Corporate Credit Spread Chartbook
Consumer Cyclical Industry

Morningstar Credit Research
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Contents

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Executive Summary
Morningstar Credit Ratings, LLC maintains a corporate credit rating on 22 issuers in the consumer cyclical sector, including high-yield issuers. The average credit spread for the 19 investment-grade consumer cyclical issuers under coverage widened 9 basis points to +128 over Treasuries, keeping pace with the Morningstar Corporate Bond Index, which widened 8 basis points to +113 since our last consumer cyclical chartbook publication in March 2018.

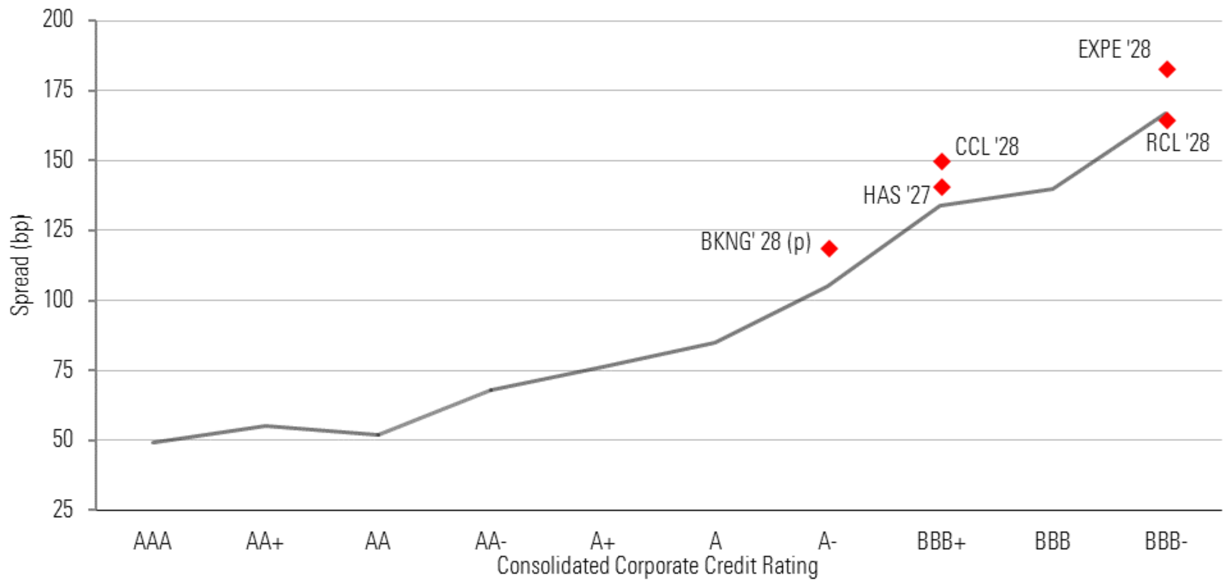
During this same period, Morningstar downgraded one issuer, upgraded one issuer, and affirmed six issuers in the consumer cyclical sector. Year to date, Morningstar downgraded Mattel Inc (BB, Negative) by two notches and Bed Bath & Beyond (BB+, Negative) by one notch. MGM Resorts International (BB, Stable) was upgraded one notch.

Despite the improving economy, credit quality is expected to remain under pressure over the next year, as indicated by the predominance of negative rating outlooks. Currently within Morningstar's consumer cyclical rated universe, six issuers have a negative outlook while only one issuer has a positive outlook. Credit trends remain somewhat negative in the department store and apparel sector, as well as the discount sector. The gaming, travel, and leisure sector features one issuer with a positive rating outlook.

Spread Charts by Consumer Cyclical Sector

Gaming, Travel, and Leisure

Exhibit 1 Gaming, Travel, and Leisure Versus Morningstar Industrials Index



Source: Morningstar Credit Ratings, LLC, Morningstar, Inc., and Interactive Data as of July 27, 2018
(UR) = rating under review/(p) = positive outlook/(n) = negative outlook

Credit Trends and Spreads

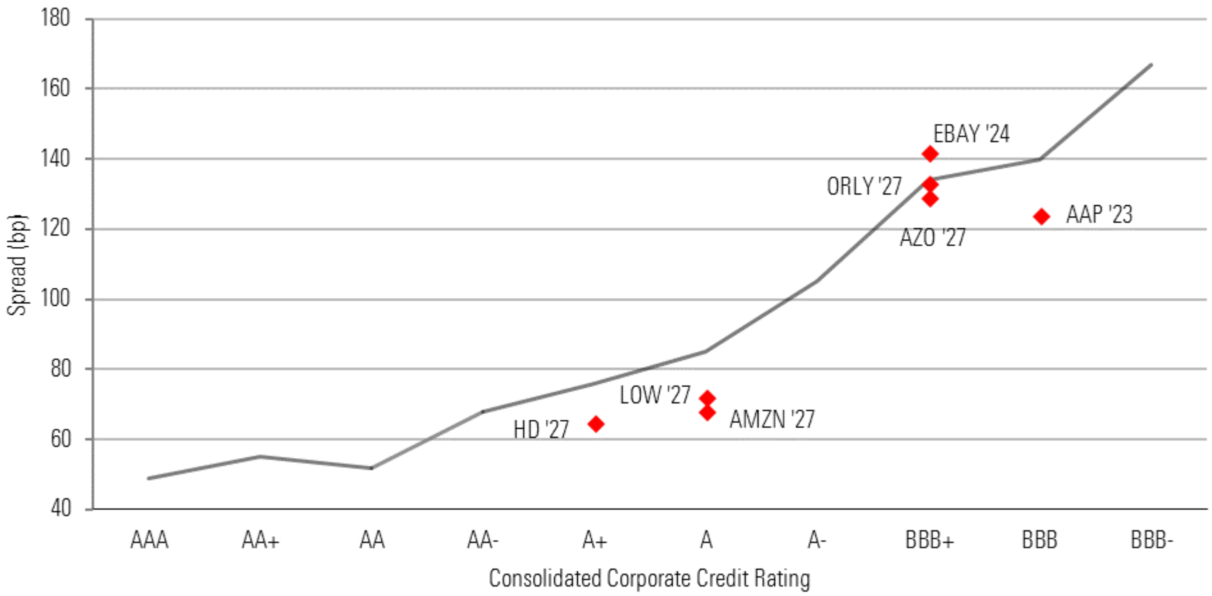
Operating performance in the gaming, travel, and leisure industry has remained robust, supported by a healthy economy featuring low unemployment and solid wage gains. Specifically, most issuers that we cover in the online travel agency, cruise line, and resort casino segments reported solid bookings growth, which led to higher revenue and margin expansion. Despite these strong industry dynamics, the average credit spread for investment-grade issuers in this industry widened by 17 basis points, outpacing the broader consumer cyclical sector average. Since the last chartbook, Morningstar affirmed two cruise line issuers under coverage, Carnival Corporation (BBB+, Stable) and Royal Caribbean Cruises (BBB-, Stable). Both of these recently reported strong operating performance, which continues to support solid credit metrics. Nevertheless, since March credit spreads for Carnival and Royal Caribbean widened 34 basis points and 25 basis points, respectively. In June, Morningstar upgraded MGM Resort's (BB, Stable) rating one notch, reflecting positive credit improvement.

Issuer Highlights

- Carnival's (BBB+, Stable) rating was affirmed with a stable outlook in March 2018, reflecting Carnival's leading position in the cyclical cruise line industry, generating high margins, and the maintenance of a moderately leveraged capital structure. Carnival's moderate Business Risk score is supported by the company's position as the world's largest cruise line, which generates cost advantages. The capital intensity of the cruise line industry discourages new competition, leaving Carnival and its two main competitors to dominate the North American market. Carnival's strong Solvency Score reflects improving returns on invested capital, approaching management's 2018 target for double-digit returns. EBITDA margins in the high 20% range reflect improved pricing and occupancy levels, as well as substantial cost-cutting efforts, including over $100 million of savings in 2017 with another $80 million planned in 2018. Carnival's rating is also supported by a moderate capital structure, with debt/EBITDA averaging 2.0 times over the past three years.
- Royal Caribbean (BBB-, Stable) rating was affirmed with a stable outlook in March 2018. The affirmation is based on Royal's competitive position in the cruise line industry, healthy profitability, and substantial leverage reduction. Royal's moderate Business Risk score is supported by its position as the world's second-largest cruise company, providing scale that allows it to leverage costs and provide competitive pricing to its customers. Royal's moderate Solvency Score reflects substantial improvement in margins and return on invested capital, which Morningstar expects will be sustained over the next several years. Over the past year, Royal reduced debt balances by nearly $1.9 billion to $7.5 billion and decreased debt/EBITDA by over one turn to 2.8 times at year-end 2017. Royal's strategy is to maintain leverage in the range of 3-3.5 times over the long term.
- MGM Resorts' (BB, Stable) rating was upgraded by one notch and its outlook revised to stable in June 2018, reflecting MGM's greater revenue diversity following the opening of several new resorts, growing free cash flow, a reduction in near-term new development, and meaningful progress toward management's targeted net leverage goal of 3-4 times. MGM's rating continues to be based on its position as the leading operator in its domestic markets, including its largest market, Las Vegas, whose fundamentals continue to improve. Free cash flow is projected to substantially improve over the next three years as capital spending on recent new development is completed. MGM continues to make progress toward reducing adjusted net debt to within management's targeted range of 3-4 times EBITDA. At the end of the latest quarter, Morningstar calculates the company's adjusted net debt/EBITDA ratio was 4.4 times. In June 2018, MGM issued $1 billion senior notes due 2025 at a spread of +284 basis points over Treasuries to support near-term maturities.
- Mattel (BB, Negative) issued $500 million 6.75% senior unsecured notes due 2025 in May 2018 at a spread of +441 basis points over Treasuries. Proceeds were used to push out its maturity schedule by repaying its 2014 senior notes due 2019. Mattel's recent downgrade reflects ongoing revenue and cash flow declines, weaker credit protection measures, and heightened uncertainty regarding future operating performance. A negative outlook reflects the potential for a lower rating if Mattel is unable to stabilize revenue and improve margins and debt protection metrics.

Specialty Retail

Exhibit 2 Specialty Retail Versus Morningstar Corporate Bond Index



Source: Morningstar Credit Ratings, LLC, Morningstar, Inc., and Interactive Data as of July 27, 2018
(UR) = rating under review/(p) = positive outlook/(n) = negative outlook

Credit Trends and Spreads

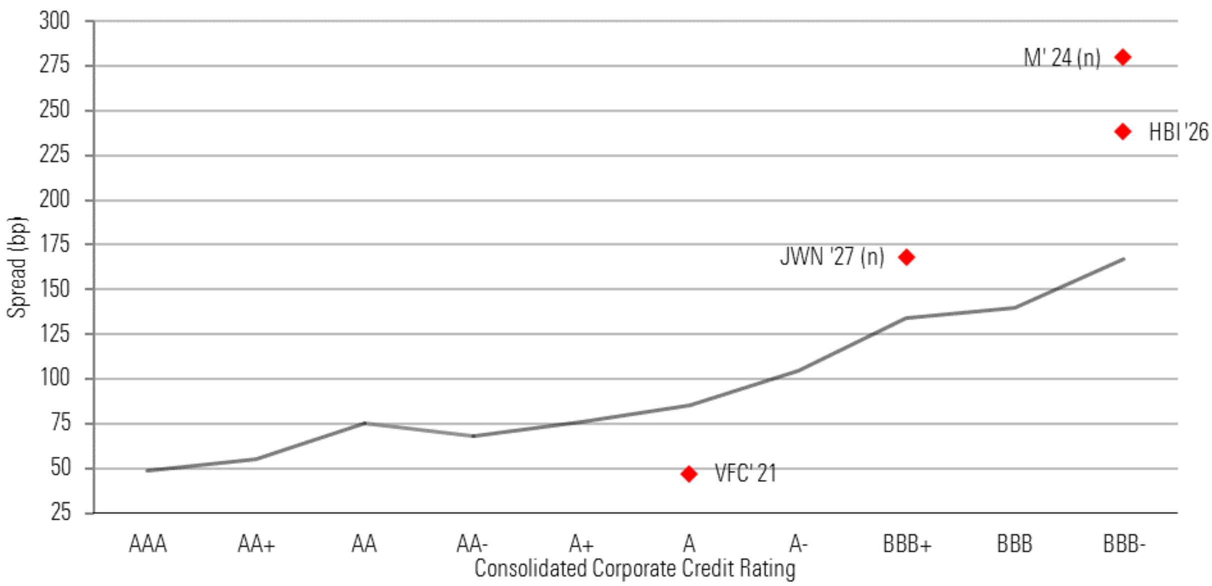
Auto-parts retailers and home centers, which provide in-store service expertise and low-cost distribution capabilities that can quickly deliver a breadth of inventory, possess modest defenses against online threats. Nevertheless, given the increasing customer demands for more convenience, these retailers continue to invest in their online presence and expand their distribution and supply chain efficiencies. Morningstar's recent rating affirmations on The Home Depot (A+, Stable) and Lowe's Companies (A, Stable) reflect these considerations. The average bond spread for issuers in the specialty retail category sector widened by 9 basis points since March 2018. All three issuers covered by Morningstar in the auto-parts retail space outpaced this move, with each widening by double digits. Meanwhile, the home improvement companies tightened, especially Lowe's, whose 2027 bonds tightened 10 basis points. Finally, Bed Bath & Beyond's (BB+, Negative) rating was downgraded to high-yield in April 2018, based on Morningstar's expectation for further deterioration in cash flow and credit protection measures.

Issuer Highlights

- Home Depot's (A+, Stable) rating was affirmed with a stable outlook in July 2018. Home Depot’s credit rating is supported by its competitive advantages, accelerating free cash flow, and the maintenance of a moderately leveraged balance sheet. Home Depot’s competitive strengths include its large scale, breadth of product offerings, and low-cost operations that allow the company to provide everyday low pricing. Home Depot’s strong Solvency Score (score: 4/10) reflects further expected improvement in the company’s return on invested capital, which was 32% in 2017, compared with a return that was in the high teens only five years ago. Morningstar calculates that adjusted leverage has remained within a range of 1.7-2.0 times for the past several years, including 1.9 times at the end of the first quarter ended April 29.
- Lowe's Companies (A, Stable) rating was affirmed with a stable outlook in July 2018. Lowe's credit rating continues to be supported by its competitive advantages in home-improvement retailing, consistent free cash flow generation, and adherence to a moderate leverage target. Lowe's competitive advantages include its large scale that enables it to negotiate advantageously with vendors, while a low-cost position is supported by an automated distribution network that integrates its vendors, distribution centers, and stores. Morningstar believes Lowe's brand is a strong intangible asset, as evidenced by a loyal customer base that relies on the expertise and knowledge of its store-based employees. Lowe’s moderate Solvency Score (score: 5/10) reflects ongoing improvement in the company’s return on invested capital, which was 19% in 2017 compared with a low-teens return a few years ago. Lowe’s maintains an adjusted leverage target of 2.25 times EBITDA.
- Bed Bath & Beyond (BB+, Negative) was downgraded by one notch and its outlook revised to negative in April 2018. This action was based on Morningstar's expectation that a decline in profitability is likely to continue over the next two years at a more severe pace than previously anticipated, further stressing cash flow and credit protection measures. Bed Bath & Beyond’s Solvency Score remains weak (score: 8/10), based in part by lower projected margins and return on invested capital over the next several years. EBITDA margins have steadily declined, falling to 8.7% in fiscal 2017 from peak margins of 18.4% in 2011. Likewise, return on invested capital declined to 10.3% from 21.3% over the same period. Morningstar forecasts EBITDA margins to contract by more than 200 basis points over the next two years, with return on invested capital settling into the mid-single-digit range. Adjusted gross debt leverage, including operating leases, was 3.7 times at year-end 2017, marking a considerable increase from leverage of 2.6 times at the time of the 2014 bond issuance.
- O'Reilly Automotive (BBB+, Stable) issued $500 million of 4.35% senior notes due 2028 in May 2018 at a spread to Treasuries of +140 basis points. Proceeds were used to repay its credit facility. O'Reilly's rating is based on its leading competitive position among auto parts retailers, as evidenced by strong returns on invested capital and further supported by the maintenance of modest leverage.

Department Stores and Apparel

Exhibit 3 Department Stores and Apparel Versus Morningstar Corporate Bond Index



Source: Morningstar Credit Ratings, LLC, Morningstar, Inc., and Interactive Data as of July 27, 2018
(UR) = rating under review/(p) = positive outlook/(n) = negative outlook

Credit Trends and Spreads

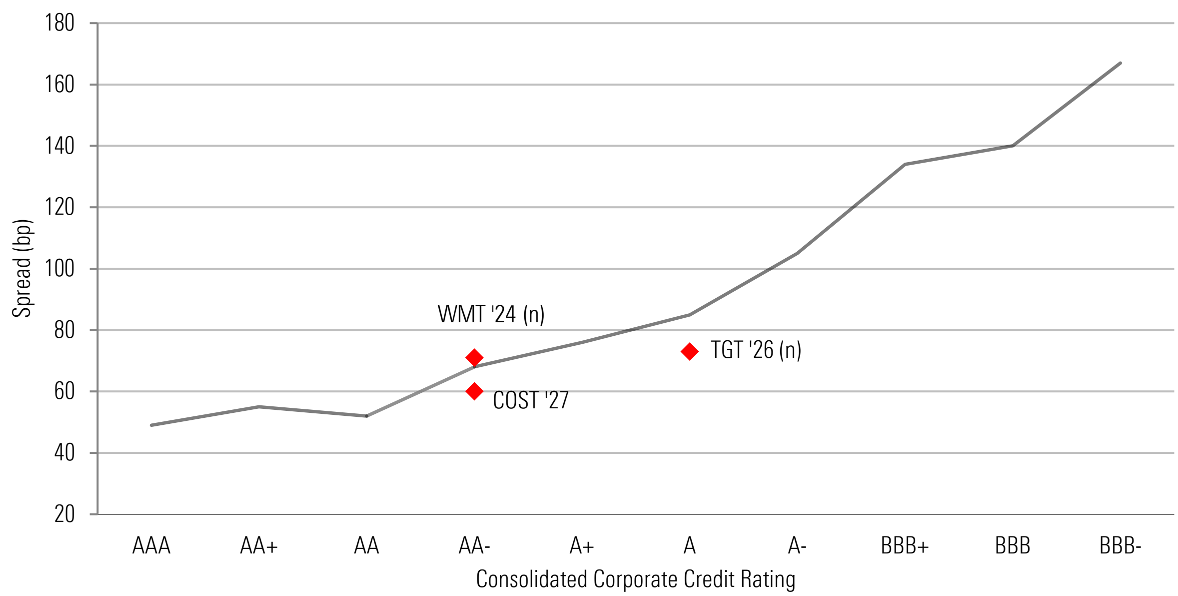
The operating performance of traditional store-based retailers continue to improve, as issuers have generally posted stabilizing sales and margins. Department stores have increased investment in stores, online distribution, inventory management, and price. Likewise, branded apparel manufacturers have stabilized operations, aided in part by the growth of their own online and direct to consumer distribution, while also focusing on lowering supply-chain costs and focusing on faster time to market and delivery. Still this segment is experiencing lower or slower revenue growth, pricing pressure, and higher investment costs. Morningstar maintains a negative outlook on several issuers in the sector, including Macy’s Inc (BBB-, Negative) and Nordstrom Inc (BBB+, Negative). The average credit spread on bonds in this segment has tightened 1 basis point since the last chartbook, led by Macy's, whose 2028 bonds tightened by 18 basis points to +280 basis points.

Issuer Highlights

- Nordstrom's (BBB+, Negative) rating was affirmed in March 2018, based on a solid competitive market position and the maintenance of a moderately leveraged balance sheet. Nordstrom's moderate Business Risk score reflects the company's position in apparel retailing, which has been supported by substantial investments in e-commerce initiatives and new store growth. Management is forecasting a turning point in 2018, which includes a stabilization of EBIT margins at 6%, followed by margin expansion as it further integrates and leverages its digital and physical assets. Nordstrom's moderate Solvency Score (score: 6/10) is supported by solid midteens return on invested capital and modest leverage. Over the past several years, debt leverage has remained relatively stable, and Morningstar calculates adjusted debt/EBITDAR of 2.7 times at the end of fiscal 2017. Our negative outlook reflects the possibility that the rating could be lowered if investments fail to stabilize profitability.
- Macy's (BBB-, Negative) rating was affirmed in March 2018, based on Macy's leading competitive position in department store retailing, management's commitment to further debt leverage reduction, and early success with efforts to stabilize revenue and EBITDA declines. A moderate Business Risk score reflects Macy's position as one of the largest U.S. department stores, offset by increasing competitive threats that have eroded profitability. Asset sales, as well as a 1.9% same-store sales decline, tempered results in 2017. While management forecasts minimal, yet positive, same-store sales growth in 2018, we believe operating margins may continue to erode. A negative outlook reflects the potential for a lower rating if the company is unable to steady profitability and reduce leverage. Management has made significant progress toward reaching its debt leverage target of 2.5-2.8 times. Morningstar calculates year-end adjusted debt leverage at 3.1 times.

Discounters and Grocery

Exhibit 4 Discounters and Grocery Versus Morningstar Corporate Bond Index



Source: Morningstar Credit Ratings, LLC, Morningstar, Inc., and Interactive Data as of July 27, 2018
(UR) = rating under review/(p) = positive outlook/(n) = negative outlook

Credit Trends and Spreads

Strong retail sales fueled by fully employed consumer base have supported big-box discounters and grocers as they address an evolving retail landscape with investments in online and direct to customer initiatives. Since the last chartbook, credit spreads widened by 7 basis points on average in this segment, which was in line with our rated universe on consumer cyclical issuers. Walmart Inc (AA-, Negative) led the way, as its 2027 bond spreads widened 12 basis points to +71 over Treasuries.

Issuer Highlights

Walmart (AA-, Negative) issued a multitranche $16 billion debt offering, including 2- and 3-year fixed- and floating-rate notes and 5-, 7-, 10-, 20-, and 30-year fixed-rate notes this past June 2018. The new issuance included a 10-year $2.75 billion tranche with a 3.70% coupon issued at +80 basis points over Treasuries. The new debt was raised to fund its $16 billion acquisition of Flipkart Group. While the acquisition will add incremental debt leverage to Walmart's credit profile, Morningstar believes the transaction furthers Walmart's efforts to expand its e-commerce business, which has been supported by significant acquisitions of online retailers over the past several years. Flipkart would add India's leading e-commerce company to Walmart's omnichannel platform. Morningstar estimates Walmart's adjusted debt leverage will increase to 2.3 times from 2.0 times pro forma for the transaction. A negative outlook reflects the potential for the rating to be lowered if investments in existing stores and e-commerce do not sustain comparable sales growth or stabilize operating margins and returns on invested capital.

Exhibit 5 Consumer Cyclical Coverage

Issuer	Rating	Outlook	Rating Date	Direction	Coupon	Maturity	Bid	YTW	STW
Department Stores and Apparel									
VF Corp.	A	Stable	12/21/2017	Affirmation	3.50%	9/1/2021	100.72	3.23%	47
Nordstrom Inc.	BBB+	Negative	3/27/2018	Affirmation	4.00%	3/15/2027	95.48	4.64%	168
HanesBrands Inc.	BBB-	Stable	10/17/2017	Affirmation	4.88%	5/15/2026	97.13	5.33%	238
Macy's Retail Holdings Inc.	BBB-	Negative	3/27/2018	Affirmation	3.63%	6/1/2024	108.89	5.77%	280
Discounters & Grocery									
Costco Wholesale Corp.	AA-	Stable	1/24/2018	Affirmation	2.35%	5/18/2022	95.78	3.56%	60
Walmart Inc.	AA-	Negative	1/25/2018	Affirmation	3.33%	4/22/2024	116.39	3.67%	71
Target Corp.	A	Negative	1/24/2018	Affirmation	2.50%	4/15/2026	92.15	3.68%	73
Gaming, Lodging & Leisure, Casino									
Booking Holdings Inc.	A-	Positive	3/12/2018	Affirmation	3.60%	6/1/2026	95.14	4.17%	119
Hasbro Inc.	BBB+	Stable	10/17/2017	Affirmation	3.50%	9/15/2027	93.48	4.32%	141
Carnival Corp.	BBB+	Stable	3/28/2018	Affirmation	6.65%	1/15/2028	116.62	4.47%	150
Royal Caribbean Cruises LTD	BBB-	Stable	3/22/2018	Affirmation	3.70%	3/15/2028	92.86	4.63%	165
Expedia Inc.	BBB-	Stable	3/12/2018	Affirmation	3.80%	2/15/2028	92.39	4.80%	183
MGM Resorts International	BB	Stable	6/28/2018	Upgrade	4.63%	9/1/2026	94.00	5.56%	260
Mattel Inc.	BB	Negative	2/09/2018	Downgrade	3.15%	3/15/2023	96.50	7.37%	442
Specialty Retail									
Home Depot Inc.	A+	Stable	7/26/2018	Affirmation	3.00%	2/12/2026	93.70	3.61%	65
Amazon.com Inc.	A	Stable	2/22/2018	Affirmation	3.80%	12/5/2024	96.18	3.65%	68
Lowe's Companies Inc.	A	Stable	7/26/2018	Affirmation	3.10%	5/3/2027	95.62	3.69%	72
Advance Auto Parts Inc.	BBB	Stable	2/27/2018	Affirmation	4.50%	12/1/2023	101.80	4.10%	124
AutoZone Inc.	BBB+	Stable	2/20/2018	Affirmation	3.75%	6/1/2027	96.31	4.25%	129
O'Reilly Automotive Inc.	BBB+	Stable	2/27/2018	Affirmation	3.55%	3/15/2026	94.80	4.30%	133
eBay Inc.	BBB+	Stable	2/22/2018	Affirmation	3.45%	8/1/2024	94.32	4.35%	142
Bed Bath & Beyond Inc.	BB+	Negative	4/19/2018	Downgrade	3.75%	8/1/2024	91.88	5.35%	245

Source: Morningstar Credit Ratings, LLC, Morningstar, Inc., and Interactive Data as of July 27, 2018

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