Credit Summary: Abbott Laboratories (A-, positive)

Abbott is focused on deleveraging with tax reform benefits in 2018.

Morningstar Credit Ratings, LLC
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Contents

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Executive Summary

Morningstar Credit Ratings, LLC recently upgraded our credit rating for Abbott Laboratories one notch to A-, which reflects ongoing deleveraging following the St. Jude and Alere acquisitions that were completed in 2017. With about half of its planned deleveraging in 2018 already completed, Abbott’s Cash Flow Cushion and Solvency Score pillars have already improved enough to warrant an upgrade. If Abbott completes its full deleveraging plans as expected by the end of 2018, further improvement in the firm’s Cash Flow Cushion and Solvency Score could lead us to upgrade our rating again in the next year or so. Therefore, we have increased our outlook on the company’s rating to positive from stable to reflect the ongoing improvement in its financial health.

Key Takeaways

- Since its split from AbbVie in 2013, Abbott's credit rating has declined, primarily on leverage-increasing acquisitions. While the firm's leverage still remains inflated relative to historical levels, Abbott plans to significantly reduce leverage in 2018, creating upward momentum in its Cash Flow Cushion and Solvency Score pillars that contributed to our recent upgrade and positive outlook.
- Abbott's pro forma segment analysis reveals that the St. Jude and Alere acquisitions have increased the company's reliance on medical devices and diagnostics while reducing its reliance on the nutritional and established pharmaceutical businesses.
- Our financial forecast suggests that Abbott can reach its gross and net leverage targets around 3 and 2 times, respectively, by the end of 2018, if profits grow as expected and the firm achieves its plan to redeem about $8 billion of debt.
- Among its peers, Abbott's capital allocation goals now appear closely aligned with A rated Baxter. Both companies aim to operate with net leverage around 2 times eventually. While Baxter currently operates below that target and Abbott operates above that target, we think these firms may deserve the same ratings if they both wind up operating with similar net leverage and maintain similar Business Risk pillars. These comparable factors are reflected in our positive outlook for Abbott.

Companies Mentioned

Name (Ticker)	Rating	Outlook	Coupon	Maturity	Price	Yield	Spread
Abbott Laboratories (ABT)	A-	Positive	3.75%	11/30/2026	98.72	3.92%	+108
Medtronic PLC (MDT)	A+	Stable	3.35%	04/01/2027	98.62	3.53%	+67
Stryker Corp (SYK)	A+	Stable	3.65%	03/07/2028	99.61	3.70%	+82
Baxter International Inc (BAX)	A	Stable	2.60%	08/15/2026	91.35	3.81%	+96
Agilent Technologies Inc (A)	A-	Stable	3.05%	09/22/2026	93.54	3.95%	+110

Source: Interactive Data, as of Feb. 27 2018

Abbott Laboratories Overview

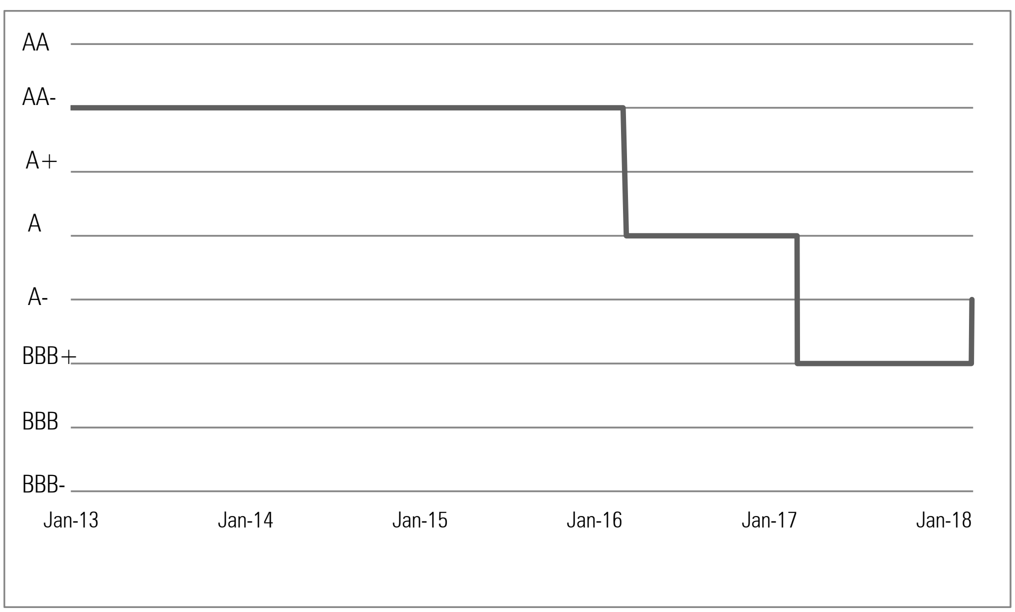
Company Description

Abbott operates a diverse set of healthcare businesses through four segments: medical devices (36% of pro forma sales), diagnostics (26%), nutritionals (23%), and established pharmaceuticals (14%). In its medical device segment, Abbott just increased its exposure to highly engineered cardiac, vascular, and neuromodulation devices through the acquisition of St. Jude Medical, which added to its other devices such as glucose monitors for the treatment of diabetes and stents for coronary artery disease. In diagnostics, Abbott recently expanded its exposure to point-of-care tools through its acquisition of Alere, expanding the reach of this segment's diagnostic equipment and tools. Through its nutritional segment, Abbott sells a variety of products for children and adults, such as Similac infant formula and Pediasure and Ensure nutritionals primarily through consumer marketing channels. In emerging markets, Abbott sells branded generic products through its established pharmaceutical division.

MCR Credit Rating History

- In January 2013, Abbott Laboratories split into two companies focused on medical products (Abbott) and biopharmaceuticals (AbbVie). After that split, we rated Abbott AA-.
- In March 2016, we downgraded our credit rating on Abbott by two notches to A to reflect the plan to acquire Alere in a leverage-increasing transaction. That deal closed in October 2017.
- In March 2017, we downgraded our credit rating two more notches to BBB+ on Abbott's leverage-increasing acquisition of St. Jude Medical. That deal closed in January 2017.
- In February 2018, we upgraded our credit rating on Abbott by one notch to A- to reflect ongoing deleveraging efforts in 2018 that have improved its Cash Flow Cushion and Solvency Score pillars.

Exhibit 1 Abbott Laboratories Credit Rating History



Source: Morningstar Credit Ratings, LLC

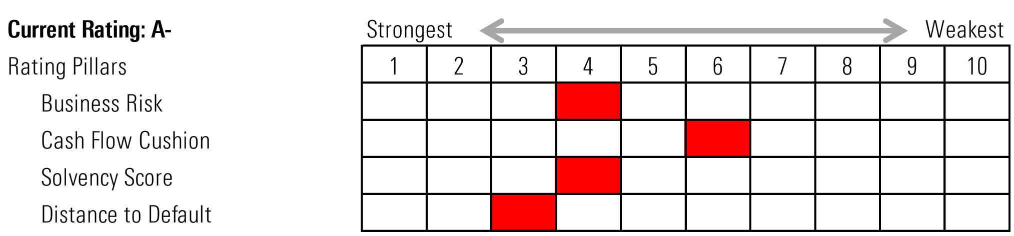
Credit Rating Rationale

In February 2018, we upgraded our credit rating for Abbott Laboratories one notch to A- on its ambitious deleveraging plans for 2018. After the leverage-increasing St. Jude and Alere acquisitions were completed during 2017, Abbott owed $28 billion of debt at the end of 2017, or gross debt/EBITDA over 4 times, which constrained the company’s leverage-sensitive pillars, the Cash Flow Cushion and Solvency Score. Since then, though, Abbott's management highlighted a plan to reduce debt by about $8 billion by the end of 2018 with newly accessible cash from tax reform. Abbott already paid down $4 billion of debt in January 2018, positively influencing the firm’s Cash Flow Cushion and Solvency Score pillars enough to cause our recent upgrade. Management estimates gross and net leverage could decline to about 3 and 2 times, respectively, by the end of the 2018 with an additional $4 billion of debt redemption and profit growth, which could further improve its Cash Flow Cushion and Solvency Score pillars. That potential for continued improvement in the firm’s credit pillars influences our positive rating outlook. Abbott’s credit rating also remains supported by its large, diverse operations and advantages in medical products, which contributes to its low Business Risk. Abbott sells medical devices, diagnostics, nutritional products, and established pharmaceuticals. After acquiring St. Jude, which Morningstar’s Equity Research Group previously gave a wide moat assessment, Abbott has expanded its medical device segment by adding cardiac, vascular closure, surgery, and neuromodulation products. The Alere acquisition expanded its diagnostic operations. While Abbott still only earns a narrow moat assessment, it appears situated on the strong end of that category after these recent deals, in our opinion.

Pillar Analysis

With its deleveraging plan well underway in 2018, Abbott's credit profile already appears to have improved on better Cash Flow Cushion and Solvency Score pillar scores, which accounts for our recent upgrade. We project incremental improvement in those pillars by early 2019 as well, if the company redeems debt as expected through the rest of 2018. These factors along with low Business Risk and a strong Distance to Default pillar suggest that our rating could increase in the next year or so, which influences our positive outlook.

Exhibit 2 Abbott Credit Pillar Summary



Source: Morningstar Credit Ratings, LLC

- Business Risk (Low): We view Abbott as having low Business Risk, reflecting its large, diverse operations in generally recession-resistant healthcare businesses. However, the score is somewhat constrained by its narrow, rather than wide, moat status, neutral management, and dependence on capital markets, which have been negatively influenced by recent leverage-increasing acquisitions.

  - Size (Very Large): With $27 billion in 2017 sales, Abbott earns the highest score for size that we award. This pillar component has been positively influenced by the recent St. Jude and Alere acquisitions, and mid-single-digit organic growth trends suggest that it should remain in this top category throughout our forecast period.
  - Economic Moat (Narrow): Abbott currently earns a narrow economic moat assessment from Morningstar's Equity Research Group. That group recently noted that with the addition of St. Jude, which previously earned a wide moat assessment, Abbott's moat stands on the strong end of the narrow category. However, uncertainty around Abbott's ability to innovate in this sector keeps the group from pushing Abbott into the wide category. In all of its four businesses (medical devices, diagnostics, nutritionals, and established pharmaceuticals), though, Abbott is one of the top three or four competitors, which helps it generate higher returns on invested capital than its capital costs and contributes to its narrow moat.
  - Uncertainty (Medium): With a relatively diverse product set and limited exposure to cyclical events, Abbott earns a medium uncertainty assessment from Morningstar's Equity Research Group. Like with most other healthcare companies, though, uncertainty around new innovations, both internally and from competitors, keeps Abbott out of the low uncertainty category.
  - Product/Customer Concentration (Diversified): With a broad set of medical products in its portfolio, Abbott earns a strong score on this pillar component, just below the scores of highly diversified companies like Johnson & Johnson (AAA, stable).
  - Management (Neutral): Despite two leverage-increasing acquisitions in 2017 that cut into its credit profile substantially, we recently increased our management score from fairly aggressive to neutral for Abbott to recognize its ambitious deleveraging target for 2018.
  - Dependence on Capital Markets (Dependent): This score is based on the minimum adjusted Cash Flow Cushion in any year of our five-year forecast. With the firm projecting nearly $8 billion of debt redemption in 2018, this score is constrained by the acceleration of the firm's maturity schedule. However, we would expect this component of the Business Risk pillar to improve somewhat, as its debt-related obligations decrease going forward.
  - Cyclicality (Mild Cyclicality): While generally recession-resistant, Abbott's results can be influenced by product commercialization cycles in medical devices, laboratory capital spending budgets in diagnostics, and general consumer patterns in its other segments.
- Cash Flow Cushion (Moderate): After outlining its deleveraging plans for 2018, this pillar improved one notch as its debt-related obligations fell during our five-year forecast period. However, obligations still remain somewhat elevated after recent acquisitions, and Abbott scores at moderate levels in the Cash Flow Cushion pillar. The company's roughly $2 billion annual dividend payment to shareholders also constrains this score. Going forward, we think this pillar could improve another notch if it redeems existing debt as planned in 2018, which represents a much higher outflow than what comes due in 2023.
- Solvency Score (Strong): With some debt redemption already completed, this pillar has already improved a notch and reflects some of management's deleveraging plan since forward-looking interest obligations are considered in the interest coverage metric of this score. However, we project this pillar will

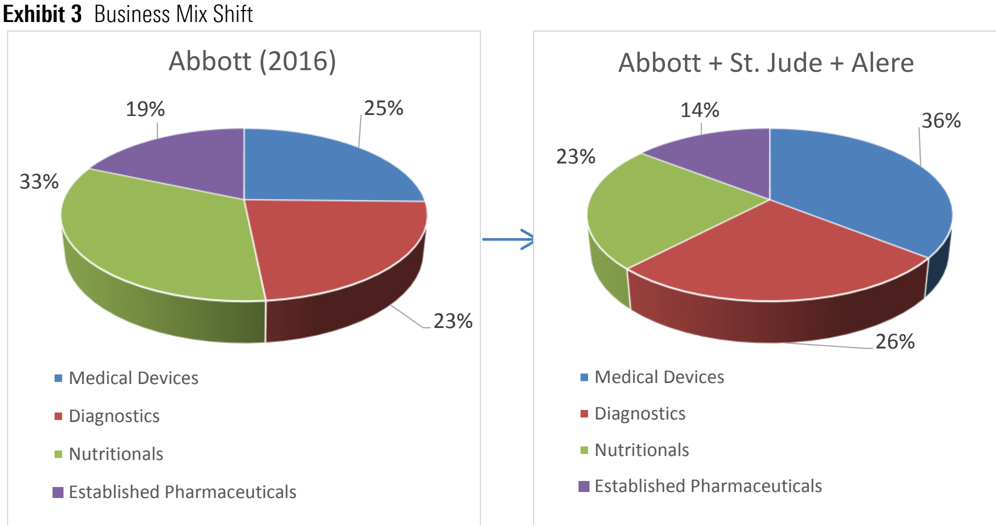
strengthen further in 2019, as its leverage, interest coverage, and profitability metrics could continue to improve on further debt redemption.

- Distance to Default (Strong): With Abbott's equity cushion ($106 billion) greatly exceeding its debt at the end of 2017 ($28 billion), Abbott scores strongly on this pillar, and the DTD score could improve as the firm reduces its debt obligations in 2018.

Abbott's Business Mix Diversifying With St. Jude and Alere Acquisitions

Through the St. Jude and Alere acquisitions in 2017, Abbott has increased its exposure to the medical device and diagnostic sectors while reducing its emphasis on nutritionals and established pharmaceuticals, which can be seen in Exhibit 3. By our estimates, the medical device segment now accounts for about 36% of pro forma sales, up from 25% in 2016 before the St. Jude acquisition. Through that combination, Abbott increased its exposure to highly engineered cardiac, vascular, and neuromodulation devices, and it continues to sell other devices, such as glucose monitors for the treatment of diabetes and stents for coronary artery disease. We estimate the diagnostic segment now accounts for about 26% of sales after the Alere transaction, which increased Abbott's exposure to point-of-care tools. After these acquisitions, the nutritional segment has significantly decreased in importance to Abbott, contributing just 23% of sales by our estimates compared with 33% in 2016. This segment has also been growing at the slowest pace during this period, as regulatory changes constrained its Chinese operations. The established pharmaceutical segment has also decreased in relative size to 14% of Abbott's sales from 19% in 2016 but still continues to lead the pack in terms of growth, as healthcare spending grows in its targeted emerging markets.

Exhibit 3 Business Mix Shift



Source: Company filings and Morningstar Credit Ratings, LLC Estimates

In comparable operational growth, Abbott grew 5% year over year in 2017, led by the established pharmaceuticals division, mid-single-digit growth in medical devices and diagnostics, and low-single-digit growth in nutritionals. By our estimates, the margin profiles of these segments after the recent acquisitions are relatively close with segment operating margins ranging from 20% (in established pharmaceuticals) to 26% (in medical devices).

By segment, medical devices grew 6% in 2017, after adjusting for the St. Jude acquisition. In this segment, the neuromodulation business led the pack, turning in 43% growth year over year, as caregivers and patients increasingly sought out nonpharmaceutical methods of alleviating pain. Also within medical devices, the diabetes care business grew 23% year over year primarily on international growth from the continued expansion of FreeStyle Libre, a glucose monitor that does not require routine finger sticks. The U.S. Food and Drug Administration approved the product in late September, and the company is making progress on the reimbursement front (including at the Centers for Medicare and Medicaid Services in January 2018). Therefore, we expect strong growth from this product in 2018 and beyond, which should help the medical device segment build on its momentum. Specifically, management expects the medical devices segment to grow in the mid- to high single digits in 2018.

The diagnostics segment grew 6% year over year in 2017. These growth trends could remain strong after the recent completion of the Alere point-of-care diagnostics acquisition. In 2018, management expects the diagnostics segment to grow in the mid- to high single digits.

The nutritionals segment remained a slow grower at only 1% year over year in 2017, as weakness in China continued to constrain results. Abbott is looking forward to how new regulatory standards in that country that started on Jan. 1 will affect its results, as they may lead to a more stable pricing and demand environment after noncompliant competitors are forced out of the market. However, the company is only incorporating low-single-digit growth from the nutrition segment in its 2018 outlook.

The established pharmaceuticals business continued to lead the charge for Abbott in 2017, increasing 10% operationally on continued expansion in emerging markets such as Brazil, Russia, India, and China. The company's 2018 outlook incorporates high-single-digit top-line growth for this segment.

Financial Projections

Specifically in 2018, Abbott management expects about 6% to 7% top-line growth and higher adjusted earnings growth on some margin expansion and a lower tax rate. With these assumptions, gross and net leverage can reach management's projections of roughly 3 and 2 times, respectively, by the end of 2018.

In our forecast, we assume that revenue, adjusted EBITDA, and free cash flow will grow in the midsingle digits compounded annually through 2022. With the maintenance of about $20 billion of debt on its balance sheet through our forecast period, gross leverage may decline even further. We currently do not assume a significant change in the firm's net leverage, as we assume excess cash flows may eventually be used for acquisition or shareholder return activities.

Exhibit 4 Financial Estimates

$s in Millions	2015	2016	2017	2018e	2019e	2020e	2021e	2022e	CAGR 2017-2022e
Revenue	$20,405	$20,853	$27,390	$29,363	$30,443	$31,527	$32,666	$33,835	4%
% Growth		2%	31%	7%	4%	4%	4%	4%	
Adjusted EBITDA	$4,339	$4,538	$6,420	$6,916	$7,356	$7,844	$8,099	$8,363	5%
Margin	21.3%	21.8%	23.4%	23.6%	24.2%	24.9%	24.8%	24.7%	
Free Cash Flow	$1,856	$2,082	$4,435	$4,881	$5,306	$5,294	$5,410	$5,538	5%
as % of Sales	9.1%	10.0%	16.2%	16.6%	17.4%	16.8%	16.6%	16.4%	
Debt	$8,998	$22,003	$27,924	$19,669	$20,669	$19,822	$19,972	$20,222	
Cash	$6,125	$18,775	$10,493	$5,382	$6,138	$4,892	$4,696	$4,670	
Net Debt	$2,873	$3,228	$17,431	$14,287	$14,531	$14,930	$15,276	$15,552	
Gross Debt/EBITDA	2.1x	4.8x	4.3x	2.8x	2.8x	2.5x	2.5x	2.4x	
Net Debt/EBITDA	0.7x	0.7x	2.7x	2.1x	2.0x	1.9x	1.9x	1.9x	

Source: Morningstar Credit Ratings, LLC, company filings

Capital Structure

After completing the St. Jude and Alere acquisitions in 2017, Abbott's financial position weakened materially. At the end of 2017, Abbott owed $28 billion in debt, consisting primarily of senior unsecured bonds but also including $1.2 billion of revolver and $2.8 billion of unsecured term loan borrowings that were subsequently paid off in January 2018. Considering this January debt redemption that was enabled by recent U.S. tax reform, Abbott owed $24 billion, or pro forma gross leverage in the mid-3s, and held cash and investments of roughly $6 billion, leading to net leverage in the mid-2s. Management has noted that it plans to redeem up to $4 billion of additional debt in the near future, too, so by the end of 2018, Abbott could wind up with just $20 billion of debt. We think that this plan is possible considering existing financial resources (an estimated $6 billion), projected free cash flow of nearly $5 billion in 2018 by our estimates, and expected dividend payments around $2 billion in 2018. The company has not highlighted which obligations it plans to redeem beyond the revolver and term loan, but the $4 billion of expected debt redemption activities represents nearly half of the remaining $9 billion of debt coming due through 2022. Creditors should know that management has highlighted a goal of pushing gross leverage and net leverage down to around 3 and 2 times, respectively, by the end of 2018 when incorporating expected profit growth. That deleveraging magnitude and timeline look more ambitious than we previously anticipated when we assumed net leverage could fall to the low-2s in a couple years. Overall, management's focus on achieving a more flexible financial position after last year’s leverage-increasing acquisition activities contributes to our better view of its credit profile and outlook.

Exhibit 5 Capital Structure ($s in Millions)

	Debt as of January 5, 2018	x EBITDA
Abbott Laboratories		
5.13% notes due 2019	$947	
2.35% notes due 2019	$2,850	
2.80% notes due 2020	$500	
4.13% notes due 2020	$597	
2.00% notes due 2020	$750	
2.90% notes due 2021	$2,850	
2.55% notes due 2022	$750	
3.25% notes due 2023	$900	
3.40% notes due 2023	$1,500	
3.88% notes due 2025	$500	
2.95% notes due 2025	$1,000	
3.75% notes due 2026	$3,000	
4.75% notes due 2036	$1,650	
6.15% notes due 2037	$547	
6.00% notes due 2039	$515	
5.30% notes due 2040	$694	
4.75% notes due 2043	$700	
4.90% notes due 2046	$3,250	
Total Debt	$23,500	3.7x
Estimated Cash and Investments (January 5, 2018)	$6,493	1.0x
Abbott Net Debt	$17,007	2.6x
Market Capitalization (February 28, 2018)	$105,740	16.5x
Enterprise Value	$122,747	19.1x
Abbott EBITDA (2017)	$6,420	

Source: Morningstar Credit Ratings, LLC, company filings

Capital Allocation Policy

Abbott's management has highlighted an ambitious deleveraging target by the end of 2018, which should be helped by recent U.S. tax reform. Management noted that its effective tax rate will decline modestly (to 14% to 15% in 2018 from about 16.5% on a comparable basis in 2017), but the big change for Abbott will be the much improved access to its overseas cash. With that newly accessible cash, the company has prioritized debt repayment in 2018. It ended 2017 with about $28 billion in debt. The company already paid down $4 billion of debt in January, and management plans cut its debt levels by another $3.5 billion to $4.0 billion by the end of 2018. With these actions, we estimate that pro forma gross leverage has declined by more than half a turn from the end of 2017, standing in the mid-3s, and could decline to about 3 times by the end of the 2018 with expected debt reduction and profit growth. The company also projected that net leverage could fall to roughly 2 times by the end of 2018. If the company follows through on these goals in a timely manner, we see room for further improvement in our credit view of Abbott, which is reflected in our positive outlook.

Peer Comparison

While still inflated because of the 2017 acquisitions of St. Jude and Alere, Abbott's debt leverage is declining, and we believe its best credit comparable is higher-rated Baxter International Inc (A, stable), which can be seen in Exhibit 6. After divesting Baxalta, which was acquired by Shire PLC (BBB-, positive), Baxter has operated with net leverage well below its target of 2 times. However, Baxter's management has noted a goal of pursuing more tuck-in acquisitions at a faster clip going forward. With those expected outflows, we would not be surprised to see leverage rise toward its net leverage target of 2 times in the next couple of years, and our A rating and stable outlook on Baxter already account for that potential increase in leverage. On the other side of the target, Abbott is also working toward a net leverage target around 2 times, which it could achieve by the end of 2018 if it follows through on its debt redemption goal. With their similar moat and uncertainty assessments from Morningstar's Equity Research Group, we think Baxter and Abbott could deserve similar credit ratings if they both wind up operating at their net leverage targets around 2 times. This comparable analysis reinforces the positive outlook on Abbott's A- rating.

Exhibit 6 Abbott Credit Comparable Table

Medical Technology Tickers	**MDT**	**SYK**	**BAX**	**ABT**	**A**
Morningstar LLC Rating	A+	A+	A	A-	A-
Outlook	Stable	Stable	Stable	Positive	Stable
Information from Morningstar's Equity Research Group:					
Economic Moat	Wide	Wide	Narrow	Narrow	Narrow
Moat Trend	Stable	Stable	Stable	Stable	Stable
Uncertainty	Medium	Medium	Medium	Medium	Medium
Pro Forma Credit Metrics ($s in millions)					
TTM as of Date ($s in millions)	1/26/2018	12/31/2017	12/31/2017	1/5/2018	1/31/2018
Revenues	$28,525	$12,444	$10,561	$27,390	$4,616
Adj'd EBITDA	$8,604	$3,271	$2,293	$6,420	$1,082
Adj'd EBITDA %	30%	26%	22%	23%	23%
Total Debt	$28,820	$7,222	$3,512	$23,500	$2,145
Cash and Investments	$14,436	$2,793	$3,394	$6,493	$2,887
Net Total Debt/(Cash)	$14,384	$4,429	$118	$17,007	($742)
Market Capitalization	$110,100	$61,490	$37,100	$105,740	$22,290
Enterprise Value	$124,484	$65,919	$37,218	$122,747	$21,548
Debt % of EV	23%	11%	9%	19%	10%
TD/EBITDA	3.3x	2.2x	1.5x	3.7x	2.0x
Net TD/EBITDA	1.7x	1.4x	0.1x	2.6x	-0.7x
Adj TD/EBITDAR*	3.6x	2.5x	2.4x	3.8x	2.3x
Interest Expense	$984	$247	$85	$904	$79
EBITDA/Interest	8.7x	13.2x	27.0x	7.1x	13.7x
(EBITDA-CapX)/Int	7.6x	10.8x	19.5x	5.8x	11.1x
OCF	$5,419	$1,559	$1,853	$5,570	$988
CapX	($1,106)	($598)	($634)	($1,135)	($204)
FCF	$4,313	$961	$1,219	$4,435	$784
FCF/Debt	15%	13%	35%	19%	37%
Share Repurchases	($2,099)	($230)	($564)	($117)	($130)
Dividends	($2,464)	($636)	($315)	($1,849)	($176)
Net FCF	($250)	$95	$340	$2,469	$478

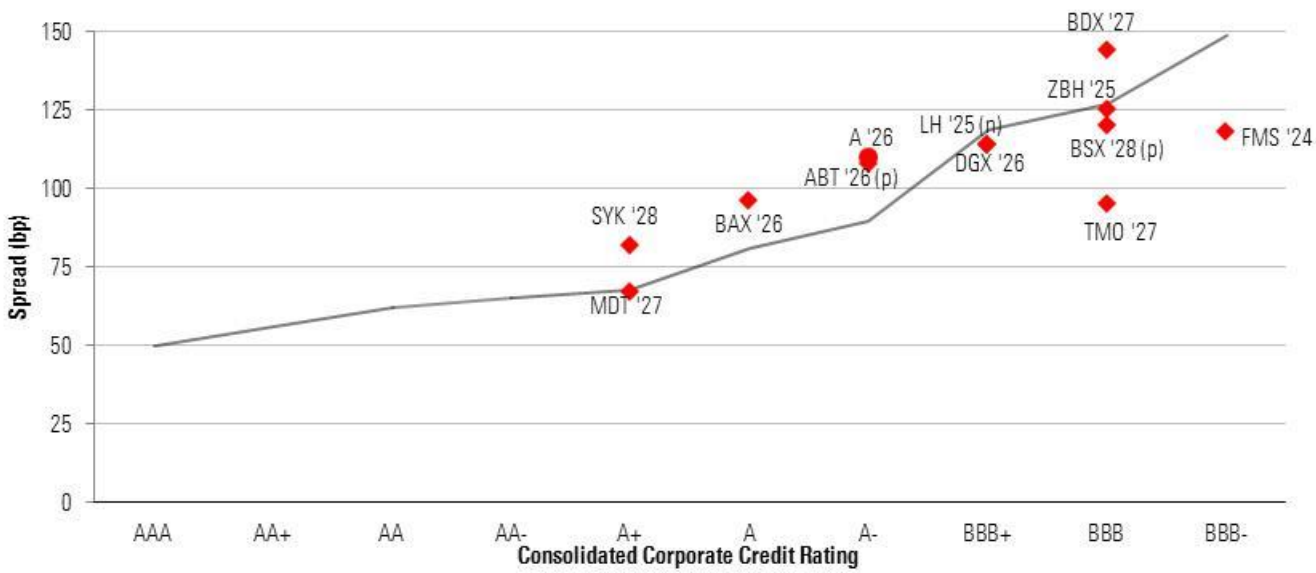
Source: Company Filings and Morningstar Credit Ratings, LLC as of Feb 28, 2018

*Adjusted TD includes total debt plus underfunded pension liabilities plus 8 times rents.

Market Data

Since Abbott's management team highlighted its deleveraging strategy in late January, its bonds due in 2026 have tightened 1 basis point to +108 basis points. They recently traded between Morningstar Inc's Corporate Bond Index at A- (+90 basis points) and BBB+ (+119 basis points) and roughly in line with bonds from A- rated Agilent's bonds due in 2026.

Exhibit 7 Medical Technology and Services Sector Versus Morningstar Corporate Bond Index



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

Recently trading about 18 basis points wide of the index at A-, Abbott's bonds now trade wider than the average differential in the investment-grade medical technology and services sector, which trades in line with the index on average.

Exhibit 8 Medical Technology and Service Sector Spreads

Health Care Issuer	Rating	Rating Outlook/ Review Status	Coupon	Maturity	Yield	Spread	Difference From Index	Average Difference
Agilent Technologies	A-	Stable	3.05%	9/22/2026	3.95%	+110	20	
Abbott Laboratories	A-	Positive	3.75%	11/30/2026	3.92%	+108	18	
Becton, Dickinson and Co	BBB	Stable	3.70%	6/6/2027	4.30%	+144	17	
Baxter International Inc	A	Stable	2.60%	8/15/2026	3.81%	+96	15	
Stryker Corp	A+	Stable	3.65%	3/7/2028	3.70%	+82	14	0
Medtronic PLC	A+	Stable	3.35%	4/1/2027	3.55%	+67	-1	
Zimmer Biomet Holdings Inc	BBB	Stable	3.55%	4/1/2025	4.06%	+125	-2	
Quest Diagnostics Inc	BBB+	Stable	3.45%	6/1/2026	3.98%	+114	-5	
Laboratory Corp of America Holdings	BBB+	Negative	3.60%	9/1/2027	4.01%	+114	-5	
Boston Scientific Corp	BBB	Positive	4.00%	3/1/2028	4.08%	+120	-7	
Fresenius Medical Care AG & Co.	BBB-	Stable	4.75%	10/15/2024	3.94%	+118	-31	
Thermo Fisher Scientific Inc	BBB	Stable	3.20%	8/15/2027	3.86%	+95	-32	

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

Appendix

Abbott Laboratories Moat and Trend

The following description comes directly from Morningstar's Equity Research Group: "We've given Abbott a narrow economic moat rating. We think the addition of St. Jude pushes Abbott toward the wider side of a narrow moat, but we're not fully convinced that Abbott has tipped into the wide moat category, especially if the firm cannot nurture the kind of ongoing (and occasionally revolutionary) innovation that is necessary to secure reimbursement over the longer term.

"In most cases, Abbott is one of three or four competitors that dominate the market, including nutritionals, cardiac rhythm management devices, surgical heart valves, glucose monitors, coronary stents, and immunoassays. In these markets, Abbott participates in rational oligopolies and enjoys the benefits of intangible assets.

"We think the nutritional business is one of the moatiest parts of new Abbott, where it wields a leadership position in this highly consolidated market that is estimated to be $35 billion worldwide. Aside from strength in developed markets, the firm faces brighter growth prospects in emerging markets, where the growth of middle-class families has spurred demand for pediatric and adult nutrition products. Thanks to the strong Similac and Ensure brands, Abbott is in an advantageous position to introduce new formulations and line extensions and penetrate new markets. Abbott made substantial investments early on to build out its infrastructure in emerging markets, including its new venture with New Zealand-based Fonterra to build out a large-scale dairy farm hub in China. The firm should reap the rewards of this investment as it expands the nutritional business.

"These building blocks and experience with nutritionals should also play out well when applied to Abbott's established pharmaceutical product segment, which is mainly sold outside the U.S. This business, frequently called branded generics, operates more like a consumer business than traditional branded drugs. For example, Abbott's branded generics will mainly be sold in less developed markets that often lack a well-developed infrastructure for distribution. Instead, Abbott must sell its products directly to pharmacy chains and physicians. As a result, brand recognition and reputation are key factors that Abbott can leverage. Selling to a fragmented market also translates into less pricing pressure for Abbott. This could change over the longer term once more emerging markets turn to the tender system that characterizes developed nations. However, that change remains further off.

"In the near and medium term, we think Abbott should benefit from the addition of St. Jude's impressive expertise in cardiac rhythm management, structural heart, and heart failure. However, the jury is still out on Abbott's ability to nurture and renew innovation in this area over the long haul. Abbott has demonstrated its competence at launching next-generation products that are the lifeblood of the device business, but we are less enthusiastic about its attempts at greater leaps of innovation.

"Finally, Abbott relies on intellectual property to ward off competitors in the device and diagnostic segments. We think the firm has earned a narrow moat in each of its four segments, which translates to a narrow moat for the entire company.

"We think Abbott's moat trend remains stable. Although there is potential for pricing pressure from various sources across Abbott's markets (for example, a trend toward more government tenders in branded generics, declining reimbursement for some vascular devices), the firm's investment in its pipeline should lead to a stream of new products that can fortify pricing power through the medium term. Abbott's scale and diversity help to steady its moat trend. We anticipate strength in its cardiac device segment, core diagnostics, remodeled established pharmaceuticals division, and diabetes business should more than offset current weakness in its international nutrition and molecular diagnostic businesses.

"Abbott has the ability to deploy robust and predictable cash flows from its businesses toward acquisitions and partnerships, which should help replenish its pipeline of next-generation products. The external development efforts not only support Abbott's growth but also keep smaller companies from gaining the critical mass to encroach on Abbott's narrow moat. If Abbott were to develop some revolutionary device pipeline candidates that demonstrated strongly favorable clinical outcomes, or if it acquired an extensive collection of med-tech products that allowed it to be a more comprehensive partner with hospitals, then we'd consider turning its moat trend rating positive."

Morningstar Credit Ratings, LLC | 21 February 2018

Abbott (ABT)

Corporate Credit Rating N/A

Economic Moat (1)	**Moat Trend** (1)	Outlook
Narrow	Stable	Review

Sector	Healthcare	Business Risk Rank	4	Insert company description here.
Industry	Medical Devices	Cash Flow Cushion Rank	6	
		Solvency Score Rank	4	
		Distance to Default Rank	3	

All values (except per share amounts) in: USD Millions	2015	2016	2017	Forecast 2018	2019	2020	2021	2022
Income Statement								
Revenue	20,405	20,853	27,390	29,363	30,443	31,527	32,660	33,835
Gross Profit	11,658	11,829	15,053	17,618	18,266	19,074	19,760	20,470
Operating Income	2,867	3,185	1,726	3,204	3,791	4,407	4,772	5,130
Adjusted EBITDA	4,339	4,538	6,420	6,916	7,356	7,844	8,099	8,363
Net Income	4,423	1,400	477	2,020	2,554	3,068	3,362	3,631
Balance Sheet								
Cash + Investments	6,125	18,775	10,493	5,382	6,138	4,892	4,696	4,670
Total Debt	8,998	22,003	27,924	19,669	20,669	19,822	19,972	20,222
Total Adjusted Debt	10,160	23,201	29,149	21,453	22,519	21,737	21,956	22,278
Cash Flow Statement								
Cash Flow From Operations	2,966	3,203	5,570	6,056	6,524	6,556	6,717	6,892
Capital Expenditures	(1,110)	(1,121)	(1,135)	(1,175)	(1,218)	(1,261)	(1,306)	(1,353)
Free Cash Flow (CFO-Capex)	1,856	2,082	4,435	4,881	5,306	5,294	5,410	5,538
Free Cash Flow / Sales	9.1%	10.0%	16.2%	16.6%	17.4%	16.8%	16.6%	16.4%
Growth (% YoY)								
Revenue	3.0%	2.2%	31.3%	7.2%	3.7%	3.6%	3.6%	3.6%
Gross Profit	10.0%	1.5%	27.3%	17.0%	3.7%	4.4%	3.6%	3.6%
Operating Income	32.3%	11.1%	-45.8%	85.6%	18.3%	16.3%	8.3%	7.5%
Adjusted EBITDA	16.8%	4.6%	41.5%	7.7%	6.4%	6.6%	3.3%	3.3%
Profitability (%)								
Gross Margin	57.1%	56.7%	55.0%	60.0%	60.0%	60.5%	60.5%	60.5%
Operating Margin	14.1%	15.3%	6.3%	10.9%	12.5%	14.0%	14.6%	15.2%
Adjusted EBITDA Margin	21.3%	21.8%	23.4%	23.6%	24.2%	24.9%	24.8%	24.7%
Net Margin	21.7%	6.7%	1.7%	6.9%	8.4%	9.7%	10.3%	10.7%
Adjusted ROIC	12.6%	13.3%	12.5%	10.7%	11.7%	12.4%	12.6%	12.8%
Adjusted RONIC	32.5%	15.3%	15.3%	-25.2%	-38.6%	-114.7%	-107.4%	-541.0%
Coverage / Cash Flow								
Adjusted EBITDA / Interest Expense	26.6	10.5	7.1	8.4	9.4	9.8	9.9	9.7
(Adj. EBITDA-CapEx) / Int. Exp.	19.8	7.9	5.8	6.9	7.8	8.3	8.3	8.2
Adj. EBITDAR / (Int. Exp. + 1/3 Rents)	21.2	9.7	6.9	7.9	8.8	9.2	9.3	9.1
Dividends / FCF	78%	74%	42%	40%	40%	43%	43%	43%
Share repurchase (issuance) / FCF	104%	13%	3%	0%	19%	19%	18%	18%
Leverage								
Total Debt / Adj. EBITDA	2.1	4.8	4.3	2.8	2.8	2.5	2.5	2.4
Net Debt / Adj. EBITDA	0.7	0.7	2.7	2.1	2.0	1.9	1.9	1.9
Total Adj. Debt / Adj. EBITDAR	2.3	4.9	4.4	3.0	3.0	2.7	2.6	2.6
EV /Adj. EBITDA	0.7	0.7	2.7		-	-	-	-
Debt / Capital	30%	52%	47%	39%	40%	40%	40%	40%
FCF / Total Debt	21%	9%	16%	25%	26%	27%	27%	27%

Descriptors for Pillar Analysis

Rating Pillars

	Score Range	Business Risk	Cash Flow Cushion	Solvency Score	Distance to Default
Strongest	1-2	Minimal	Very Strong	Very Strong	Very Strong
	3-4	Low	Strong	Strong	Strong
	5-6	Moderate	Moderate	Moderate	Moderate
	7-8	High	Weak	Weak	Weak
Weakest	9-10	Very High	Very Weak	Very Weak	Very Weak

Business Risk Pillar Components

Country Risk (10% of Business Risk Score)

Weakest	Very High Risk
	High Risk
	Moderate Risk
Strongest	Low Risk

Company Risk (90% of Business Risk Score)

	Size	Economic Moat	or Sustainable Competitive Advantage	Uncertainty
Weakest	Very Small	None	None	Extreme
	Small			Very High
	Moderate	Narrow	Moderate	High
	Large			Medium
Strongest	Very Large	Wide	Substantial	Low

	Product/Customer Concentration	Management	Dependence on Capital Markets	Cyclicality
Weakest	Highly Concentrated	Aggressive	Extremely Dependent	Highly Cyclical
	Concentrated	Fairly Aggressive	Highly Dependent	Cyclical
	Neutral	Neutral	Dependent	Average Cyclicality
	Diversified	Fairly Conservative	Low Dependence	Mild Cyclicality
Strongest	Highly Diversified	Conservative	Very Low Dependence	Non-Cyclical

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