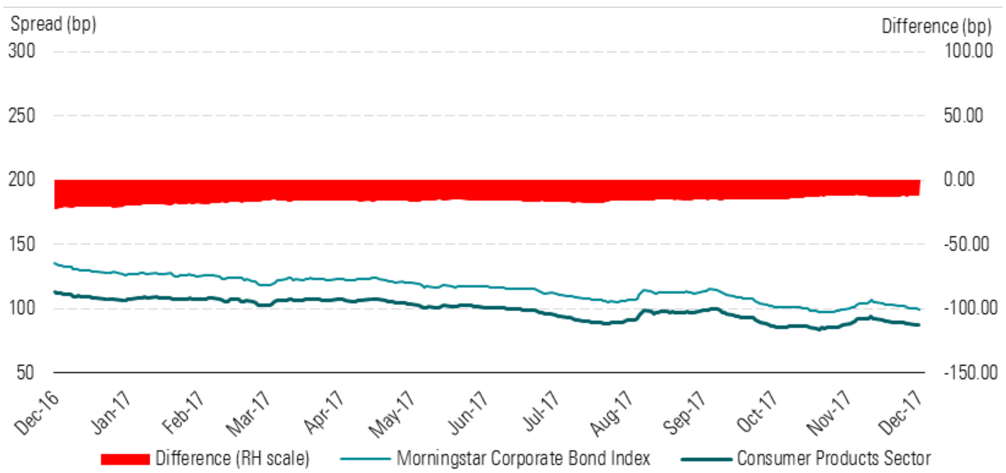
Executive Summary

Since the last Consumer Defensive Chartbook was published in August, the average credit spread for the highlighted bonds in all investment-grade consumer defensive companies covered by Morningstar Credit Ratings, LLC has tightened 10 basis points to 87 basis points. Over the same period, the Morningstar Corporate Bond Index tightened 13 basis points to 99 basis points.

During this period, MCR upgraded one issuer, downgraded another and affirmed four others. Heightened merger and acquisition, or M&A, activity is expected to be maintained throughout the sector, which could lead to greater credit rating volatility. Excluding firms engaged in M&A, MCR expects credit quality to improve modestly for the consumer defensive sector in the near term, driven mainly by higher operating earnings and stable capital structures. Companies within the sector are reducing costs through widespread restructurings and nontraditional means, such as zero-based budgeting.

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

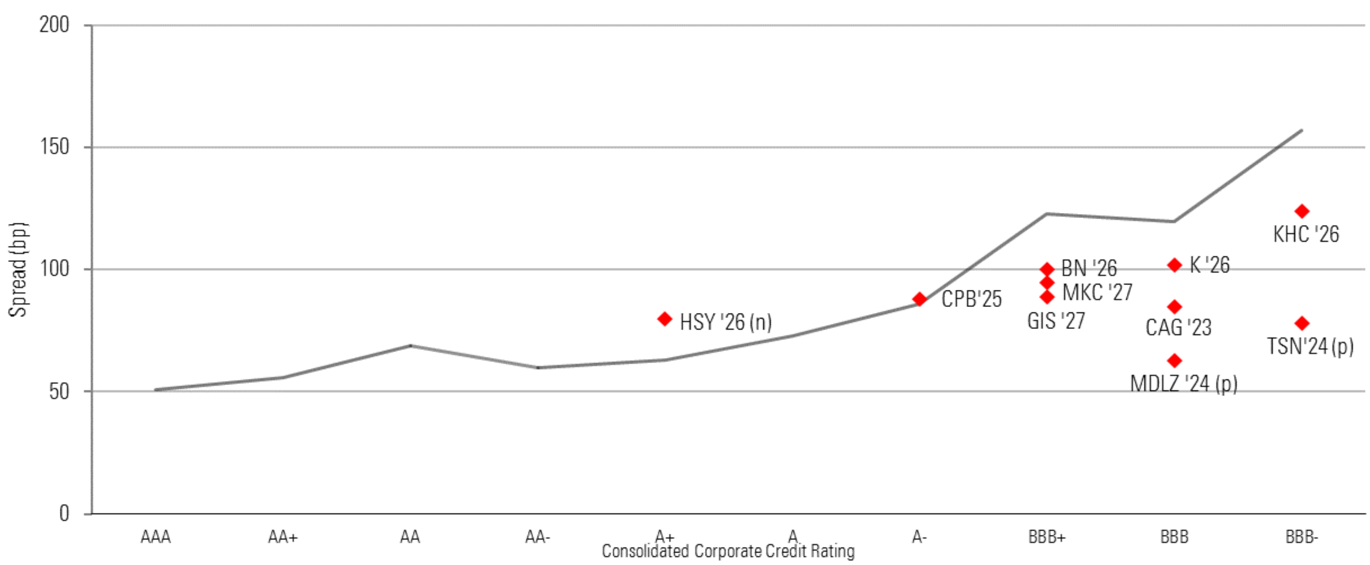


Source: Morningstar, Inc. Data as of Dec. 6, 2017.

Spread Charts by Consumer Defensive Sector

Packaged Foods

Exhibit 2 Packaged-Foods Subsector Versus Morningstar Industrials Index



Source: Morningstar Credit Ratings, LLC, Morningstar, Inc., and Interactive Data as of Dec.6, 2017
UR = rating under review / (p) = positive outlook / (n) = negative outlook

Spreads and Credit Trends

Credit spreads for the packaged-foods subsector have narrowed by an average of 11 basis points since the last chartbook publication in August. Spreads narrowed for most companies in the packaged-foods subsector, with McCormick & Co. Inc. (BBB+, stable) and Mondelez International Inc. (rating: BBB, positive) leading the pack with their spreads narrowing 26 and 22 basis points, respectively. MCR recently downgraded McCormick one notch to BBB+ following its acquisition of Reckitt Benckiser's food division, which substantially increased its leverage. However, MCR is expecting margin improvement and debt reduction in near future. Spreads narrowed to the high-teens for Danone SA (rating: BBB+, stable), ConAgra Foods Inc. (BBB, stable), Kraft Heinz (BBB-, stable), and Tyson Foods Inc. (BBB-, positive), while spreads for General Mills (BBB+ stable), Campbell Soup Company (A-, stable) narrowed by low-single digits, and spreads for Kellogg Co. (BBB, stable) and Hershey Co. (A+, negative) widened by 6 and 1 basis points, respectively.

Operating earnings continue to improve for the packaged-foods companies Morningstar covers, as management teams continue to spend considerable time and resources implementing restructuring programs and cost-saving initiatives, which have resulted in margin expansion across the subsector. Excluding Tyson, which is benefiting from increased meat consumption, top-line growth has been muted, and weaknesses in European economies and emerging markets have had a negative impact on internationally diversified companies. With a few exceptions, nearly every firm in this subsector is engaged in mergers and acquisitions, ranging from small bolt-ons to strategic acquisitions. Improvements in credit measures have for the most part proven to be temporary in the packaged-foods sector, as M&A risk remains high and is one of the disruptive forces to credit ratings stability, and dominates the outlook for the consumer defensive sector.

Issuer Highlights

- Campbell Soup's (A-, stable) credit rating was affirmed on Jan. 19, 2017. Anemic growth and margin pressure resulted in a downward revision of Campbell's EBIT guidance range from negative 1%–1% to negative 4%–negative 2% in its current fiscal year. Campbell reported net sales declined 2% to $2.2 billion and EBIT declined 10% to $412 million for its first quarter of fiscal 2018 ended Oct. 29, 2017. These poor results were mainly attributed to U.S. soup sales declining by 9% in which a key customer chose to carry significantly lower inventory, and minimal contributions from its Fresh Business. Although Campbell dominates the mature U.S. soup category with a reported 58.5% market share, it lost 0.3% during the period. However, the company fared better than its branded competitors as private label picked up 1.3% for the period. With under 1% growth throughout our forecast period and earnings weakness, the company's credit measures are approaching Morningstar's bear-case scenario. Further deterioration is not anticipated; however, the pending acquisition of Pacific Foods of Oregon Inc. for $700 million will weaken the company's credit profile. We estimate pro forma debt/adjusted EBITDA at 2.5 times, still within the rating category. In terms of profitability, Campbell maintains high adjusted EBITDA margins at approximately 21% for its fiscal year ended July 30, 2017. Campbell also increased its cost-savings target from its restructuring program to $450 million by the end of fiscal 2020 from $300 million by the end of 2018. We anticipate that Campbell will redirect some of its cost savings toward increasing support for marketing, advertising, and promotion, which may slow its margin growth.
- Kraft Heinz's (BBB-, stable) credit rating was affirmed on Feb. 27, 2017, and its outlook was revised to stable from positive because of heightened M&A risk after the company withdrew its proposal to acquire Unilever. It is common knowledge that Kraft Heinz is seeking an acquisition that provides it with access to faster-growing international regions. Kraft Heinz continues to benefit from integration cost savings, and the company touts industry-leading adjusted EBITDA margins that exceed 30%. The company delivered third-quarter results consistent with the expectations showcasing a sequential improvement in top and bottom line in all segments. Debt/adjusted EBITDA was 4.0 times (3.9 times on a net basis) for the latest twelve months ended Sept. 30, 2017; while high for the rating category, it is expected to decline meaningfully. Management is on track to meet its $1.7 billion–$1.8 billion cost-savings goal by the end of 2017 and has achieved $1.58 billion as of Sept. 30, 2017. In the absence of a major acquisition, MCR believes that Kraft Heinz will hit its net debt/EBITDA target of less than 3.0 times in 2019. As the company approaches that target, improvements in its Cash Flow Cushion and Solvency Score could lead to a positive rating action.
- General Mills' (BBB+, stable) credit rating was affirmed on March 24, 2017. Stability in operating earnings and cash flows, steady credit measures, and a well-balanced capital-allocation policy make the company one of the most predictable firms in the packaged-food sector. Revenue contracted 5% to $15.4 billion and adjusted operating income declined 5% to $2.6 billion for the 12-month period ended Aug. 27, 2017. A significant portion of the volume contraction is attributed to consumers' focus on

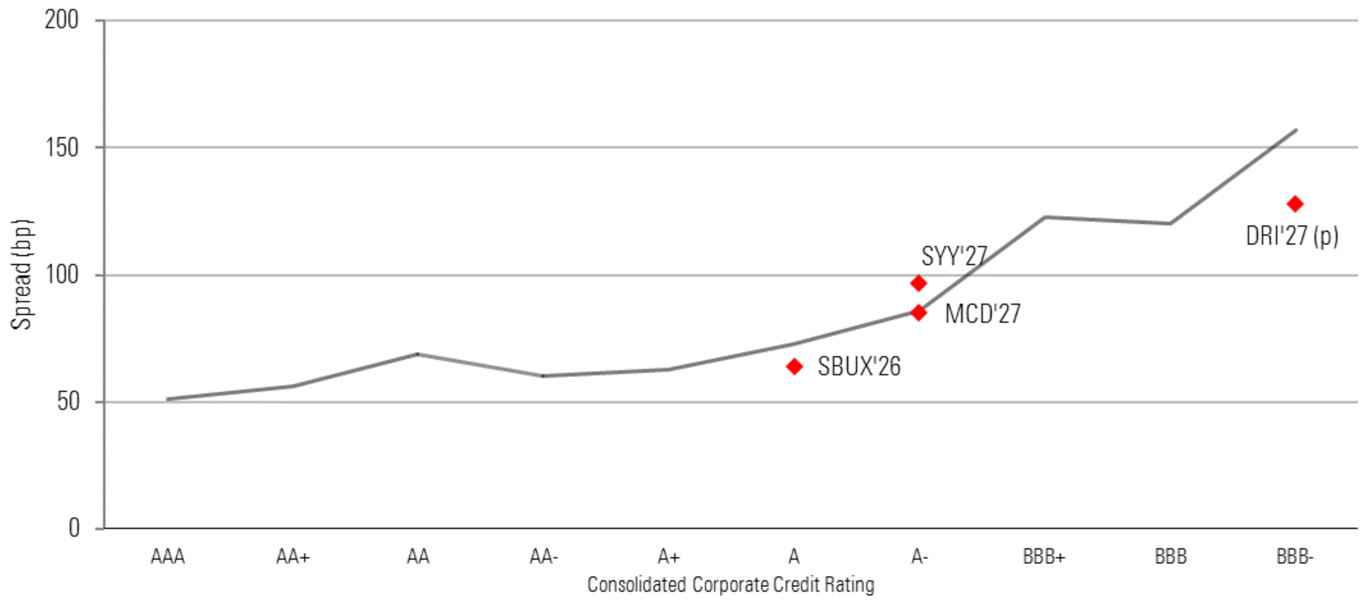
freshly prepared foods and purchasing fewer products in the center of the store, where the company's products are prominent. Also, a decline in the competitive position of its yogurt business over the past few years has hurt the company's top-line growth. For the 12-month period ended Aug. 27, 2017, adjusted operating margins were flat at 17.3%. We believe that General Mills' multiyear restructuring initiatives to increase efficiency by consolidating and eliminating excess production capacity and redirecting those savings into high-growth areas are sound strategies to restore long-term growth. New, innovative, and organic products in cereal and yogurt under its Annie's, Yoplait, and Liberté brands align well with consumer demand. We anticipate that increased investment in marketing, advertising, and promotion to support product introductions and to defend its competitive position may also slow its margin growth. For the 12-month period ended Aug. 27, 2017, total debt (including redeemable interest)/adjusted EBITDA was about 2.5 times, and EBITDA/interest was 11 times.

- McCormick & Co. Inc. (BBB+, stable) credit rating was downgraded to BBB+ from A+, removed from under review negative and assigned stable outlook on Sept. 19, following its acquisition of Reckitt Benckiser's food division for $4.2 billion. Leverage has risen substantially to over 5 times to finance the transaction, which was funded with approximately $4.0 billion of new debt and $500 million of equity. This increase in leverage was the key catalyst for our downgrade. The addition of French's Mustards, Frank's RedHot, and other condiment and sauce brands will enhance the company's seasoning and spice portfolio and bolster its margins. Acquired brands are expected to generate revenue of $581 million, adjusted EBITDA of $215 million, and EBITDA margin of 37% in 2017. In the near term, we expect operating margin improvement of $100 million from the company's ongoing cost-savings program and $30 million–$50 million of acquisition cost synergies to be offset by $140 million of transaction and integration costs. We are also forecasting that free cash flow generation (cash flow from operations less capital expenditure and dividends) will average $300 million annually over the next few years, which we expect to be used for debt reduction.
- Tyson's (BBB-, positive) credit rating was affirmed, and a positive outlook assigned on May 18, 2017, following what MCR believes to be a sustained increase in profitability and earnings stability. Tyson's realization of $640 million of cost synergies from the acquisition of Hillshire has enhanced and increased the stability of its operating earnings and cash flow, and represents a step up in the company's profitability. A positive outlook was assigned, as these elements have resulted in a stronger credit profile and improved Tyson's Business Risk Score. Tyson issued $4.5 billion of debt in 10-year and 30-year senior unsecured notes in May to finance the acquisition of AdvancePierre Foods Holdings Inc., a leading national producer of ready-to-eat lunch and dinner sandwiches, sandwich components, and snacks. AdvancePierre's product categories are complementary to Tyson's and may also provide opportunities for vertical integration. AdvancePierre had $1.6 billion of revenue and adjusted EBITDA of $280 million in 2016. The transaction was enhanced by cost synergies of $200 million and Tyson’s ability to further increase revenue of the combined entity. Pro forma debt/adjusted EBITDA is 2.9 times. However, Tyson is expected to reduce debt with free cash flow and proceeds from divestitures, which should allow the company to deleverage rapidly and achieve its targeted debt/adjusted EBITDA range of 1.5–2.0 times. Tyson is targeting to reduce leverage to approximately 2 times level by third-quarter fiscal-year 2018, and thereafter would increase share buyback similar to historical levels. Separately, Tyson announced that it intends to sell three nonprotein businesses: Sara Lee Frozen Bakery, the Kettle business, and the Van's Company, which collectively had revenue of approximately $650 million for fiscal

2017 and a net carrying value of $803 million at Sept. 30, 2017. Tyson expects to sell these businesses by the end of 2017, or early 2018, and record pretax gains. Proceeds are expected to be used for debt reduction. In September, Tyson announced a multiyear restructuring program, which will further contribute to savings and increase its operational effectiveness.

Restaurants

Exhibit 3 Restaurant Subsector Versus Morningstar Industrials Index



Source: Morningstar Credit Ratings, LLC, Morningstar, Inc., and Interactive Data as of Dec. 6, 2017
UR = rating under review/(p) = positive outlook/(n) = negative outlook

Spreads and Credit Trends

McDonald's Corporation (A-, stable) spreads tightened 10 basis points, Sysco Corporation (rating: A-, stable) spreads tightened 5 basis points, and Darden Restaurants Inc. (BBB-, positive) widened 2 basis points. Spreads for McDonald's tightened the greatest for the restaurant subsector, which we believe is the result of the company's continued exceptional operating performance. Starbucks Corporation's (A, stable) spreads tightened less than McDonald's at 5 basis points, which we are attributing to its slower growth and a more aggressive capital-allocation policy.

Restaurant companies we cover performed well in terms of same-restaurant sales and operating margins, despite some observed weakness attributed to excess industry capacity. Food consumed away from home is expected to benefit from an expanding economy and greater disposable income. On the operational side of the business, commodity costs, and labor costs, while rising, are manageable. We expect value-menu food and beverage items, as well as inexpensive indulgence-menu items, to benefit in this economic environment. Credit trends for the firms in this subsector are stable, but they are highly dependent on the aggressiveness of companies' capital-allocation policies.

Issuer Highlights

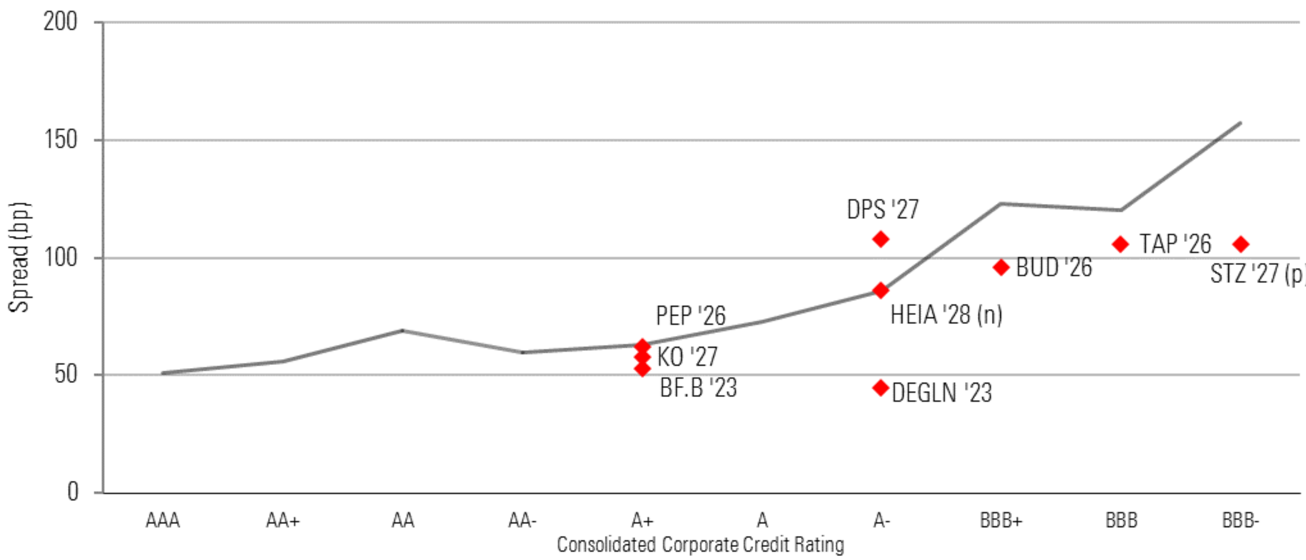
- Darden Restaurants' (BBB-, positive) rating was affirmed on Jan. 30, 2017, with the outlook revised to positive. The company is positioned well in the rating category. Darden continues to execute a highly successful turnaround of Olive Garden, its largest concept, which generated 50% of its revenue and 57% of segment profits. Olive Garden produced 1.9% same-restaurant sales increase for the first quarter ended Aug. 27, 2017, of fiscal 2018, following a 2.6% increase for its fiscal year ended May 28, 2017. Five of Darden's seven restaurant concepts reported positive same-restaurant sales increases for the first quarter of fiscal 2018, with the company's other larger restaurant chain, LongHorn Steakhouse, reporting 2.6%. The increase was attributed to pricing and menu as same restaurant traffic was weak at 0.3% and 0.1% for Olive Garden and Longhorn, respectively. Sales increased 12.9 % to $1.9 billion, mainly reflecting the acquisition of Cheddar's Scratch Kitchen for $780 million, which Darden completed in April 2017 and MCR views as a positive. The acquisition fits well with consumers' desire for prepared foods that contain fewer additives and more natural ingredients. Darden funded the acquisition with $500 million senior unsecured notes and cash on hand. Overall, Darden's pillars are fair, and its credit metrics are better than the rating category, total adjusted debt/EBITDAR is forecast at 2.5 times and EBITDAR/interest at about 9.0 times.
- McDonald's (A-, stable) rating was affirmed on Feb. 1, 2017, as its operating fundamentals, same-store sales, operating margin and cash flow continue to improve. MCR believes that McDonald's is amid a full-fledged turnaround, which is reflected in the strength of the company's pillar scores and our A- credit rating. Global comparable-store sales increased 6.0%, and U.S. comparable-store sales advanced 4.1% for the third quarter. Systemwide sales, which include sales of all restaurants, whether owned or franchised, increased 8%, and was only aided 1% by currency translation. Consolidated revenue decreased 10% to $5.8 billion, as anticipated, due to refranchising. Reported operating income increased 44% to $3.1 billion, benefiting from an $850 million gain on the sale of the company's businesses in China and Hong Kong. Excluding the gain and restructuring and impairment charges, operating income increased 5% for the period. General and administrative expense was down 4% for the quarter, and management confirmed that G&A will be down 7% for the full year, in line with its previous guidance. We believe McDonald's exceptional top-line performance for the past few quarters is indicative of the company increasing its market share. We estimate that McDonald's leverage, lease-adjusted debt/EBITDAR will be stable in the near term at about 4.0 times, which is high for the rating category, but depending on the aggressiveness of the company's allocation policy, which encompasses a three-year cash return to shareholders of $22 billion–$24 billion in the form dividends and share repurchases, it could migrate to 3.5 times during the near to intermediate term. Leverage metrics could also benefit from refranchising proceeds, which would reduce the need for the company to finance share repurchases solely with debt.
- Starbuck's (A, stable) credit rating was affirmed on April 26, 2017, reflecting stability and excellent operational and financial performance and moderate use of debt, which supports the company's strong Business Risk Score and Solvency Score. With the Nov. 2, 2017 announcement of a new commitment to return $15 billion to shareholders through dividends and share repurchases over the next three fiscal years (2018–21), Starbucks joins the ranks of McDonald's Corporation and YUM Brands (BB, stable), that have altered their capital allocation policy to increase shareholder returns. The firm's new long-term financial targets include global comparable-store sales growth of 3%–5%, revenue growth in the high-

single digits, and ROIC of 25% or greater. The new targets represent a downward revision from mid-single-digit comparable same-store sales growth and double-digit revenue growth. We expect debt levels and leverage to increase, but unlike McDonald's Corporation and YUM Brands, Starbucks management indicated that the majority of the $15 billion will come from its strong operating cash flow. The step-down in performance concurrent with an anticipated increase in leverage takes the headroom out of the company's credit rating. We anticipate that Starbucks' Solvency Score will weaken slightly as higher debt levels and slightly lower interest coverage are offset by the company's strong returns on invested capital. The company's Cash Flow Cushion is expected to remain adequate for the rating category. Although Starbucks issued $1.0 billion in two tranches on Nov. 22, 2017, $500 million of 2.2% senior notes due 2020 and $500 million of 3.750% senior notes due 2047, further debt issuances are anticipated given the company's new capital allocation policy. Although Starbucks' financial performance has moderated, it has a foundation of industry-leading same-store sales growth anchored by successful menu innovation, channel expansion, cross-branding, and a best-in-class retail digital platform that supports its loyalty program and generates extraordinary mobile engagement.

- Sysco's (A-, stable) credit rating was affirmed on Feb. 27, 2017, reflecting the execution of its strategic plan to increase operating margins and returns on invested capital, which has resulted in improving the company's credit measures. Recent debt-financed share repurchases and heighted working capital have resulted in increased debt levels, which have weakened Sysco's credit measures. For the latest 12-month period ended Sept. 30, 2017, lease-adjusted credit measures were as follows: debt/EBITDAR was 3.3 times and EBITDAR/interest plus rents was 8.5 times. Prolonged aggressive share repurchases could pressure the company's Solvency Score and the company's credit rating.

Beverages

Exhibit 4 Beverage Subsector Versus Morningstar Industrials Index



Source: Morningstar Credit Ratings, LLC, Morningstar, Inc., and Interactive Data as of Dec. 6, 2017
UR = rating under review/(p) = positive outlook/(n) = negative outlook

Spreads and Credit Trends

Except for The Coca-Cola Company (A+, stable), whose spreads tightened 11 basis points, the remaining nonalcoholic beverage companies' spreads were essentially flat. Spreads for Constellation Brands Inc. (BBB-, positive), narrowed more than 20 basis points, MCR revised Constellation's outlook to positive in October on the continued stellar performance of its beer business. Excluding Diageo (A-, stable), whose spreads widened 3 basis points, the remaining alcoholic beverage companies' spreads narrowed as follows: Molson Coors Brewing (BBB, stable) 16 basis points, Anheuser-Busch InBev SA/NV (BBB+, stable) and Heineken NV (A-, negative) each narrowed 15 basis points, and Brown-Forman (A+, stable) 7 basis points.

The beverage subsector generates substantial free cash flow, derived from high profitability and somewhat stable demand. Coca-Cola (A+, stable) and PepsiCo (A+, stable) are the nonalcoholic industry leaders and are experiencing low-single-digit beverage volume growth. With these companies focused on improving their cost structures and obtaining incremental pricing, we anticipate continued operating margin expansion. Coca-Cola is refranchising several of its company-owned bottling operations, which could have a positive impact on its credit profiles, depending on how much debt remains at the parent/franchisor level as well as the application of any funds received. PepsiCo indicated that it will retain ownership of its major U.S. bottlers, which will lessen the company's opportunity to reduce debt. On the alcoholic beverage side, spirits firms are seeking to broaden their portfolios, and typically engage in small bolt-on acquisitions that have occasionally lifted leverage. But overall, these firms have managed credit measures to remain at their current credit rating levels. Except for periodic M&A, the credit trends are generally stable. On the beer side of the business, and particularly regarding Anheuser-Busch InBev and Molson Coors, we expect credit measures to improve, as these companies are focused on reducing debt after the latest round of mergers and acquisitions.

Issuer Highlights

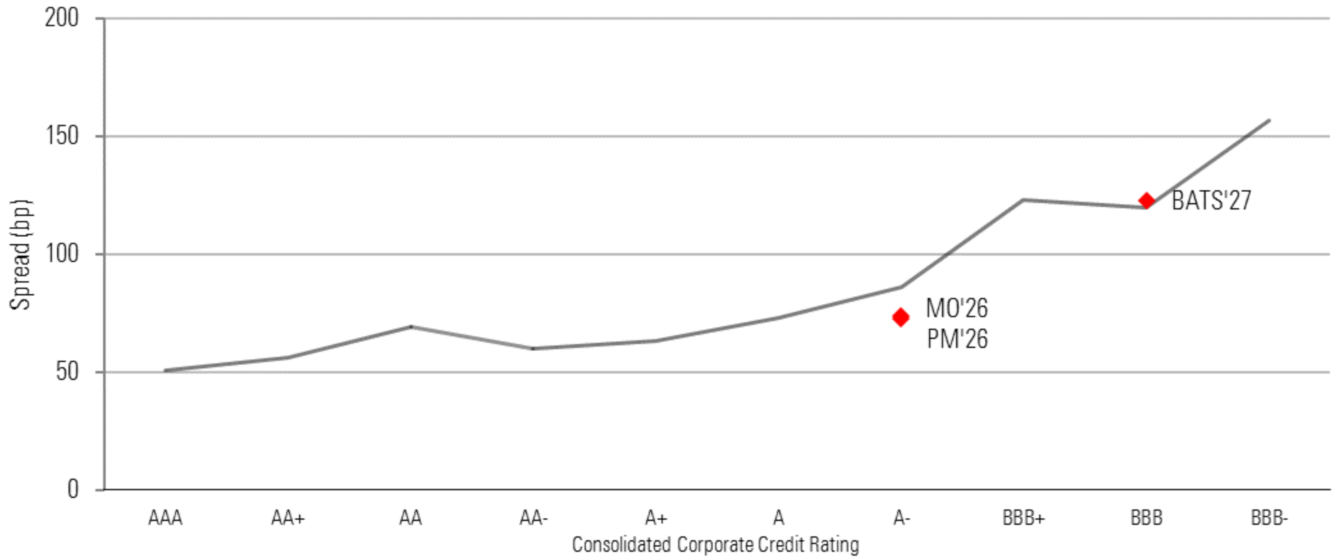
- Coca-Cola's (A+, stable) corporate credit rating was affirmed on June 29, 2017. The rating continues to be supported by solid returns on invested capital, improving operating margins, substantial liquidity, and cash flow generation. With the completion of refranchising of bottling systems in North America, the company is confident on delivering operating margin expansion and expects the margins to be 35%-plus by 2020. Refranchising has also made the firm less capital intensive, therefore the forecast return on invested capital has expanded to the high-teens from the low-teen levels over the past few years. Debt is high, at $35.7 billion, but is balanced by significant liquidity, which is provided by Coca-Cola's sizable cash, marketable securities, and short-term investments balance of $27.4 billion at Sept. 30, 2017. Coca-Cola's Cash Flow Cushion is weak because of the firm's heavy reliance on short-term debt. Yet, we believe that this weakness is offset by Coca-Cola's excess liquidity, strong Solvency Score, and Business Risk Score. For the latest 12-month period ended Sept. 30, 2017, gross debt/adjusted EBITDA was 4.1 times and net debt/adjusted EBITDA was less than 1 times; these metrics are expected to improve, but are weak for the rating category, as we are not contemplating that the company's excess liquidity will be used fully to reduce debt. The company is expected to make more bolt-on M&A in near term and is therefore tapering its share repurchase program, covering only dilution going forward. Because Coca-Cola would be using its own free cash flow for future M&A, we don't expect the credit metrics to weaken.
- PepsiCo's (A+, stable) corporate credit rating was affirmed on June 29, 2017, and we view the company's ongoing portfolio transformation as a significant positive. The continuing development of more nutritious foods and beverages aligns well with the demands of today's health-conscious consumers. We believe that increasing its product offerings to appeal to a broader range of consumers should meaningfully stimulate PepsiCo's top-line growth. The company's new products complement its current portfolio of beverages and savory snack foods, providing it with exceptional earnings diversification and stability. Although the PepsiCo trimmed its outlook for organic growth this year to below 3% (its original expectation), our view of its long-term trajectory is unchanged. We think Pepsi will be able to leverage line extensions and product innovation in its portfolio of leading brands to revitalize sales over the next several years. We forecast five-year compound annual revenue growth above 3%, with price/mix contributing above two thirds of this growth. Although a substantial portion is held outside of the U.S. and is subject to local and repatriation taxes, the company had significant liquidity of $18 billion in cash, cash equivalents, and short-term investments at quarter-end. Debt/adjusted EBITDA was 3.1 times and 2.6 times on a net basis for the latest 12-month period ended Sept. 09, 2017. Furthermore, PepsiCo's free cash flow generation (cash flow from operations less capital expenditures and dividends) for its latest 12-month period ending Sept. 9, 2017, was considerable and in excess of $2.0 billion.
- Dr Pepper Snapple's (A-, stable) corporate credit was affirmed on May 18, 2017. The rating action was supported by strong operating margins, high returns on invested capital, and a measured usage of debt, which have resulted in a strong Solvency Score and substantial free cash flow (cash flow from operation

less capital expenditures and dividends) generation. The company's recent $1.7 billion acquisition of Bai Brands, a producer of premium antioxidant-infused beverages, has increased its leverage and temporarily weakened the company's credit position. However, we view Bai as an excellent strategic fit because it increases the company's exposure to the growing enhanced-water beverage category. Since Dr Pepper Snapple already distributed 65% of Bai products, we anticipate limited integration risk and the restoration of credit metrics in the near term. Operating margin for the quarter ended Sept. 30, 2017 stood slightly below our expectation for the year, and we plan to revise our outlook to incorporate slightly higher raw material costs (including an increase in the price of resin because of the supplier default), in addition to the firm's continued investments in marketing Bai and strengthening its direct store delivery workforce. We continue to think these investments will be partly offset by Dr Pepper's productivity initiatives, which include improvements in display execution and supply chain. We contend these investments will bolster the firm’s profitability over the long run, given they should reinforce Dr Pepper's brand equity and further entrench its retail relationships. In the near to intermediate term, debt/adjusted EBITDA is projected at the mid-2.0 times, interest coverage in the low teens, and annual free cash flow generation at between $400 million and $500 million, which we expect would be distributed to shareholders.

- Constellation Brands Inc. (BBB-, positive) rating was affirmed on Oct. 6, 2017, and its outlook was revised to positive. The affirmation is supported by the strength and predictability of Constellation's operating earnings and cash flow. These results are derived from the company's ownership of five of the top 15 bestselling import beer brands in the United States, including Corona and Modelo, which has resulted in a strong intangible asset and Morningstar's Equity Research Group assigning the company a narrow economic moat. MCR's moderate Business Risk assessment of Constellation is balanced by the company's weak Cash Flow Cushion, due primarily to high debt maturities within our five-year forecast period. The positive outlook is a result of the continued strength of Constellation's beer business, demonstrated by double-digit organic volume growth, higher operating income and margins, and the company's capital allocation discipline.
- Heineken NV (A-, negative) rating was affirmed on Jan. 19, 2017, and a negative outlook was initiated. The negative outlook is due to the weakening in the company’s Cash Flow Cushion and Solvency Score reflecting an increase in leverage resulting from acquisitions and significant debt maturities within the forecast period. Heineken termed out $1.75 billion of debt in March 2017 by issuing 10-year and 30-year bonds, which should improve its Cash Flow Cushion; however, subsequent debt-financed acquisitions could negate any improvement. The acquisition of Punch Taverns' pub portfolio closed in August 2017, and combining it with Heineken's Star Pubs & Bars business will more than double the company's pub business in the U.K. The estimated enterprise value of transaction was EUR 1.4 billion. Heineken's other major acquisition was Brasil Kirin Holding SA, which closed in May 2017. Although the acquisition expanded the company's footprint, making Heineken the second-largest beer company in Brazil, according to the company, it is margin dilutive by 40 basis points in 2017 and would not cover its cost of capital for approximately five years. The estimated enterprise value of Brasil Kirin was EUR 1.0 billion. Heineken reported that its net debt/EBITDA at June 30, 2017 was 2.5 times; however, this measure does not include the financing of Punch Taverns' pub portfolio.

Tobacco

Exhibit 5 Tobacco Subsector Versus Morningstar Industrials Index



Source: Morningstar Credit Ratings, LLC, Morningstar, Inc., and Interactive Data as of Dec. 6, 2017
UR = rating under review /(p) = positive outlook/(n) = negative outlook

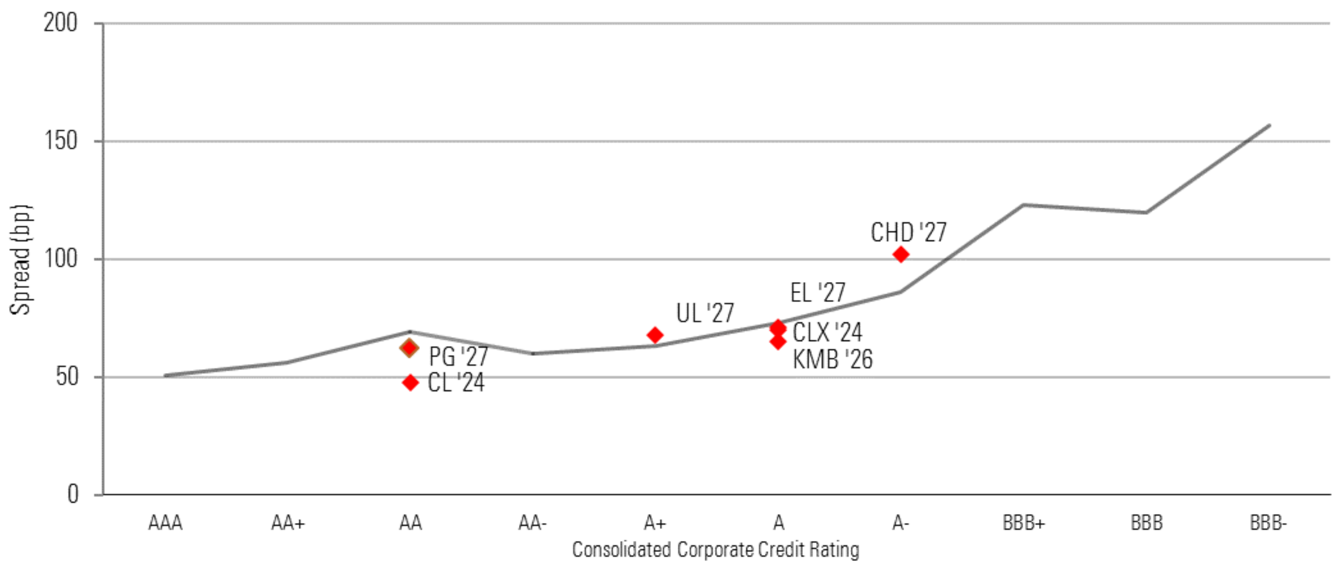
Spreads and Credit Trends

Spreads narrowed an average of 13 basis points for all firms within MCR's tobacco coverage with minimum deviation among the individual firms. Both Altria Group Inc.'s (A-, positive) and Philip Morris International's (A-, stable) ratings were affirmed on Nov. 22, 2017. Altria outlook was revised to positive reflecting the sustained strengthen of its Solvency Score and operating margins. British American Tobacco's (BBB, stable) ratings were downgraded in August 2017, following its acquisition of the remaining 57.8% of Reynold's American Inc. (rating: withdrawn) for approximately $54 billion and $13 billion of assumed debt, because of a weakening Cash Flow Cushion and Solvency Score. The acquisition created a global tobacco company, broadened British American's ownership in the Americas, and strengthened the company's position in the next generation of tobacco products.

Morningstar's tobacco coverage consists of the largest U.S. and global producers whose primary business is manufacturing and marketing cigarettes, which is highly lucrative and one of the most profitable businesses among the consumer defensive subsectors. All the firms have wide moats that were assigned by Morningstar's Equity Research Group and generate tremendous operating earnings and free cash flow. In developing economies, cigarette consumption has been declining for decades, and the industry has consolidated and restructured. Companies have offset volume declines by raising prices and reducing their cost structures, resulting in an overall increase in profitability. These elements, combined with debt reduction and the refinancing of high coupon debt, have improved the credit profiles for Altria. With the exception of M&A and the transitory impact of depreciating currencies, the international firms have stable credit trends.

Consumer Products

Exhibit 6 Consumer Products Subsector Versus Morningstar Industrials Index



Source: Morningstar Credit Ratings, LLC, Morningstar, Inc., and Interactive Data as of Dec. 6, 2017
UR = rating under review/(p) = positive outlook/(n) = negative outlook

Spreads and Credit Trends

Average credit spreads for the consumer products companies Morningstar covers have tightened by 4 basis points since the last chartbook. Firms whose spreads tightened most were Unilever Plc. (A+, stable) at 17 basis points, The Clorox Company (A, stable) at 14 basis points, and Colgate-Palmolive Company (AA, stable) at 7 basis points. The Estee Lauder Companies Inc. (A, stable) spreads were at the average. Procter & Gamble (AA, stable) spreads were flat for the period. Church & Dwight Co. Inc. (A-, stable) widening 7 basis points and Kimberly-Clark Corporation (A, stable) widened 8 basis points. We believe the M&A cloud still hangs over the sector since Unilever Plc. (A+, stable) rebuffed Kraft Heinz Company merger overtures earlier this year. In addition, private equity interest in the sector, as seen from Procter & Gamble Co.'s (AA, stable) ongoing proxy battle with Nelson Peltz, is not likely to bode well for debt investors.

The consumer products subsector consists of companies that provide household and personal-care products. The global leaders—all highly rated and fairly positioned in the rating category—are Procter & Gamble (AA, stable), Colgate-Palmolive (AA, stable), and Unilever. (A+, stable). Another international competitor with a strong but less diversified product portfolio is Kimberly-Clark Corporation (A, stable). More-regional players with competitive or leadership positions in smaller categories include Clorox (A, stable), Church & Dwight (A-, stable), and Estee Lauder (A, stable), which is singularly focused on cosmetics. The products of household and personal-care companies have strong demand characteristics and generate considerable operating earnings and excess free cash flow. The credit trends are influenced more by management financial policies regarding capital allocation than by near-term fundamentals. After decades of expanding, the global players have begun pruning their product portfolios and restructuring their operations over the past few years. As growth has slowed, mainly because of a stagnant global macroeconomic environment and overexpansion, their focus has turned to continuous cost reduction. Standouts for the subsector that have improved revenue and margins are Clorox, Church & Dwight, and Estee Lauder. However, through a conservative capital-allocation policy, Clorox continues to strengthen its credit profile.

Issuer Highlights

- Church & Dwight's (A-, stable) rating was affirmed on Dec. 8, 2017, and is supported by solid credit measures and free cash flow generation, which has resulted in healthy Solvency Score and Distance to Default metrics. Church & Dwight recently acquired PIK Holdings, Inc. (Waterpik) for $1.0 billion. Waterpik is a water-jet technology company that designs and sells both oral water flossers and shower heads. Financing for the acquisition was provided in the company's July 25, 2017, senior notes offering. Pro forma debt/adjusted EBITDA was approximately 3.0 times, with adjusted EBITDA/interest expense at 15 times. Leverage is high for the rating category, but it is expected to be reduced during the near to intermediate term. Free cash flow (cash flow from operation less capital expenditure and dividends) generation is high at approximately $300 million for the latest 12 months ended Sept. 30, 2017. Acquisitions remain a key element of Church & Dwight's growth strategy; as a result, we don't anticipate debt reduction, and maturing debt is likely to be refinanced. While the firm has a solid record of successful acquisitions, we would re-evaluate our rating if an acquisition significantly increases debt leverage.
- Clorox's (A, stable) credit rating was upgraded Dec. 6, 2017, and its outlook was revised to stable from positive based upon continued portfolio diversification, a sustained improvement in the Solvency Score and Cash Flow Cushion, and moderate use of leverage. Clorox's strong brand equity is supported by its leading market shares, as more than 80% of the firm's portfolio consists of number-one or number-two brands. The company also maintains a healthy balance sheet with strong liquidity. Total debt remains at $2.2 billion and debt/EBITDA has been consistently maintained at a little less than 2 times, and management continues to target a leverage ratio of 2–2.5 times. We expect steady financial performance and credit metrics over our five-year forecast period.

Appendix

Exhibit 7 Morningstar Credit Ratings Sector Coverage: Consumer Defensive

Issuer	Ticker	Corporate Rating	Outlook	Rating Action	Date
Packaged Foods					
Campbell Soup Co	CPB	A-	Stable	Affirmed	1/19/17
Conagra Brands Inc.	CAG	BBB	Stable	Upgraded	2/13/2017
Danone SA	BN	BBB+	Stable	Affirmed	6/9/2017
General Mills Inc.	GIS	BBB+	Stable	Affirmed	3/24/2017
Hershey Co (The)	HSY	A+	Negative	Affirmed	12/29/2016
Hormel Foods Corp	HRL	AA-	Stable	Affirmed	2/28/2017
Kellogg Co	K	BBB	Stable	Affirmed	3/24/2017
Kraft Heinz Co (The)	KHC	BBB-	Stable	Affirmed	2/27/2017
McCormick & Co Inc.	MKC	BBB+	Stable	Downgraded	9/19/2017
Mondelez International Inc.	MDLZ	BBB	Positive	Affirmed	1/18/2017
Tyson Foods Inc.	TSN	BBB-	Positive	Affirmed	5/18/2017
Restaurants					
Darden Restaurants Inc	DRI	BBB-	Positive	Affirmed	1/30/2017
McDonald's Corp	MCD	A-	Stable	Affirmed	2/1/2017
Starbucks Corp	SBUX	A	Stable	Affirmed	4/26/2017
Sysco Corp	SYY	A-	Stable	Affirmed	2/27/2017
Yum Brands Inc.	YUM	BB	Stable	Affirmed	4/26/2017
Beverages					
Anheuser-Busch InBev SA/NV	BUD	BBB+	Stable	Affirmed	10/6/2017
Brown-Forman Corp	BF.B	A+	Stable	Affirmed	9/6/2017
Coca-Cola Co	KO	A+	Stable	Affirmed	6/29/2017
Constellation Brands Inc.	STZ	BBB-	Positive	Affirmed	10/6/2017
Diageo PLC	DEO	A-	Stable	Affirmed	9/6/2017
Dr Pepper Snapple Group Inc	DPS	A-	Stable	Affirmed	5/18/2017
Heineken NV	HEIA	A-	Negative	Affirmed	1/19/2017
Molson Coors Brewing Co	TAP	BBB	Stable	Affirmed	10/6/2017
PepsiCo Inc.	PEP	A+	Stable	Affirmed	6/29/2017
Tobacco					
Altria Group Inc.	MO	A-	Positive	Affirmed	11/22/2017
British American Tobacco PLC	BATS	BBB	Stable	Downgraded	8/11/2017
Philip Morris International Inc.	PM	A-	Stable	Affirmed	11/22/2017
Consumer Products					
Church & Dwight Co Inc.	CHD	A-	Stable	Affirmed	12/8/2017
Clorox Co	CLX	A	Stable	Upgraded	12/6/2017
Colgate-Palmolive Co	CL	AA	Stable	Affirmed	12/20/2016
Estee Lauder Companies Inc.	EL	A	Stable	Affirmed	12/20/2016
Kimberly-Clark Corp	KMB	A	Stable	Affirmed	2/13/2017
Procter & Gamble Co	PG	AA	Stable	Affirmed	12/29/2016
Unilever NV	UL	A+	Stable	Affirmed	12/19/2016

About Morningstar® Credit Research

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

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