# Morningstar Corporate Credit Research Highlights

## Volatility remains low, but French elections could drive turmoil.

Morningstar Credit Ratings, LLC
27 February 2017



### Credit Market Insights

- Market data and insights.
- New issue volume and secondary market trading volume slow to normalized levels.

### Credit Rating Actions

- Rating Changes

| Issuer/Ticker | Current Issuer Credit Rating | Previous Issuer Credit Rating |
|---|---|---|
| Marathon Oil MRO | BBB- | BBB |
| Amazon AMZN | A | BBB+ |
| Parker Hannifin PH | A- | A |

- Rating Affirmations

| Issuer/Ticker | Current Issuer Credit Rating | Previous Issuer Credit Rating |
|---|---|---|
| eBay EBAY | BBB+ | BBB+ |
| Discover Financial Services DFS | BBB+ | BBB+ |
| American Express AXP | A- | A- |
| Capital One COF | A- | A- |
| Synchrony Financial SYF | BBB | BBB |
| Thomson Reuters TRI | BBB+ | BBB+ |

### Recent Notes Published by Credit Analysts

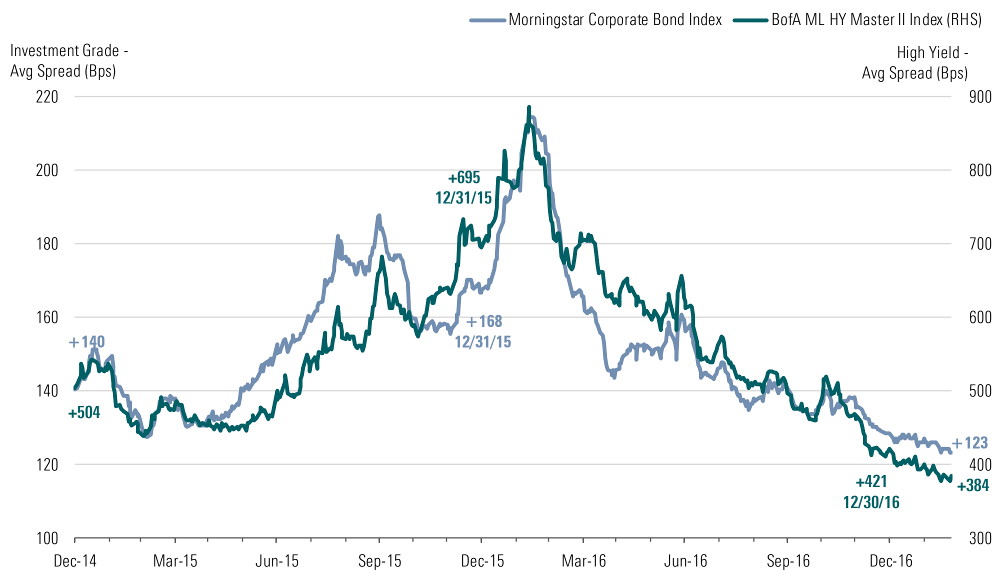
- **Parker Hannifin** is raising 10- and 30-year debt to fund its Clarcor acquisition.
- **Medtronic**'s leverage remains static in fiscal 3Q, reinforcing stable outlook.
- **Anglo American** posts 25% increase in EBITDA year over year.
- **Ecolab** posts flat adjusted EBITDA for 2016.
- **Bristol-Myers Squibb** issuing debt to fund accelerated share-repurchase program.
- **Fresenius** deleverages further in 4Q, reinforcing our positive rating outlook.
- **Newmont Mining** reports 25% increase in adjusted EBITDA.
- **Summit Materials**' net leverage unchanged year over year.
- **Dish Network** reports modest 4Q improvement, but substantial challenges lie ahead.
- **Vale**'s leverage drops to 2.4 times.
- **Viacom** issues $1.3 billion junior subordinated notes to address upcoming maturities.
- **L Brands**' 4Q results demonstrate that challenges remain.

## Credit Market Insights

### Volatility Remains Low, but French Elections Could Drive Turmoil

Major U.S. stock market indexes hit all-time highs last week, but investment-grade corporate credit spreads remained in a very tight trading range. Since the end of last year, the credit spread in the investment-grade corporate bond market has traded within a 5-basis point range. The average spread of the Morningstar Corporate Bond Index, our proxy for the investment-grade bond market, tightened 1 basis point to +123 last week. In the high-yield market, the credit spread of the Bank of America Merrill Lynch High Yield Master Index tightened only 2 basis points to +384. While stock prices have been rising on the expectations that revisions to tax and regulatory policies will reinvigorate economic growth and earnings, investors in corporate bonds have been unwilling to chase credit spreads tighter.

**Corporate Bond Credit Spreads**




Source: Morningstar,Inc., BofA Merrill Lynch Global Indexes. Data as of 02/24/2017.

Volatility in the corporate bond market is also very low in Europe. The average credit spread of the Morningstar Eurobond Corporate Index has traded within a 5-basis-point range thus far this year. However, while volatility in the corporate bond markets remains low, there are signs that some investors are becoming increasingly concerned that the French presidential election could result in a shakeup of the eurozone. The first round of voting is scheduled for April 23. If no candidate achieves a majority vote, then a runoff between the two with the most votes will occur May 7. Recent polls show that National Front leader Marine Le Pen's popularity has been gaining and she could garner enough votes to enter the runoff. The National Front has long advocated against the European Union, and Le Pen's platform calls for a referendum on France's membership in the EU as well as restoring a national currency.

With Le Pen's rise in the polls, some investors have sought the safety provided by German sovereign bonds. Year to date, the yield on the 2-year German sovereign bond has dropped 18 basis points, with 14 basis points of the decline occurring just last week. Based on the price of this bond, the yield has reached a new historical low of negative 0.95%. The yield on Germany's 5-year sovereign bond dropped to a negative 0.60% at the end of last week and is only 2 basis points higher than its historical low. Considering that if investors hold either of these bonds to maturity, they will have locked in a loss, these yields reveal that investors are willing to pay a premium to safeguard their principal. The only way an investor can make money would be to sell the bond to another investor who would be willing to lock in an even greater loss.

While the yield on German sovereign bonds has been plunging, the spread between the yield on German and French sovereign bonds has been widening. Although the credit spread between the two is still much lower than where it peaked during the European sovereign debt crisis in 2011, it has widened 26 basis points since the end of last year. Currently, the spread is 74 basis points, the widest it has been since 2012, when the markets were still recovering from the European sovereign debt crisis.

**French 10-Year Government Bond Yield Over Germany 10-Year Bond**

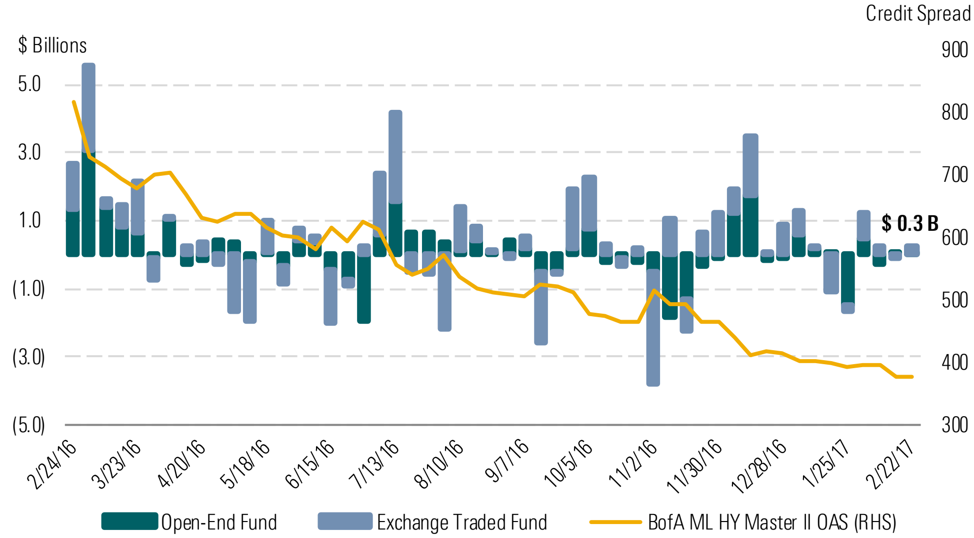

Source: Bloomberg. Data as of 2/24/2017.

### New Issue Volume and Secondary Market Trading Volume Slow to Normalized Levels

After a record amount of new issuance was brought to the corporate bond market in January, the new issuance market has slowed considerably. Similarly, after registering historically high trading volume in the secondary corporate bond market, the amount of bonds that traded hands over the course of the week declined toward more normalized levels. According to Bloomberg, of the five highest-volume trading sessions since the data began in 2005, four have occurred this year, with the other occurring last November. Six of the top ten highest-volume sessions has occurred just this year.

While the stock market seems to climb ever higher, fixed-income investors remain especially cautious, especially in the high-yield market. Fund flows into the high-yield asset class were essentially unchanged last week, rising only $0.3 billion last week. The small amount of inflows into exchange traded funds slightly offset the amount of outflows among the open-end mutual funds.

**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 Feb. 24, 2017
(000,000s $ unless otherwise noted)

| Issuer | | | Issue | | | | |
|---|---|---|---|---|---|---|---|
| Name | Ticker | Morningstar Corporate Rating (1) | Size | Coupon | Description | Maturity | Approx Spread to US Treasuries |
| Bristol-Myers Squibb | BMY | AA- | $750 | 1.60% | Senior Unsecured | 2019 | +43 |
| Bristol-Myers Squibb | BMY | AA- | $750 | 3.25% | Senior Unsecured | 2027 | +90 |
| Parker Hannifin | PH | A- | € 700 | 1.13% | Senior Unsecured | 2025 | +60(2) |
| Parker Hannifin | PH | A- | $700 | 3.25% | Senior Unsecured | 2027 | +83 |
| Parker Hannifin | PH | A- | $600 | 4.10% | Senior Unsecured | 2047 | +108 |
| Viacom | VIAB | BBB | $650 | 5.88% | Junior Subordinated | 2057 | +405 |
| Viacom | VIAB | BBB | $650 | 6.25% | Junior Subordinated | 2057 | +391 |

Source: Advantage Data, Company SEC fillings.
*(1) Morningstar's issuer credit rating is assigned at the holding company level.*
*(2) Spread over mid-swaps.*

**Exhibit 2** Morningstar, Inc. 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-** | **4,681** | **6.8** | **123** | **(4)** | **(5)** | **1.29** | **1.65** |
| **FINANCIAL** | **A-** | **1,450** | **5.5** | **115** | **(5)** | **(7)** | **1.11** | **1.48** |
| Bank | A- | 899 | 5.1 | 116 | (5) | (6) | 1.05 | 1.33 |
| Finance | A | 260 | 5.7 | 108 | (7) | (13) | 1.27 | 1.85 |
| Insurance | A | 212 | 7.7 | 117 | (1) | (4) | 1.24 | 1.77 |
| REITs | BBB+ | 71 | 6.0 | 128 | (2) | (7) | 1.23 | 1.83 |
| **INDUSTRIAL** | **A-** | **2,673** | **7.4** | **126** | **(4)** | **(4)** | **1.43** | **1.69** |
| Basic Industries | BBB+ | 228 | 7.5 | 157 | (9) | (23) | 2.01 | 3.49 |
| Consumer Products | A- | 289 | 7.5 | 107 | (2) | (1) | 1.23 | 1.35 |
| Energy | A- | 406 | 7.0 | 149 | (4) | (6) | 1.46 | 2.15 |
| Healthcare | A- | 403 | 7.4 | 113 | (1) | (2) | 1.39 | 1.62 |
| Manufacturing | A- | 389 | 6.1 | 101 | (5) | (9) | 1.17 | 1.58 |
| Media | BBB+ | 193 | 8.2 | 155 | (5) | (3) | 1.66 | 1.59 |
| Retail | A- | 164 | 8.1 | 110 | (2) | 2 | 1.51 | 1.25 |
| Technology | A+ | 276 | 7.0 | 102 | (4) | (4) | 1.46 | 1.47 |
| Telecom | BBB+ | 150 | 8.3 | 163 | (0) | 5 | 1.24 | 0.75 |
| Transportation | BBB+ | 133 | 8.9 | 129 | (2) | (4) | 1.52 | 1.96 |
| **UTILITY** | **BBB+** | **515** | **8.3** | **145** | **1** | **(7)** | **1.23** | **2.25** |
| Electric Utilities | A- | 304 | 8.7 | 130 | (1) | (6) | 1.28 | 2.05 |
| Gas Pipelines | BBB+ | 203 | 7.7 | 167 | 3 | (10) | 1.15 | 2.56 |
| **Rating Bucket** | | | | | | | | |
| AAA Bucket | | 103 | 7.5 | 68 | (4) | 2 | 1.30 | 0.98 |
| AA Bucket | | 539 | 5.9 | 78 | (4) | (5) | 1.06 | 1.31 |
| A Bucket | | 1,761 | 6.7 | 102 | (3) | (4) | 1.22 | 1.47 |
| BBB Bucket | | 2,278 | 7.0 | 156 | (5) | (9) | 1.42 | 1.94 |
| **Term Bucket** | | | | | | | | |
| 1-4 | A- | 1,466 | 2.3 | 82 | (5) | (11) | 0.50 | 0.87 |
| 4-7 | A- | 1,149 | 4.6 | 108 | (4) | (7) | 1.02 | 1.55 |
| 7-10 | A- | 892 | 7.1 | 134 | (4) | (3) | 1.59 | 1.84 |
| 10PLUS | A- | 1,174 | 13.6 | 175 | (2) | 0 | 2.25 | 2.51 |

*Data as of 02/24/2017*

**Exhibit 3** Morningstar, Inc. Corporate Bond Index Spread by Sector

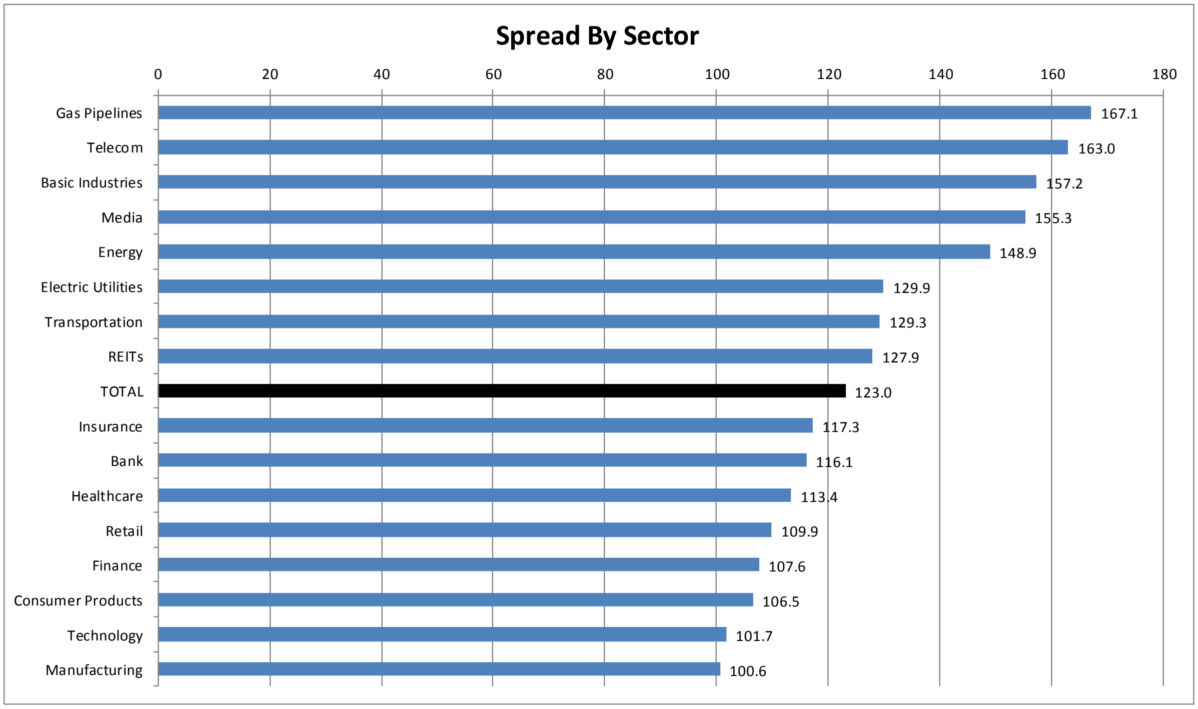



**Exhibit 4** Morningstar, Inc. Corporate Bond Index YTD Spread Change

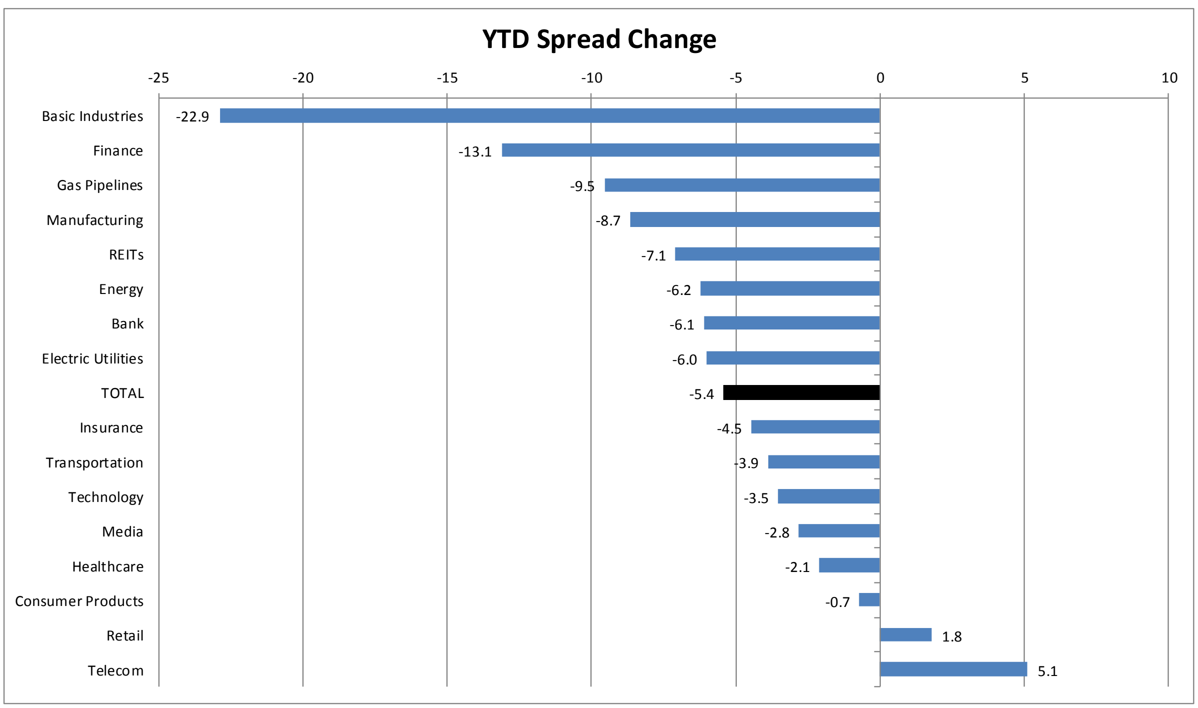
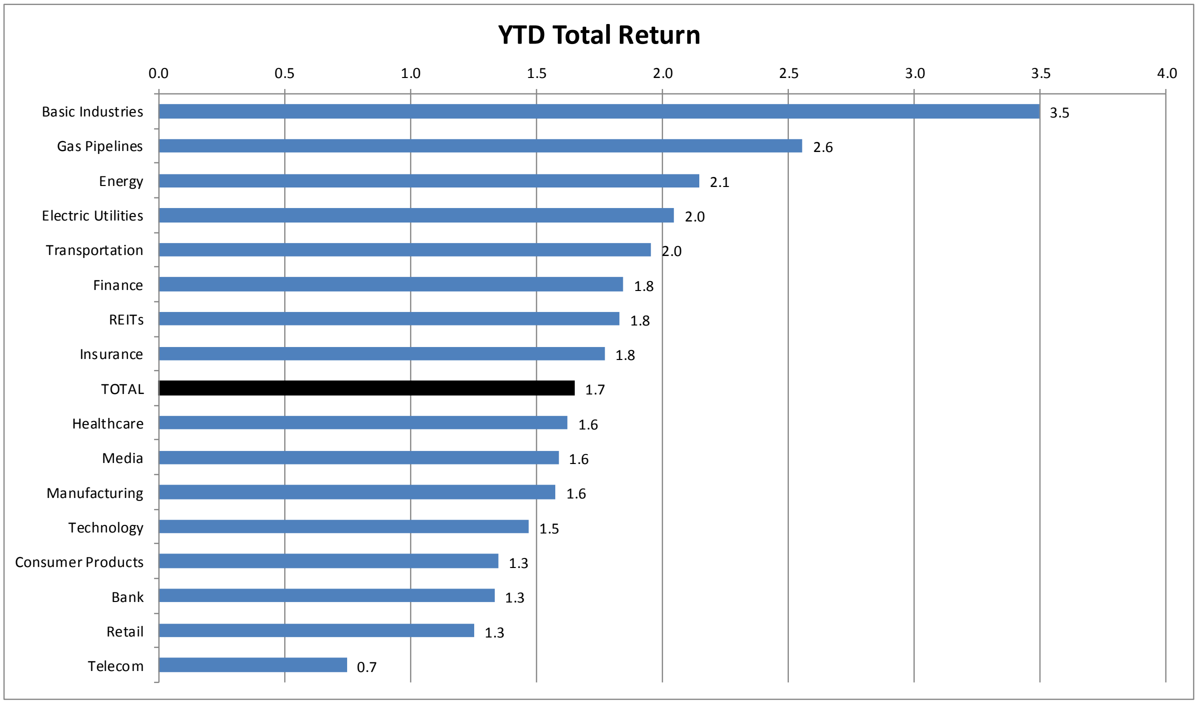


**Exhibit 5** Morningstar, Inc. Corporate Bond Index YTD Return



## Credit Rating Actions

► Rating Changes

| Issuer/Ticker | Current Issuer Credit Rating | Previous Issuer Credit Rating |
|---|---|---|
| Marathon Oil MRO | BBB- | BBB |
| Amazon AMZN | A | BBB+ |
| Parker Hannifin PH | A- | A |

► Rating Affirmations

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|---|---|---|
| eBay EBAY | BBB+ | BBB+ |
| Discover Financial Services DFS | BBB+ | BBB+ |
| American Express AXP | A- | A- |
| Capital One COF | A- | A- |
| Synchrony Financial SYF | BBB | BBB |
| Thomson Reuters TRI | BBB+ | BBB+ |

### Marathon Oil Downgraded to BBB-, but Stable Outlook Maintained

Morningstar Credit Ratings, LLC is downgrading the corporate credit rating of Marathon Oil by one notch to BBB- and maintaining a stable outlook, based on our renewed oil and gas price forecast.

Our rating reflects estimated companywide, organic production growth of about 10% per year for the next few years, at the low end of management's forecast range of production growth of 10%-12% per year. Our forecast accounts for Marathon's large inventory of repeatable, low-risk, oil-weighted drilling opportunities in the Oklahoma resource basins and Eagle Ford Shale of Texas. We incorporate cost and production growth-related synergies coming about from the June 2016 acquisition of privately held PayRock Energy Holdings, expanding the quality and scale of the company's so-called Stack holdings in the Anadarko Basin in Oklahoma. Our rating also reflects the cyclicality of exploration and production (upstream) activity and the view of Morningstar's Equity Research Group that Marathon does not benefit from an economic moat, resulting in a Business Risk score at the high (riskier) end of the spectrum. The rating outlook incorporates our expectation that operating margins will gradually increase in light of cyclically rebounding oil and natural gas price realizations over the next several quarters, but not to the level commensurate with our previous rating.

When the sharp decline in oil and gas prices began in the fall of 2014, Marathon refocused its resources on the best acreage and undertook aggressive cost-reduction measures. These actions include ongoing field and capital efficiency gains and capture of deflation in exploration and production supply-chain inputs, resulting in a steadily declining cash operating cost per barrel of oil equivalent. Simultaneously, the company simplified and concentrated its portfolio of oil and gas holdings by selling U.S. noncore assets and making a tactical acquisition that helped to block up acreage in its key Oklahoma shale play.

We regard Marathon's liquidity as very good. Marathon ended the December quarter with $2.5 billion in cash and equivalents and full availability on its $3.3 billion unsecured revolving credit facility. Marathon has guided for total capital expenditures to be $2.2 billion in 2017, double the amount in 2016, with over

90% allocated to its Oklahoma resource basins, Eagle Ford and Bakken shale plays. After adjusting for capital expenditures, dividends (current level), acquisitions and divestments, we estimate positive free cash flow for Marathon in 2017 and following years, resulting in an average Cash Flow Cushion score. An increasing return on invested capital drives an improving Solvency Score through our forecast period.

In our base-case forecast, we estimate the company's EBITDAX margin gradually rising to 52% by 2020, after bottoming at about 40% in 2015. Commensurate with this, we estimate total debt/trailing EBITDAX to have peaked at 4.0 times in 2016, declining to around 2 times by 2019. Our base operating forecast incorporates an average 2017 price assumption of $3.50 per million British thermal units for U.S. natural gas and $55/barrel for West Texas Intermediate oil. Our forecast incorporates natural gas pricing 2%-4% above the futures price curve (as of Feb. 8) through 2020. For oil (WTI basis), our yearly forecast is 6%-12% above the futures price curve through 2020, at the top end of our range for the last two years of our forecast. We assume net proceeds from the sale of noncore assets of $100 million per year from 2017 on, which is conservative, in our view. The company realized $1.2 billion in proceeds from asset divestitures in 2016, $225 million in 2015, and $3.8 billion in 2014.

Our rating outlook is stable and assumes that the company is able to incrementally reduce leverage from higher price realizations that should come from the gradual improvement in oil and gas supply/demand fundamentals. However, if spot pricing continues to languish, further squeezing margins, we may consider a further downgrade of the credit rating. If oil and gas supply/demand fundamentals and the pricing outlook improve more quickly than our current expectation, we would consider raising the credit rating.

**Amazon's Rating Upgraded to A on Profitability Improvements; Stable Outlook Assigned**
Morningstar Credit Ratings, LLC is upgrading Amazon.com's rating to A and assigning a stable outlook. MCR's upgrade is based on Amazon's improving competitive position as evidenced by a multiyear expansion in EBITDA margins and return on investment, along with the maintenance of moderate leverage and excellent liquidity.

Amazon's above-average Business Risk score reflects a leading competitive position in e-commerce, low-cost operations, a network effect, and excellent customer service. Morningstar's Equity Research Group has assigned Amazon a wide economic moat based on these attributes. Amazon's competitive advantages are expected to generate additional market share gains for the next several years. The company's scalable fulfillment and distribution network provides a lower-cost structure versus having a large physical retail presence, allowing it to price below these peers. Amazon possesses a network effect as customers are increasingly attracted to the breadth of its products, offered at low prices through an attractive website, which in turn attracts additional merchants including third-party sellers, wholesalers, and manufacturers that sell direct on Amazon. Over the past five years, active users have grown at nearly a 20% compound annual rate to over 300 million. Amazon Web Services has developed similar competitive advantages, including a cost advantage, an intangible asset, and a network effect.

Amazon's revenue growth rates have generally exceeded 20% annually over the past several years, including 27% growth in 2016. Gross margins have expanded substantially over the past five years to

35.1% in 2016 compared with 22.4% five years earlier. Operating margins continue to remain relatively low for a retailer as a result of ongoing significant investments. In 2016, Amazon invested in additional warehouses, digital content, marketing, Prime benefits, the Alexa and Echo devices, and international growth including India and China. An above-average Solvency Score reflects margin expansion and increasing returns as evidenced by a 62% increase in adjusted operating income to $7.3 billion and a 120-basis-point margin gain to 5.4% in 2016.

Amazon's strong Cash Flow Cushion score reflects improving free cash flow and excellent liquidity. Free cash flow generation has accelerated during the past two years, including 32% growth in 2016 to $9.7 billion. Amazon's cash flow is aided by quick-turning inventory and a cash-generating operating cycle, which allows the company to collect from its customers before paying suppliers. Total debt including capital and finance leases was $20 billion at year-end 2016. Amazon maintains excellent liquidity, including $26 billion of cash and investments at year-end. On a lease-adjusted basis, Amazon's total debt was $34 billion, and adjusted debt/EBITDAR declined to 2.0 times at year-end from 2.2 times a year earlier.

A stable rating outlook reflects MCR's expectation that strong double-digit revenue and EBITDA growth will continue over the next several years despite the recent acceleration in investment spending. The rating could be raised further depending on the company's financial policies and commitment to a conservative balance sheet, or through improved profitability and returns that could improve the Solvency Score. The rating could be lowered if margin expansion fails to materialize as expected, coupled with the initiation of shareholder distributions that lead to higher leverage and weaker liquidity.

**Parker Hannifin's Rating Downgraded One Notch to A- and Stable Outlook Assigned**
Morningstar Credit Ratings, LLC is downgrading our corporate credit rating on Parker Hannifin Corp one notch to A-, resolving our under review status. The downgrade reflects the impact of the incremental debt associated with the Clarcor acquisition, which the firm expects to close by the end of February. We are assigning Parker a stable outlook, as we think the prospects for debt reduction over the next few years will limit any further downgrades.

Our A- rating on Parker Hannifin reflects strong earnings potential across all operating segments offset by elevated leverage associated with the Clarcor acquisition. Parker's motion and control products are integral components throughout the global manufacturing process, and the firm boasts a leading position in the motion and control industry, which is estimated to be a $120 billion global market. Parker's broad suite of product offerings as a systems integrator and its brand name have enabled the firm to garner a narrow economic moat from Morningstar's Equity Research Group, which helps support its Business Risk score. The firm's Business Risk pillar also benefits from its large customer base of nearly half a million customers with no single one representing more than 4% of sales. This is offset by the firm's predominant exposure to general manufacturing, although its aftermarket exposure (54% of pro forma sales) allays the impact. Still, the firm has monetized its competitive position into solid returns on invested capital and interest coverage ratios, supporting its Solvency Score. We forecast that the firm will generate $1.5 billion in annual operating cash flow and reinvest a nominal 2% of sales (approximately $240 million) per year in the business annually, while facing a manageable debt maturity schedule. These factors help its Cash Flow Cushion, although they are offset somewhat by the firm's 30% target dividend payout ratio.

Although we project that the firm can deliver on its guidance to reduce debt by approximately $1.3 billion by 2020, we are assigning the firm a stable outlook at this time. Given the stated time frame for deleveraging, we need to see both EBITDA growth and debt reduction before assigning the firm a positive outlook. Over time, we expect that gross leverage will contract to around 2.0 times. Should the deleveraging prove permanent, then we would expect the improving credit profile would boost both the Solvency and Cash Flow Cushion scores, resulting in a possible rating upgrade. However, should the firm miss its debt-reduction targets and earnings growth underwhelms, then we would expect a reduction in both scores, resulting in a possible downgrade.

### EBay's Rating Affirmed at BBB+; Stable Outlook Assigned

Morningstar Credit Ratings, LLC is affirming eBay Inc.'s BBB+ credit rating and assigning a stable outlook. MCR's affirmation is based on eBay's strong competitive position, excellent liquidity, and healthy free cash flow generation.

EBay's average Business Risk score reflects a strong competitive position in its ecommerce business, supported by a network effect through a growing base of 167 million active buyers across the globe. Morningstar's Equity Research Group has assigned eBay a narrow economic moat based on these attributes. Nevertheless, while the company's scale provides barriers to entry for new competitors, eBay's Marketplace business is losing share as gross merchandise volume is growing at a low-single-digit pace compared with industry growth in the midteens. EBay's other businesses, including StubHub and classifieds, possess certain competitive strengths, including an expansive global network, widely recognized brands, and ample advertising resources. While these businesses combined represent only about 20% of total revenue in 2016, growth rates are high, including near 30% transaction revenue growth at StubHub and near 13% revenue growth for the classifieds business.

Recent operating results have reflected higher investments in product development and marketing to reposition its business. EBay's structured data initiative in its core Marketplace platform is designed to improve the customer experience and accelerate gross merchandise volume growth. In 2016, GMV was $84 billion, representing a 5% year-over-year increase (excluding currency). EBITDA fell 2% to $3.4 billion and margins contracted 250 basis points to 38.1%, largely reflecting increased investments. While MCR anticipates eBay can approach its 2017 targeted growth rate in the high single digits, adjusted operating margins could compress an additional 200 basis points before they begin to level off.

A very strong Solvency Score reflects eBay's excellent liquidity and net cash position, minimal working capital requirements, and modest capital spending requirements. EBay's adjusted debt of $9.7 billion includes $2.25 billion in new debt raised during the first quarter of 2016 and roughly $700 million of commitments related to operating leases. The ratio of adjusted gross debt/EBITDAR was 2.7 times at year-end 2016. EBay has historically maintained strong liquidity due to the nature of its competitive and evolving e-commerce industry. Cash and investments total over $11 billion, including approximately $3.6 billion held in foreign operations that would not be available for use in the United States without incurring additional U.S. income taxes. Accordingly, eBay's balance sheet is in a net cash position. In addition, eBay's cash position mitigates a modest debt maturity schedule. EBay does not pay a cash dividend; however, share repurchases have been substantial and at times exceeded free cash flow. EBay generated $2.2 billion of free cash flow in 2016 yet paid out $2.9 billion for share repurchases. Cash flow is supported by the lack of any inventory, minimal working capital requirements, and modest capital expenditures. Management has indicated that it could consider a substantial, leveraging acquisition, given the company's strong liquidity and cash flow. EBay believes its current credit profile would allow it to increase debt leverage up to 3.5 times.

MCR's stable rating outlook contemplates that eBay has the ability and the willingness to maintain its current liquid balance sheet and credit metrics, despite the potential for continued margin pressure, EBITDA declines, share repurchases, and the potential for a sizable acquisition. EBay's rating could be raised if operating performance stabilizes and management commits to maintaining its current balance sheet strength. Ratings could be lowered if operating performance and returns continue to decline over the next several years, negatively affecting its Solvency Score, or if it pursues a significant debt-financed acquisition that significantly increases debt leverage and reduces liquidity.

### Discover's BBB+ Rating and Stable Outlook Affirmed on Solid Profits and Capital

Morningstar Credit Ratings, LLC is affirming its BBB+ credit rating and maintaining its stable outlook on Discover Financial Services. Our credit rating reflects the company's above-average profits generated by its growing closed-loop credit card business, the positive effects of which are mitigated by the company's narrow business focus and smaller size. Discover's closed-loop business model, which establishes direct relationships with merchants and consumers, has grown, with increased levels of merchant acceptance in the U.S. However, the company remains a distant challenger in payment processing behind Visa, Mastercard, and American Express.

Discover's fifth-decile Business Risk score reflects the firm's competitive advantages, moderate size and business diversification, and above-average management. Morningstar's Equity Research Group assigns Discover Financial Services a narrow moat rating, which reflects the strong network effects and intangible assets associated with payment brands like Discover. However, Discover's Business Risk score is hampered by its relatively small size, concentration on the U.S. payments market, and dependence on wholesale funding.

Discover Financial Services performs fairly well in our Stress Test because of its strong earnings power. It exits our hypothetical two-year period of adverse conditions with a common tangible equity/risk-weighted assets ratio of 9.3% and a common tangible equity/tangible assets ratio of 7.9%, earning good scores compared with a broad universe of U.S. banks.

Discover Financial Services also performs well above average in our Solvency Score. It benefits from its top-tier earnings power as well as its above average capital levels. The firm earned a 21% return on equity in 2016 and reported a 13.2% common equity Tier 1 ratio at year-end. The firm's score is held back by somewhat below-average asset quality and its relative lack of deposit funding relative to our universe of U.S. banks, and it scores near the bottom on this metric. At year-end, 1.97% of Discover's loans (excluding purchased credit-impaired loans) were 30 days or more past due, and allowance for loan losses covered 148% of delinquent loans. Deposits funded 47% of loans.

Our stable outlook on Discover Financial Services indicates that we are unlikely to change our rating over the next year. Our rating could be negatively affected by higher levels of nonperforming or impaired loans or by lower levels of capital, which could lead to lower Stress Test and Solvency scores. Our Stress Test score could also be negatively affected if the firm were to reduce its underwriting standards or expand into riskier lending segments. Higher levels of deposit funding and reduced dependence on wholesale funding could have a positive impact on our Business Risk and Solvency scores.

**Amex's A- Rating and Stable Outlook Affirmed, Reflecting Wide Moat and Strong Profits**
Morningstar Credit Ratings is affirming its A- credit rating and maintaining its stable outlook on American Express Co. Our credit rating reflects the company's position as one of the world's premier credit services providers for affluent customers, its strong profitability, and sound asset quality. American Express's Solvency Score reflects the company's very strong profitability, which ranks at the top of a broad U.S. bank universe as well as its above-average asset quality and capital, but is hampered by its reliance on wholesale funding and relatively narrow business model.

American Express' credit rating also benefits from an above-average Business Risk Score. Importantly, Morningstar's Equity Research Group assigns the company a wide economic moat because of the strong network effects that support the company's business model. Its well-known brand and closed-loop network allow American Express to service multiple points in the payment loop and collect highly sought-after data about the spending patterns of its affluent cardholders, although we think it is struggling to fully monetize this data. American Express' Business Risk score also benefits from the firm's large size. American Express has over $150 billion in total assets and operates globally, offering travel, network, and other services in addition to its core payment services. About 60% of its revenue comes from merchant discounts, about 17% from net interest income, and the remaining 23% from other fee-based revenue. American Express' Business Risk score is hampered by a business model focused on providing consumer credit and by its dependence on wholesale funding, as only approximately 35% of its balance sheet is funded by deposits.

American Express performs very well in our Stress Test because of its strong earnings power and high credit quality. It exits our hypothetical two-year period of adverse conditions with a common tangible equity/risk-weighted assets ratio of 16.0% and a common tangible equity/tangible assets ratio of 13.2%, earning top scores compared with a broad universe of U.S. banks.

American Express also performs well above average in our Solvency Score. It benefits from its top-tier earnings power as well as its above-average capital and asset quality. The firm's score is held back by its relative lack of deposit funding relative to our universe of U.S. banks; it scores near the bottom on this metric.

Our stable outlook for American Express indicates that we are unlikely to change our rating over the next year. Our rating could be negatively affected by higher levels of nonperforming or impaired loans or by lower levels of capital, which could lead to lower Stress Test and Solvency scores. Our Stress Test score could also be negatively affected if the firm were to reduce its underwriting standards or expand into riskier lending segments. Higher levels of deposit funding and reduced dependence on wholesale funding could have a positive impact on our Business Risk and Solvency scores.

**Affirming Capital One's A- Rating on Solid Profits and Diverse Operations; Outlook Stable**
Morningstar Credit Ratings, LLC is affirming its A- credit rating and maintaining its stable outlook on Capital One Financial Corp. Our credit rating reflects the company's strong profitability driven by economies of scale in its large consumer credit card business, good asset quality, and average capital levels.

Capital One Financial's third-decile Business Risk score reflects its narrow economic moat as assigned by Morningstar's Equity Research Group and its size and geographic diversification as one of the top issuers of Visa and MasterCard credit cards in the U.S., with over $300 billion of credit card transactions in 2016. Capital One's Business Risk score is further enhanced by the firm's increasingly diverse loan portfolio, driven by acquisitions and organic expansion. At year-end, 43% of loans held for investment were credit cards, 30% were consumer banking (66% of which were vehicle loans), and 27% were commercial banking. However, the bank's score is hampered by its dependence on capital markets relative to a broad set of U.S. peers; Capital One funded 66% of its assets with deposits at year-end.

Capital One performs slightly above average in our Stress Test. In our hypothetical two-year stress period, Capital One's average initial capital levels are enhanced by strong earnings power but eroded by a relatively high-risk loan portfolio dominated by consumer credit card and vehicle loans. The bank exits our Stress Test with a pro forma 9.1% ratio of common tangible equity/risk-weighted assets and a pro forma 7.6% ratio of common tangible equity/tangible assets.

In our Solvency Score, Capital One performs slightly below average. The bank's top-tier earnings power and average capital levels are offset by its high level of impaired loans relative to total assets and its low level of deposit funding relative to a broad universe of U.S. banks. Capital One's asset quality has declined in recent quarters, with loans 30-plus days delinquent rising to 3.27% of loans at year-end compared with 2.79% as of June 30. We see this as resulting, in part, from recent growth and expect credit quality to stabilize as the portfolio seasons. Moreover, we continue to believe that charge-offs are at a cyclical low and therefore see even recent increased loan losses as within our medium-term expectations.

Our stable outlook on Capital One Financial indicates that we are unlikely to change our rating over the next year. Our rating could be negatively affected by continued increases in nonperforming or impaired loans or by lower levels of capital, which could lead to lower Stress Test and Solvency scores. Our Stress Test score could also be negatively affected if the firm were to reduce its underwriting standards or expand into riskier lending segments. Conversely, higher levels of deposit funding and reduced dependence on wholesale funding could have a positive impact on our Business Risk and Solvency scores.

### Synchrony's BBB Rating Affirmed on Strong Profits and Capital Buffers: Outlook Stable

Morningstar Credit Ratings, LLC is affirming its BBB credit rating and maintaining its stable outlook on Synchrony Financial. Our credit rating reflects the high profits generated by the company's dominant position and switching costs in the U.S. private-label credit card market as well as Synchrony's high capital levels. The positive effects of these are mitigated by the company's highly concentrated business model and the possibility that credit losses could increase sharply if economic conditions were to deteriorate.

Synchrony Financial's fifth-decile Business Risk score reflects its competitive advantages, moderate size, and dependence on capital markets. Morningstar's Equity Research Group assigns Synchrony a narrow economic moat, which reflects high implicit switching costs in the private-label credit card market. With over $125 billion in purchase volume in 2016, Synchrony is the largest issuer of private-label credit cards in the U.S. and helps corporate partners such as large retailers offer credit to their customers and collect data on their purchasing patterns. While we see this as an attractive business, it is a highly concentrated source of revenue for Synchrony. In 2016, it was the source of 69% of the firm's revenue and 81% of its purchase volume. Synchrony also remains dependent on access to securitization markets for funding, as deposits account for only 68% of liabilities.

Synchrony Financial earns top scores in our Stress Test. It benefits from its strong earnings power and high capital levels. The firm earned a 16.6% return on equity in 2016 and reported a 17.2% common equity Tier 1 capital ratio on a transitional basis at year-end. While we project heavy credit losses for Synchrony's retail-focused lending portfolio during our hypothetical two-year stress period, these losses are largely offset by Synchrony's earnings power and pre-stress capital levels. As a result, it exits our stress test with an 18.2% ratio of common tangible equity/risk-weighted assets and a 15.0% ratio of common tangible equity/tangible assets.

Synchrony Financial performs slightly above average in our Solvency Score. Its top-tier earnings power and capital levels relative to a broad universe of U.S. banks are offset by its high level of impaired loans. Synchrony's dependence on wholesale funding, as reflected in its low ratio of deposits/liabilities, also weighs on the bank's Solvency Score.

Our stable outlook on Synchrony Financial indicates that we are unlikely to change our rating over the next year. Our rating could be negatively affected by higher levels of nonperforming or impaired loans or by lower levels of capital, which could lead to lower Stress Test and Solvency scores. Our Stress Test score could also be negatively affected if the firm were to reduce its underwriting. Conversely, higher levels of deposit funding and reduced dependence on wholesale funding could have a positive impact on our Business Risk and Solvency scores.

### Thomson Reuters' Rating Affirmed at BBB+; Stable Outlook Assigned

Morningstar Credit Ratings, LLC is affirming Thomson Reuters Corporation's BBB+ credit rating and assigning a stable outlook. MCR's affirmation is based on its competitive position in business information services, strong cash flow-generating capacity, and moderate capital structure.

Thomson's average Business Risk score reflects a strong position in information services that is supported by industry-leading market positions, intangible assets, and switching costs. Morningstar's Equity Research Group has assigned Thomson a narrow economic moat. Thomson holds expertise in market-leading platforms and services in each of its three core businesses: financial and risk; legal; and tax and accounting. Thomson provides proprietary databases and deeply embedded workflow tools and analytics largely delivered electronically. Over 80% of revenue is recurring and mostly subscription-based. Products are embedded in clients' daily activities, resulting in high switching costs and some control over product pricing. Still, ratings reflect moderate cyclicality, especially in its financial data business, where a significant portion of revenue is based on subscriptions that rely on employment levels in the financial services industry.

Recent results have reflected increased investment in core growth businesses as well as the October 2016 sale of the intellectual property and science business for $3.6 billion in cash. Thomson used proceeds to buy back shares, pay down debt, and reinvest in its other businesses. Revenue in 2016 increased 1% to $11.2 billion (adjusted for currency and intellectual property and science), driven by growth in legal and tax and accounting while its largest segment, financial and risk, was flat. Adjusted EBITDA increased 2% for the year to $3.2 billion while margins expanded 20 basis points, reflecting significant improvement in its financial and risk segment. Thomson has outlined strategic priorities to accelerate organic growth. The company's investments are focused on business segments that represent about 25% of revenue yet are growing at double-digit rates, including legal software and solutions; global trade management; global tax; and risk solutions. MCR expects Thomson to achieve low-single-digit growth for the next several years and for 2017 EBITDA margins to expand nearly 100 basis points.

Thomson has stated its intention to focus on organic growth and reduce acquisitions in an effort to maintain consistent free cash flow growth. In 2016, the company generated $2.0 billion in free cash flow while distributing $2.7 billion to shareholders with dividends and share repurchases. Nevertheless, total debt/EBITDA remained at 2.3 times, a level that has been stable over the past several years. Thomson ended the year with $2.4 billion in cash and a net leverage ratio of 1.5 times. Thomson's management calculates its net leverage at 1.8 times (including swaps on debt), well below its stated net leverage target of 2.5 times. MCR's rating also reflects adjusted leverage of 3.0 times based on estimated total adjusted gross debt of $10.6 billion, including $3.2 billion related to operating lease commitments and pension obligations.

The rating outlook is stable, based on MCR's expectation that Thomson will maintain a competitive advantage and strong profitability and cash flow. The rating could be lowered if management's financial policy targets are revised to allow for higher leverage, or if its competitive position and returns erode, resulting in a lower Business Risk score or Solvency Score. The rating could be raised if the company commits to maintaining lower leverage than current targets suggest, extends maturities, and demonstrates consistently improving profitability, which would have positive implications for the Cash Flow Cushion and Solvency Score.

## Recent Notes Published by Credit Analysts

### Parker Hannifin Is Raising 10- and 30-Year Debt to Fund Clarcor Acquisition

*Market Data*

Parker Hannifin Corp (rating: A/UR-) is reportedly in the market issuing 10- and 30-year notes to help finance its $4.3 billion purchase of Clarcor. Reportedly, this deal follows a European benchmark offering announced earlier. The firm has previously stated its intention to raise $2.5 billion in new debt, while utilizing $500 million on its credit facility and using $1.5 billion of cash on hand to fund the deal.

According to pricing service Advantage Data, bonds with maturities similar to the new issuance for Parker Hannifin and its comparable peers Honeywell International Inc (rating: A, stable) and Dover Corp (rating: A-, negative) are indicated over the nearest Treasury as follows:

Intermediate term:
Parker Hannifin's 3.30% notes due 2024 are indicated at +78 basis points;
Honeywell's 2.50% notes due 2026 are indicated at +79 basis points;
Dover's 3.15% notes due in 2025 are indicated at +78 basis points.

Longer-dated:
Parker Hannifin's 4.45% notes due 2044 are indicated at +111 basis points;
Honeywell's 5.375% notes due 2041 are indicated at +105 basis points;
Dover's 5.375% notes due in 2041 are indicated at +127 basis points.

*MCR Credit Risk Assessment*

We placed our A rating on Parker Hannifin under review with negative implications because of its Dec. 1 announcement that it would acquire filtration technology company Clarcor for $4.3 billion. We estimate that the deal will boost leverage to 3.6 times from 2.2, which will negatively affect our Solvency Score. Still, the business risk profile may improve somewhat, as we think the deal makes strategic sense for Parker. We expect to conclude our review soon. Our stand-alone A rating on Parker Hannifin reflects strong earnings potential across all operating segments coupled with a solid financial profile. Parker's motion and control products are integral components throughout the global manufacturing process, and it boasts a market-leading position in this $120 billion global industry. Parker's broad suite of product offerings as a systems integrator, combined with its brand name, has enabled the firm to garner a narrow economic moat rating, as assigned by Morningstar's Equity Research Group, which helps support its Business Risk score.

We look to diversified peers Honeywell and Dover for comparison. Honeywell is a direct competitor to Parker within its aerospace segment (roughly 18% of pro forma sales), but benefits from a stronger business risk profile and operates with lower leverage (2.0 times versus pro forma 3.6 times for Parker-Hannifin). Parker and Dover have seen their credit profiles affected by acquisitions. Dover has been negatively affected by its large energy exposure (roughly 20% of sales), and acquisition debt has pushed up its leverage to 3.1 times.

## Medtronic's Leverage Remains Static in Fiscal 3Q, Reinforcing Stable Outlook

*MCR Credit Risk Assessment*

On Feb. 21, Medtronic PLC (rating: A+, stable) reported fiscal third-quarter financial results that slightly beat consensus expectations on both the top and bottom lines. In constant currency, sales grew 6% to $7.3 billion on mid-single-digit growth from all of its segments. With adjusted operating margin improvement and share-repurchase activity, Medtronic turned that top-line growth into 10% adjusted earnings per share growth to $1.12 in the quarter. Medtronic maintained its outlook for fiscal 2017, including mid-single-digit growth in sales and double-digit growth in adjusted earnings per share.

By operating segment, the cardiac and vascular group (35% of sales) grew 6%, led by its cardiac rhythm and heart failure products (8%), including benefits from Arctic Front Advance cryoballoons, Reveal LINQ insertable cardiac monitoring systems, and the recently acquired HeartWare International products. Also, within this segment, aortic and peripheral vascular products grew 6%, with particularly strong growth from new peripheral products. The coronary and structural heart group only grew 3% on mid-single-digit declines in the coronary product set (including large declines in drug-eluting stents in the U.S. and Japan) and low-double-digit growth in structural heart, helped by its CoreValve transcatheter valve product set. Notably, Medtronic aims to launch a new drug-eluting stent (Resolute Onyx) in early 2018 that could help reverse declines in that important product set. Medtronic's minimally invasive therapies group (33% of sales) grew 6% year over year on solid ongoing growth of its surgical solutions products (7%), including its LigaSure vessel sealing instruments, and patient monitoring and recovery products (5%). The restorative therapies group (25% of sales) grew 4%, led by 8% growth in brain therapies, 5% growth in specialty therapies, 3% growth in spine (its best growth rate in over seven years, primarily on internal efforts to quickly commercialize new products), and a 2% decline in pain therapies, which was negatively affected by a divestiture. The company's diabetes group (7% of sales) grew a solid 7% year over year with ongoing strength from its MiniMed systems.

From a credit perspective, Medtronic's leverage has remained roughly stagnant in the past few quarters with gross debt/EBITDA in the mid-3s and net debt/EBITDA in the low 2s. This stagnant leverage informs our stable outlook on Medtronic's rating. While the firm has taken a pause on deleveraging after the early 2015 merger with Covidien, Medtronic announced plans in early fiscal 2017 to reduce debt by another $5 billion-$6 billion by the end of fiscal 2018, which could help the firm reduce its gross leverage by about a turn with some profit growth. With $11 billion in cash/investments and the firm still expecting to generate $5 billion-$6 billion of free cash flow in fiscal 2017, Medtronic could achieve this debt reduction just by paying off its maturities as they come due. With most of those maturities coming due in fiscal 2018, though, we think Medtronic will continue to make large returns to shareholders through its dividend ($2 billion paid in the past 12 months) and share-repurchase ($4 billion repurchased in the past 12 months) programs.

*Market Data*

Medtronic PLC's (rating: A+, stable) closest credit comparables are Stryker Corp (rating: A+, negative) and C.R. Bard Inc (rating: A+, negative). All of the following bond data is sourced from Advantage Data and Finra Trace.

In the approximate five-year maturity bucket, bonds from these issuers recently traded over the nearest Treasury as follows:

Medtronic PLC's 3.15% notes due in 2022 at +68 basis points;
Stryker Corp's 2.63% notes due in 2021 at +72 basis points; and
C.R. Bard Inc's 4.40% notes due 2021 at +67 basis points.

In the approximate 10-year maturity bucket, bonds from these issuers recently traded over the nearest Treasury as follows:

Medtronic PLC's 3.50% notes due in 2025 at +94 basis points;
Stryker Corp's 3.50% notes due in 2026 at +100 basis points; and
C.R. Bard Inc's 3.00% notes due 2026 at +107 basis points.

For comparison with the roughly 10-year maturities, the Morningstar Corporate Bond Index is +92 basis points at A+, +103 basis points at A, and +115 basis points at A-.

In the approximate 30-year maturity bucket, bonds from these issuers recently traded over the nearest Treasury as follows:

Medtronic PLC's 4.63% notes due in 2045 at +112 basis points; and
Stryker Corp's 4.63%% notes due in 2046 at +131 basis points.

**Anglo American Posts 25% Increase in EBITDA Year Over Year**

*MCR Credit Risk Assessment*

Anglo American PLC (rating: BB, positive) reported full-year results for 2016 that showed a 25% increase in EBITDA as well as aggregate debt reduction. Firmwide, better volume and cost reductions helped EBITDA rise to $6.1 billion in 2016 from $4.9 billion in 2015. By segment, the improvement came principally from Anglo's diamond business, its iron ore and manganese segment, and its coal division, which collectively improved $1.5 billion in EBITDA. Total debt declined to $14.5 billion ($8.5 billion net) from approximately $19.8 billion ($12.9 billion net) at the end of 2015, which was primarily driven by free cash flow of approximately $2.6 billion and asset sales proceeds of $1.8 billion. Free cash flow was up over 2015's level of a negative $1 billion and was supported by a reduction in capital spending to $2.5 billion from $4 billion in 2015. Liquidity remained robust, with cash and equivalents on hand of $6.0 billion at year-end 2016, down from $6.9 billion a year earlier, while available credit facilities were $9.7 billion at the end of the year compared with $7.9 billion of availability at the end of 2015.

Management indicated that capital spending for 2017 would be held flat at $2.5 billion and that it expected to pay a dividend to shareholders toward year-end. Also, the company said that an investment-grade credit rating remains an objective and that its net debt target is now $6.0 billion-$6.5 billion. Finally, the company indicated that it is no longer looking to dispose of its coal, iron ore, or nickel assets, which, in our opinion, is partly due to deleveraging it has already achieved as well as the significant rebound in prices for those commodities.

*Market Data*

According to Advantage Data and Finra Trace, Anglo's 4.875% notes due on May 14, 2025, recently traded at 101.75, yielding 4.62%. For comparison, we look to Vale SA's (rating: BB, positive) 6.25% notes due on Aug. 10, 2026, which recently traded at 109.13, yielding 5.03%. An index comparison would be the BofA Merrill Lynch US High Yield BB Yield to Worst Index, which was indicated at 4.51%.

**Ecolab Posts Flat Adjusted EBITDA for 2016**

*MCR Credit Risk Assessment*

Ecolab Inc. (rating: BBB+, positive) reported fourth-quarter and full-year results that had flat adjusted EBITDA ($2.9 billion) for the year. Net sales for 2016 were 3% lower on a fixed currency basis with the company's global industrial and global institutional divisions 3% and 7% higher, respectively, more than offset by a 13% decline in its global energy division. The company's balance sheet debt increased slightly to $6.7 billion from $6.5 billion in 2015. Resulting debt/adjusted EBITDA was essentially unchanged at approximately 2.3 times. Likewise, free cash flow for 2016 was flat with 2015's level of $1.2 billion and cash and equivalents increased slightly to $327 million from $93 million a year earlier. We estimate that Ecolab returned slightly over $1 billion to shareholders in 2016 in the form of share repurchases and dividends.

In terms of guidance, the company expects better growth rates for revenue in 2017 for its global institutional and global industrial segments with revenue in its global energy segment stabilizing. We expect Ecolab will continue to produce free cash flow similar to 2016's level and that debt/EBITDA will remain above 2.0 times.

For a key credit comparable, we look to similar-rated PPG Industries (rating: BBB+, positive), whose debt/adjusted EBITDA we estimate at 2.3 times (1.5 net) and which was free cash flow positive by approximately $840 million in 2016. PPG's gross debt balance was $4.9 billion, and it had cash and equivalents of approximately $1.8 billion at year-end 2016.

*Market Data*

According to Advantage Data and Finra Trace, Ecolab's 5.5% notes due Dec. 8, 2041, recently traded at a spread over nearest Treasury of +120 basis points. Meanwhile, PPG's 5.5% notes due Nov. 15, 2040, recently traded at a spread of +130 basis points.

**Bristol-Myers Squibb Issuing Debt to Fund Accelerated Share-Repurchase Program**

*Market News and Data*

Bristol-Myers Squibb Company (rating: AA-, stable) is in the market with a proposed offering that includes 2- and 10-year fixed-coupon maturities. According to a preliminary prospectus filed Feb. 22, net proceeds will be used for general corporate purposes, which include satisfying the recently announced accelerated stock-repurchase program. On Feb. 21, the firm announced an ASR program for up to $2 billion in equity, with 80% to be completed by the end of this month and the remainder by the end of the second quarter.

For best comparisons to Bristol-Myers Squibb's notes, we look to similar-rated companies Pfizer Inc (rating: AA-, stable) and Roche Holding AG (rating: AA-, stable). Also, we look for comparison with higher-rated peers Eli Lilly and Co (rating: AA, stable) and Merck & Co (rating: AA, stable). All of the following bond data is sourced from Advantage Data and Finra Trace.

In the approximate 2-year maturity bucket, bonds from these issuers recently traded over the nearest Treasury as follows:

Bristol Myers Squibb's 1.75% notes due 2019 at +41 basis points;
Roche's 2.25% notes due 2019 at +42 basis points;
Pfizer's 1.45% notes due 2019 at +29 basis points;
Merck's 1.8% notes due 2020 at +32 basis points; and
Eli Lilly's 1.95% notes due 2019 at +38 basis points.

In the approximate 10-year maturity bucket, bonds from these issuers recently traded over the nearest Treasury as follows:

Bristol Myers Squibb's 3.25% notes due 2023 at +48 basis points;
Roche's 2.625% notes due 2026 at +72 basis points;
Pfizer's 2.75% notes due 2026 at +71 basis points;
Merck's 2.75% notes due 2025 at +64 basis points; and
Eli Lilly's 2.75% notes due 2025 at +56 basis points.

For comparison with the approximate 10-year maturities, the Morningstar Corporate Bond Index is at +79 basis points in the AA category.

*MCR Credit Risk Assessment*
Bristol-Myers Squibb's AA- credit rating reflects its longstanding financial discipline. Since 2014, the company has maintained a net cash position, and at the end of 2016, it owed $6.7 billion of debt and held $9.0 billion in cash and investments. Continued profitability gains together with a steady debt level have resulted in gross debt leverage falling to 1.3 times at the end of 2016, in our estimation, from 2.6 times in 2015. The company has the flexibility to offer returns to shareholders through a healthy dividend supplemented by share repurchases, given our expectation of annual free cash flow of more than $5 billion on average through 2020 along with a light debt maturity schedule. Beyond the ASR program, we think management's anticipated pace of repurchasing activity in the vicinity of $200 million-$300 million per quarter can easily be met with current cash flow generation.

On its conference call, Bristol-Myers Squibb announced very good operating performance in the fourth quarter, with top-line growth of 22% helped by strong demand for cancer medicines Opdivo and Sprycel and cardiovascular drug Eliquis. Worldwide revenue for the full year rose 17% as Opdivo sales increased fourfold and Eliquis jumped 80%, which more than offset declines of Bristol-Myers Squibb's hepatitis C and HIV treatments. The firm met its 2016 guidance for non-GAAP earnings per share of $2.80-$2.90 by achieving non-GAAP EPS of $2.83. Readjusting for up-front payments made to Merck related to a patentinfringement litigation settlement, the EPS target for 2017 was lowered to $2.70-$2.90 from $2.85-$3.05. Despite unfavorable news regarding the firm's decision not to pursue accelerated approval in the United States for Opdivo in combination with Yervoy in first-line lung cancer, we see sustained uptake of Opdivo and Eliquis contributing to one of the highest rates of revenue and earnings growth in the large pharmaceutical industry over the next five years. Our view is supported by Bristol-Myers Squibb's historical commitment to cost control, exemplified by its plan to hold expenses constant through 2020 through its evolving operating model.

### Fresenius Deleverages Further in 4Q, Reinforcing Our Positive Rating Outlook

*MCR Credit Risk Assessment*

Fresenius Medical Care AG & Co. KGaA (rating: BB+, positive) reported fourth-quarter operating results Feb. 22 that beat consensus estimates on the bottom line and delivered further deleveraging. Adjusted for currency and acquisitions, net revenue grew 7% to $4.7 billion, EBITDA ($990 million) grew an impressive 18%, and $0.63 of earnings per ADS grew 22%, exceeding consensus. Along with these impressive results, Fresenius gave an outlook for roughly high-single-digit growth in revenue (8%-10%) and net income (7%-9%) for 2017. These growth rates and guidance compare favorably with key dialysis services peer DaVita Inc (rating: BB+, stable), which increased revenue 5% and experienced an adjusted earnings per share decline in the fourth quarter. DaVita also guided to a tough 2017 that would lead to a cash flow contraction from 2016 levels. However, Fresenius management did not appear to have the same level of concerns about insured patient volume through the Affordable Care Act in its business as DaVita expressed on its quarterly call.

From a credit perspective, net leverage is also moving in different directions at the top two dialysis service companies, with Fresenius continuing to deleverage while DaVita's leverage rises on profitability concerns and share-repurchase activities. As of December, total debt obligations stood at $8.6 billion at Fresenius, down from $8.9 billion in September but similar to its debt total at the end of 2015. With growing profits over the past year, though, gross leverage has declined to about 2.4 times from 2.8 times a year ago. This deleveraging progress informs our positive outlook on the company's rating. Fresenius management mentioned an intention to refinance obligations due in 2017 on its earnings call. Specifically, it aims to replace a U.S.-denominated bond with a presumably lower-coupon, euro-denominated bond. If Fresenius goes through with this plan, it would follow a trend of healthcare issuers increasingly turning away from the U.S. bond market in favor of lower interest rates obtained in the European bond market.

*Market Data*

Given Fresenius Medical Care's status as a firm on the border of investment-grade and high-yield territory, we use key comparables from weak investment-grade territory (Mylan and Perrigo) and high-yield issuer dialysis services company DaVita as key comparables. Based on these comparables and index data, Fresenius' bonds continue to trade between investment-grade and high-yield territory. All of the following bond data is sourced from Advantage Data and Finra Trace.

In the approximate 10-year maturity bucket, bonds from these firms recently traded as follows:

Fresenius Medical Care's 4.75% notes due 2024 at 101.26, yield to maturity of 4.55%, and spread to maturity of +226 basis points;
Mylan NV's (rating: BBB-, stable) 3.95% notes due 2026 at 96.23, yield to maturity of 4.45%, and spread to maturity of +205 basis points;
Perrigo Co PLC's (rating: BBB-, negative) 3.90% notes due 2024 at 97.65, yield to maturity of 4.26%, and spread to maturity of +194 basis points; and
DaVita's 5.00% notes due 2025 at 98.75, yield to maturity of 5.19%, and spread to maturity of +294 basis points.

For comparison, the Morningstar Corporate Bond Index is at +180 basis points in the BBB- category. Also, the BofA Merrill Lynch BB Index was recently at +252 basis points.

### Newmont Mining Reports 25% Increase in Adjusted EBITDA

*MCR Credit Risk Assessment*

Newmont Mining (rating: BBB, stable) reported fourth-quarter and full-year results for 2016 that showed adjusted EBITDA from continuing operations increasing to approximately $2.4 billion from $1.9 billion a year earlier, a 25% increase. Attributable gold production for 2016 was 4.9 million ounces, a 7% increase from the year earlier. All-in sustaining costs were lower for the fourth consecutive year at $912 per ounce (a 2% decrease from 2015) while costs applicable to sales were up slightly to $682 per ounce (a 2.9% increase). Total debt declined in 2016 to $4.6 billion from $5.9 billion in 2015, resulting in debt/adjusted EBITDA decreasing to 2.0 times (0.8 times net) from 3.1 times (1.8 times net) in 2015. The debt reduction came primarily from asset sale proceeds. During the year, free cash flow from continuing operations improved to approximately $800 million from about $300 million in 2015 on higher cash flow from continuing operations (about $300 million) as well as lower capital spending (about $200 million). Cash and equivalents on hand totaled $2.8 billion at year-end 2016, up from $2.4 billion at the end of 2015.

Newmont guided to gold production over the next five years to be 4.5 million-5.4 million ounces per annum. For 2017, gold production guidance is 4.9 million-5.4 million ounces with CAS expected to be $700-$750 per ounce and AISC at $940-$1,000 per ounce. Longer term, the company expects CAS to decline to $650-$750 per ounce and AISC to decline to $880-$980 per ounce.

For a key credit comparable, we look to Barrick Gold (rating: BBB-, stable), whose debt/EBITDA is 2.1 times (1.4 net) and which had free cash flow of $1.5 billion in 2016.

*Market Data*

According to Advantage Data and Finra Trace, Newmont's 3.5% notes due March 15, 2022, recently traded at spread of +84 basis points. Meanwhile, Barrick's 4.1% notes due May 1, 2023, recently traded at a spread to nearest Treasury of +68 basis points. For an index comparison, we look to Morningstar's BBB Corporate Bond Index, which is indicated at +152 basis points.

**Summit Materials' Net Leverage Unchanged Year Over Year**

*MCR Credit Risk Assessment*

Summit Materials (rating: B+, stable) reported fourth-quarter and full-year results that showed net debt/adjusted EBITDA remained unchanged at 3.9 times year over year. Due to Summit's acquisitive nature, balance sheet debt rose to $1.6 billion at the end of 2016 from $1.4 billion a year ago. Adjusted EBITDA rose to $382 million in 2016 from $308 million in 2015, which resulted in gross debt/adjusted EBITDA of 4.3 times at the end of 2016 compared with 4.5 times a year earlier. Net revenue for 2016 were up approximately 15% to $1.5 billion compared with a year ago with acquisitions supporting the increase. Excluding acquisitions, sales volume for the company was down and more than offset the price increases Summit was able to achieve during the year. Cash and equivalents at year-end amounted to $143 million versus $186 million a year ago, and free cash flow improved to $91 million compared with $9 million in 2015.

Summit provided guidance, excluding potential acquisitions, of adjusted EBITDA of $410 million-$425 million for 2017 and estimated capital spending for the year of $135 million-$155 million, compared with $154 million in 2016. The company also stated that its year-end 2017 net debt target is now 3.0 times. We expect the company to continue to be acquisitive and, consequently, believe the net debt goal may be a moving target.

*Market Data*

According to Finra Trace, Summit's 6.125% unsecured notes due 7/15/23 were recently traded at 103.9 yielding 4.86%. Meanwhile, similar-rated Freeport-McMoRan's (rating: B+, positive) unsecured notes due March 15, 2023, recently traded at 92.75, yielding 5.29%. For an index comparison, we compare with the BofA Merrill Lynch High Index B Yield to Worst Index, which is indicated at 5.65%.

**Dish Network Reports Modest 4Q Improvement, but Substantial Challenges Lie Ahead**

*MCR Credit Risk Assessment*

Dish Network (rating: BB-, negative) reported its fourth-quarter and full-year 2016 financial results on Feb. 22. Net subscriber losses for 2016 totaled 392,000, representing an acceleration from 81,000 losses in 2015 and marking the third straight year of net declines in pay-TV subscribers. However, the net additions number continues to hide much higher attrition among Dish's traditional satellite customers, which continues to be mitigated by customer inflow into Dish's video streaming product, Sling TV. Dish also reported a net 43,000 decline in broadband customers, bringing the total to 580,000.

Despite net customer declines of 1.8%, Dish reported total revenue up 0.6% from a year ago. This was driven by a 2.2% increase in average revenue per user, or ARPU, to $88.66. However, over the longer term, we believe ARPU trends should become more challenging as a greater proportion of its subscriber base is represented by Sling customers, which has ARPU of around a fourth of the legacy TV service.

Meanwhile, Dish's EBITDA increased 0.7% during 2016, driven by a 15% decline in subscriber acquisition costs, which management attributed in part to redeployment of used equipment to new customers. Furthermore, spending on promotions and subsidies declined around 20% from a year ago.

Finally, the migration to Sling TV is contributing due to lower upfront subscriber costs than the traditional satellite product.

With the improvement in EBITDA, Dish's consolidated balance sheet continued to strengthen during the fourth quarter. The company ended the year with total debt of $16.5 billion, supported by cash of $5.4 billion. Net debt ended the period at 3.4 times Dish's reported trailing EBITDA, compared with 3.8 times at the end of 2015. However, these results continue to obscure the more stressed position of Dish's primary debt issuer, Dish DBS. Operating results for Dish DBS are not yet available for the fourth quarter, but as of the third quarter, net debt represented 4.5 times Dish DBS' trailing 12-month EBITDA, which does not include any non-pay-TV operating profits. For the 12 months ending September, we calculate total EBITDA for Dish DBS at $3.0 billion, which supports consolidated interest expense, including capitalized amounts, of $755 million.

For comparison, CenturyLink (rating: BB/UR-) continues to maintain a more bondholder-friendly corporate structure and lower leverage (3.0 times, compared with Dish at 3.5 times EBITDA). We also believe its investment in a terrestrial fiber-optic network may allow it to offer faster broadband speeds in less urban markets than Dish can offer. Our rating on CenturyLink remains under review negative pending the finalization of its partially debt-funded acquisition of Level 3 Communications (not rated), which will add meaningful capacity to its fiber network.

We still view the asset-light corporate structure of pay-TV subsidiary Dish DBS as a source of risk and uncertainty for bondholders, particularly the fact that the wireless spectrum acquired using debt issued by Dish DBS is domiciled beyond the legal reach of DBS' bondholders. Furthermore, we note that Dish DBS also does not own most of the core operating assets that drive its business, including orbital satellites. Bondholders also face the probability that Dish management will continue to tap the retained cash flow at DBS to support the development of its wireless business or to fund other investments outside of bondholder control.

Under its current spectrum licenses, Dish has until 2021 to make its spectrum available to 70% of its covered population, which points to a steep spending curve and significant uncertainty that the technology will work as expected. With limited internal cash flow to direct toward this effort, we believe the company may continue to pursue debt financing to the extent allowable under its current indentures. Moreover, in the event the spectrum gets sold or monetized, we have no assurance that any material amount of proceeds will be applied to reduce debt, given the current asset structure.

*Market Data*

According to data provided by Advantage Data and Finra Trace, Dish Network Corp.'s 7.75% notes due 2026 recently traded at a yield to maturity of 5.57% (+316 basis points). For comparison, CenturyLink 5.63% notes due 2025 recently traded at a yield to maturity of 6.14% (+387 basis points over the nearest Treasury). Compared with levels in late November, the spread to Treasury for the Dish notes is 87 basis points tighter, while the CenturyLink notes are 80 basis points tighter. Over the same period, the BofA/Merrill Lynch High Yield BB Index is 89 basis points tighter.

**Viacom Issues $1.3 Billion Junior Subordinated Notes to Address Upcoming Maturities**

*MCR Credit Risk Assessment*

On Feb. 23, Viacom (rating: BBB, negative) announced the placement of $1.3 billion of fixed-to-floating coupon junior subordinated debentures to repay existing senior debt, specifically senior notes due in October 2017 and September 2018. The offering included two tranches of 40-year notes with noncall periods of 5 and 10 years priced at 5.88% and 6.25%, respectively. Interest on the notes may be suspended for up to five years at Viacom's discretion without triggering any default event, though the deferred interest will accrue and must be paid in full at redemption or maturity.

We view the issuance of the notes as a reaffirmation of Viacom's commitment to maintaining its investment-grade rating. In accordance with its Corporate Credit Rating Methodology (September 2016) and Methodology for Rating Parents, Subsidiaries, and Issuers (August 2016), Morningstar Credit Ratings will classify the full par amount as debt for rating purposes but also recognizes that the issue does not introduce additional dilution to any existing senior note claims. Furthermore, the offering fully addresses two years of debt maturities, which will reduce senior leverage and free management's attention to stabilize revenue and profitability. Viacom's net leverage ended the December quarter at 4.1 times trailing 12-month EBITDA (calculated off adjusted operating income), up a full turn from leverage a year ago on a 29% drop in EBITDA.

Pro forma for the new notes and the expected retirement of $1.3 billion of senior notes, we estimate that senior net leverage will decline to 3.7 times EBITDA by year-end 2018, assuming no change in Viacom's trailing 12-month EBITDA of $2.9 billion, while overall net leverage will remain unchanged at 4.1 times. For comparison, competitor Discovery Communications (rating: BBB-, negative) reported net debt equivalent to 3.5 times EBITDA while former subsidiary CBS (rating: BBB, stable) reported its net debt at 2.6 times EBITDA, both as of the September quarter.

Our BBB rating reflects moderate Business Risk and Solvency Score supported by Viacom's globally positioned portfolio of widely known network TV brands, which produce solid affiliate fees, high returns on invested capital, and solid free cash flow. These positive attributes are offset by a weak Cash Flow Cushion driven by elevated debt levels and a recent decline in free cash flow. Distance to Default has also been weakening because of the higher leverage and volatility in Viacom's common stock. Morningstar's Equity Research Group continues to assign Viacom a narrow moat, which it views as supported by high barriers to entry as well as Viacom's scale efficiencies in investing in new content. However, some of its core brands are in need of refreshing and the company is currently not as well positioned for the emergence of video on demand as its competitors.

*Market Data*

According to Advantage Data and Finra Trace, Viacom's 3.45% notes due 2026 recently traded at a yield of 4.00% and a spread over the nearest Treasury of +169 basis points, about 5 basis points tighter from a week ago. The pricing on the 5-year noncall notes and 10-year noncall notes implies 236 and 222 basis points of additional risk premium over the Viacom senior notes, priced to their respective call dates.

Though junior sub notes are uncommon in the media sector, we referenced several comparable hybrid securities in different industry sectors to gauge their pricing relative to senior notes. Most junior sub note issuance is found in the financial sector. For example, Bank of America's (rating: BBB, stable) 6.50% perpetual hybrid junior sub notes, indicated at +288 basis points to the 2024 call, are 148 basis points wider than the spread on its 3.824% senior notes due 2026. Citigroup's (rating: A-, stable) 5.95% junior sub notes due 2049 are indicated at +297 basis points to the 2023 call, which is 152 basis points wide to its 3.70% senior notes due 2026. In the gas pipeline sector, pricing for DCP Midstream's (not rated) 5.85% junior sub notes due 2043 is currently indicated at +520 basis points to the 2023 call, a 266-basis-point spread differential to DCP's 3.88% senior notes due 2023.

## L Brands' 4Q Results Demonstrate That Challenges Remain

*MCR Credit Risk Assessment*

L Brands, Inc. (rating: BB+, stable) reported fourth-quarter and full-year 2016 results. In the fourth quarter, revenue increased 2.1% to $4.5 billion, yet same-store sales were flat as the company's exit from the swim and apparel business had a negative impact of 2 percentage points. The Victoria's Secret segment posted a 3% same-store sales decline, which was brought down 4 percentage points from the sale of swim and apparel, while Bath & Body Works continues to outperform, posting a 5% increase in same-store sales. Adjusted EBITDA decreased 6.4% to $1.14 billion in the quarter, while margins compressed 230 basis points to 25.3%. Weaker results reflected the company's strategic initiatives at Victoria's Secret to streamline the business and focus on core categories as well as a decline in traffic. Further, Victoria's Secret merchandise margin rates were negatively affected by promotions necessary to clear inventory. For the year, comparable-store sales increased 2%, including a 2% negative impact from exiting the swim and apparel business. Overall Victoria's Secret comparable sales would have been up 3% excluding swim and apparel, while Bath & Body Works increased 6% over last year. Full-year adjusted EBITDA fell 3.9% to $2.6 billion in 2016, and margins compressed 150 basis points to 20.7%.

L Brands expects 2017 results will be continue to be negatively affected from the swim and apparel business, as well as from continued investments in China and investments in its Victoria's Secret and Bath & Body Works stores. In addition, first-quarter results will be negatively affected by an expected mid- to high teens decrease in February comparable sales. Longer term, management believes it can grow annual operating income by 10% and return operating income margin to the high teens area.

At year-end, adjusted gross debt/EBITDAR was 3.4 times, representing a slight increase in each of the past two years. Adjusted debt balances were $11.2 billion and include a substantial $5.5 billion adjustment for commitments under operating leases. Cash balances of $1.9 billion lower the adjusted net leverage ratio to 2.8 times. MCR estimates shareholder distributions, including dividends and share repurchases, approximated $1.5 billion in 2016 and exceeded free cash flow.

MCR's rating continues to reflect L Brands' competitive advantages, including leading market positions, its strong Victoria's Secret and Bath & Body Works brands, and economies of scale, which are offset by modest industry cyclicality and customer concentration.

*Market Data*

MCR compares L Brands with similar-rated peer Gap Inc (rating: BB+, negative). Based on pricing from Advantage Data, L Brands' outstanding $500 million 5.625% senior notes issue due in 2023 recently traded at a yield of 4.87% and a spread of +275 basis points over the nearest Treasury, while the Gap $1.25 billion 5.95% senior unsecured notes issue due in 2021 recently traded at a yield of 3.97% and a spread of +230 basis points.

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