Morningstar Corporate Credit Research Highlights

Corporate Bond Market: Summer Starts to Slip Into Fall

Morningstar Credit Ratings, LLC
06 August 2018

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Issuer/Ticker	Current Issuer Credit Rating	Previous Issuer Credit Rating
Lowe's Companies LOW	A	A
The Home Depot HD	A+	A+
Franklin Resources BEN	AA-	AA-

Recent Notes Published by Credit Analysts

- **NOV** Reports Solid 2Q Results Led by Strong Uptick in Rig Technologies Segment Issues
- **Pfizer** (AA-, Stable) Accelerated Revenue Growth in 2Q; Returned $10.1 Billion to Shareholders in 1H
- **Vulcan Materials** (BBB-, stable) Posts 13% Increase in 2Q Adjusted EBITDA
- **ArcelorMittal** (BB+, Stable) Boosted by Higher Steel Prices;28.6% Increase in 1st Half EBITDA YoY
- **Anadarko Petroleum** (BBB-, Stable) Posts 43% Increase in 2Q Operating Cash Flow Versus Year Ago
- **AmerisourceBergen** (A, Stable) Beats 3Q Expectations and Maintains Guidance Despite Ongoing Challenges
- **Teva** (BB, Stable) Raises 2018 EBITDA and Cash Flow Outlook at 3Q Call; Debt Reduction Remains Top Cash Priority
- Following the Bard Acquisition, **Becton Dickinson** (BBB, Stable) Continues Deleveraging in Fiscal 3Q
- **US Steel** (B, Positive) Posts 20% Increase in 2Q Adjusted EBITDA Year Over Year
- **Concho Resources** (BBB-, Positive) Posts Strong 2Q Results; Integration of RSP Permian Acquisition Under Way
- **Camden Property Trust** (A-, Stable) Reports Another Good Quarter Despite Pressures From New Supply

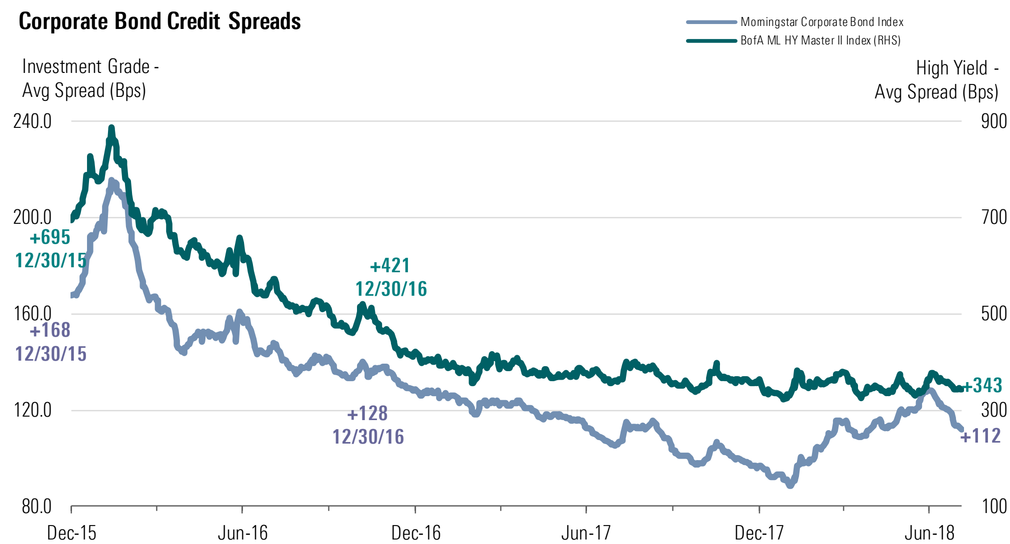
Credit Market Insights

Corporate Bond Market: Summer Starts to Slip Into Fall

Activity in the corporate bond market has begun its typical seasonal summer slowdown as market participants gear up to take their remaining summer vacations before school resumes. Even though second-quarter earnings reports continue to be strong and the S&P 500 rose by 0.75% last week, corporate credit spreads ended the week relatively unchanged. The average spread of the Morningstar Corporate Bond Index (our proxy for the investment-grade market) tightened one basis point to +112. In the high yield market, the BankAmerica Merrill Lynch High Yield Master Index widened one basis point to end last week at +343. Similarly, in the U.S. Treasury bond market, volatility was muted. The 2-year and 5-year Treasury bonds tightened 3 basis points each to end the week at 2.64% and 2.81%, respectively, whereas the 10-year was unchanged at 2.95% and the 30-year rose only one basis point to 3.09%.

In the new issue corporate bond market, according to Bloomberg, the amount of new issuance slipped to $7.8 billion last week as compared with its forecast of $20 billion. While activity was muted, those companies that came to market found a receptive investor base and those new issues were heavily oversubscribed. That allowed those companies to tighten price talk and issue their new bonds on top of the levels where their existing bonds were trading, as opposed to typically having to issue new bonds at a concession. The new issue market is expected to remain subdued over the next few weeks as the corporate bond market typically slows down during August.

Corporate Bond Credit Spreads



Source: Morningstar,Inc., BofA Merrill Lynch Global Indexes. Data as of 8/3/2018.

As we have highlighted in our credit notes over the past few weeks (available at www.morningstarcreditratings.com), second-quarter earnings reports have continued to be robust. Companies in economically sensitive sectors showed the greatest top-line increase, often well into double-digit percentage gains on a year-over-year basis. For example, Concho Resources (rating: BBB-, positive) reported second-quarter operating revenue of $945 million, a whopping $378 million (67%)

increase relative to $567 million in the second quarter of 2017. This gain was largely driven by growth in Texas Permian oil sales volumes and higher oil price realizations. Elsewhere in the energy sector, Anadarko Petroleum (rating: BBB-, stable) reported a 21% increase in second-quarter revenue to $3.3 billion, largely reflecting growth in U.S. onshore oil sales volumes and higher global oil price realizations. Industrial companies that provide services to the energy sector went along for the ride and also posted double-digit revenue increases. As an example, National Oilwell Varco, (rating: BBB+, stable) reported an almost 20% increase in second-quarter revenue to $2.1 billion from $1.8 billion reported in the year-ago quarter.

Similar to the energy sector, the basic materials sector is highly correlated to economic activity and experienced strong growth. Vulcan Materials Company (BBB-, stable) reported that its second-quarter revenue increased 16% to $1.2 billion for the quarter. US Steel's (B, positive) second quarter revenue increased 15% to $3.6 billion and the company then subsequently increased its earnings guidance for the year.

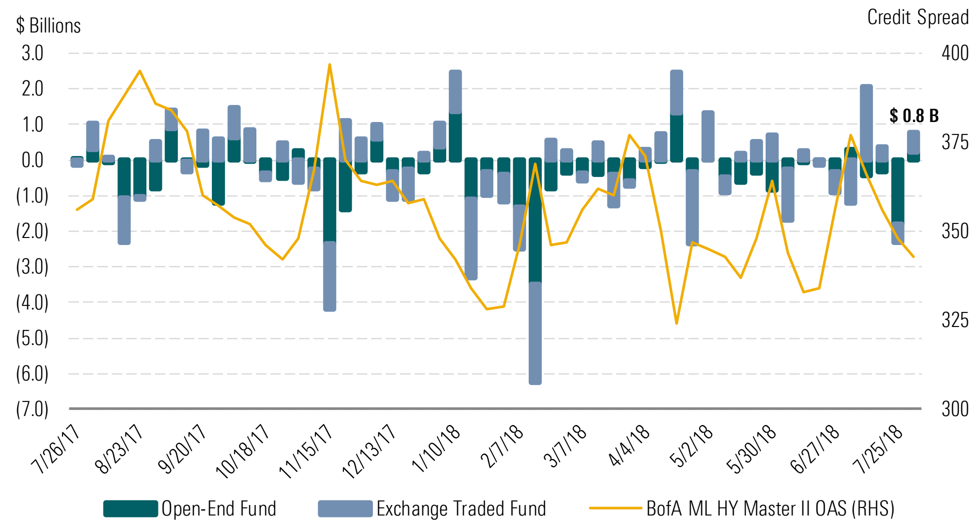
However, while an expanding economy lifted all boats in the cyclical sectors, there have been companies that experienced idiosyncratic issues last quarter. To the downside, Teva Pharmaceutical Industries' (BB, stable) operational woes were evident in the second quarter as total revenue dropped 17.8% to $4.7 billion, mainly from continued tough pricing within the U.S. generic market and erosion of Copaxone sales by 39.6%, including a 46% decline in U.S. due to generic competition. Despite Teva's debt load dropping since the end of 2017, gross debt leverage ticked up to 5.5 times for the latest 12 months versus 5.3 times in 2017. We had recently downgraded Teva to BB from BBB- in March 2018, reflecting the firm's difficult path ahead as it tries to reverse declining operational performance while handcuffed by high financial leverage.

Morningstar Credit Ratings issues credit ratings on over 250 corporate and financial institutions. For detailed analysis and research, please see our credit notes published under the Research tab at: www.morningstarcreditratings.com.

Weekly High Yield Fund Flows

Investors returned to the high yield market as high yield fund inflows reached $0.8 billion, consisting of $0.6 billion of net unit creation among the high yield exchange traded funds and inflows of $0.2 billion into high yield open end mutual funds. Year to date, fund flows have registered a total outflow of $15.9 billion, consisting of $3.9 billion of net unit redemptions across the ETFs and $12.1 billion of redemptions among the open end funds.

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



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

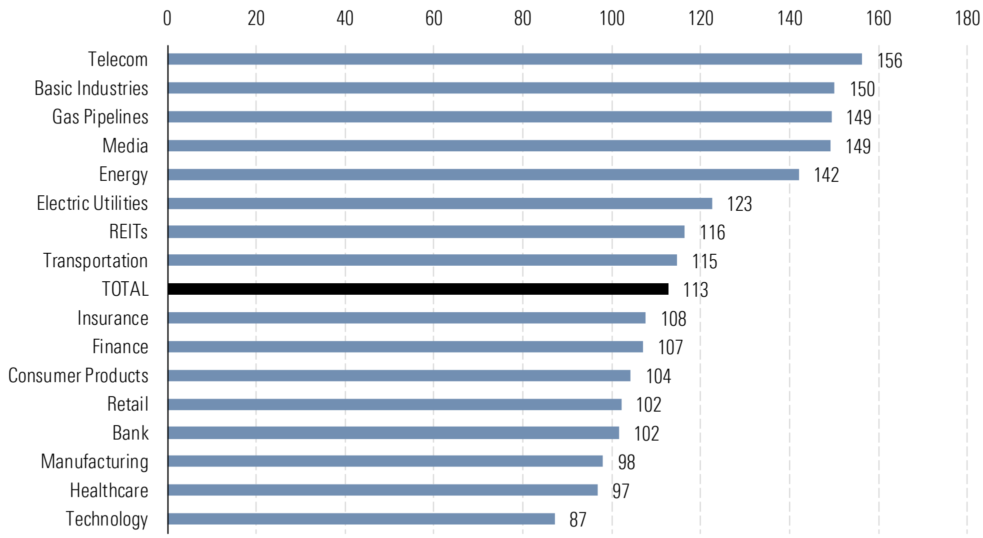
Exhibit 1 Morningstar, Inc. Corporate Bond Index Sector Summary

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-**	**5,099**	**6.9**	**112**	**(1)**	**16**	**0.12**	**(2.21)**
FINANCIAL	**A-**	**1,491**	**5.3**	**103**	**(1)**	**19**	**0.20**	**(1.82)**
Bank	A-	912	4.8	100	(2)	20	0.22	(1.58)
Finance	A-	268	5.6	107	(0)	19	0.14	(2.08)
Insurance	A	216	8.1	108	(0)	22	0.14	(2.93)
REITs	BBB+	86	5.8	116	(2)	12	0.21	(1.84)
INDUSTRIAL	**A-**	**2,955**	**7.5**	**115**	**(0)**	**14**	**0.08**	**(2.38)**
Basic Industries	BBB	241	7.6	150	1	21	0.02	(2.87)
Consumer Products	BBB+	351	7.5	104	(0)	20	0.07	(3.01)
Energy	A-	403	7.4	142	1	19	0.04	(2.17)
Healthcare	A-	416	7.7	96	(1)	8	0.12	(2.52)
Manufacturing	A-	458	5.9	97	(2)	16	0.14	(2.13)
Media	BBB+	169	8.5	148	(0)	19	0.09	(2.96)
Retail	A-	168	7.8	101	(1)	14	0.10	(2.49)
Technology	A+	354	7.3	86	0	9	0.11	(1.95)
Telecom	BBB+	168	9.1	155	(0)	12	(0.01)	(1.72)
Transportation	BBB+	169	8.9	114	(0)	16	0.02	(3.13)
UTILITY	**BBB+**	**600**	**8.7**	**134**	**(1)**	**14**	**0.15**	**(2.73)**
Electric Utilities	A-	346	9.2	122	(0)	19	0.07	(3.60)
Gas Pipelines	BBB	239	7.9	149	(3)	5	0.25	(1.43)
Rating Bucket								
AAA Bucket		124	7.6	48	(2)	0	0.05	(2.14)
AA Bucket		510	5.6	65	(1)	7	0.12	(1.46)
A Bucket		1,931	6.8	90	(1)	16	0.14	(2.38)
BBB Bucket		2,534	7.2	145	(0)	17	0.11	(2.23)
Term Bucket								
1-4	A-	1,672	2.3	67	(1)	10	0.15	0.14
4-7	A-	1,182	4.8	102	0	23	0.23	(1.23)
7-10	A-	891	7.0	125	(1)	19	0.16	(2.56)
10PLUS	A-	1,354	13.6	163	(0)	18	(0.01)	(5.24)

Data as of 08/03/2018

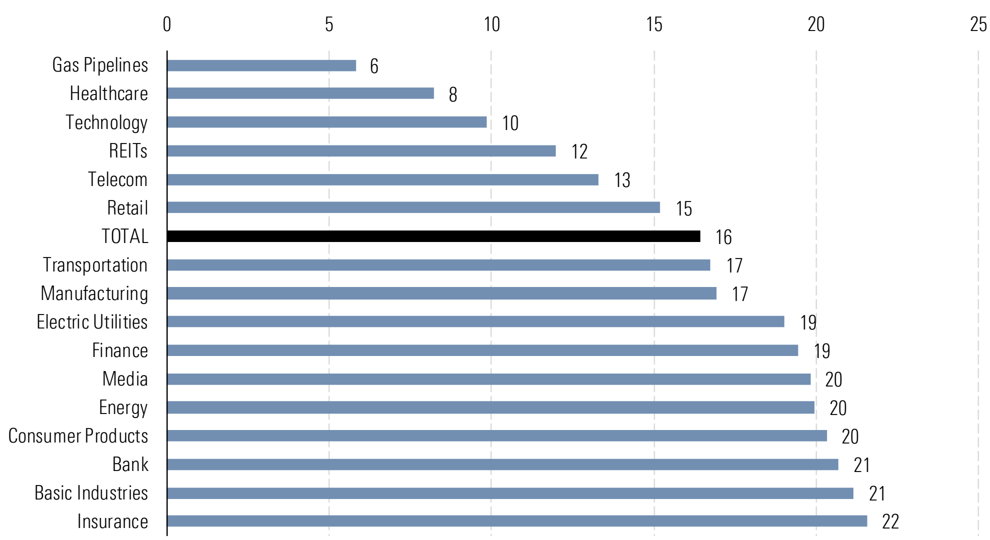
Source: Morningstar, Inc.

Exhibit 2 Morningstar, Inc. Corporate Bond Index Spread by Sector



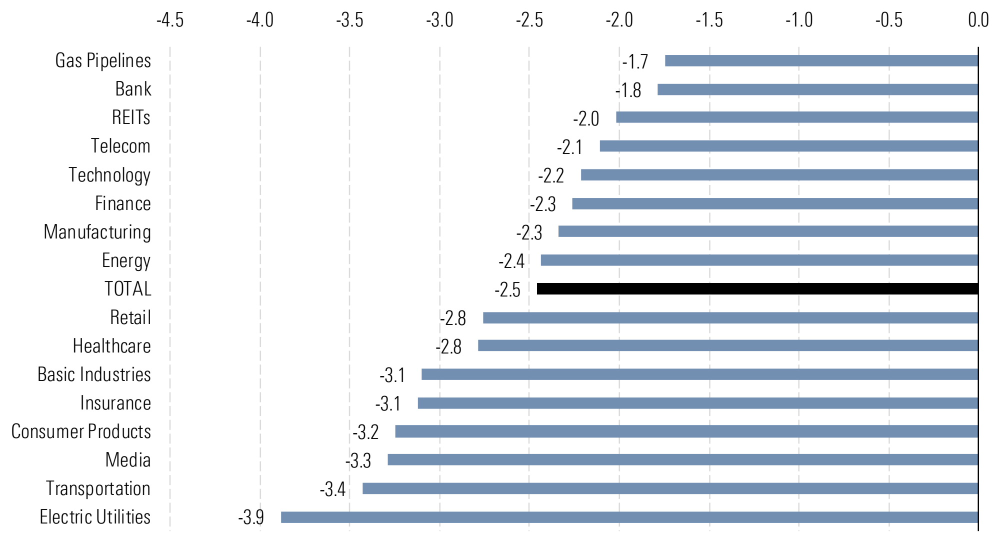
Source: Morningstar, Inc.

Exhibit 3 Morningstar, Inc. Corporate Bond Index YTD Spread Change



Source: Morningstar, Inc.

Exhibit 4 Morningstar, Inc. Corporate Bond Index YTD Return



Source: Morningstar, Inc.

Credit Rating Actions

► Rating Affirmations

Issuer/Ticker	Current Issuer Credit Rating	Previous Issuer Credit Rating
Lowe's Companies LOW	A	A
The Home Depot HD	A+	A+
Franklin Resources BEN	AA-	AA-

Morningstar Credit Ratings Releases Updated Ratings for Lowe's Companies Inc

Morningstar Credit Ratings, LLC, or MCR, is affirming Lowe's Companies corporate credit rating at A and maintaining a stable outlook. Lowe's credit rating continues to be supported by competitive advantages in home-improvement retailing, consistent free cash flow generation, and adherence to a moderate leverage target.

Lowe's is the second-largest home improvement retailer globally, which positions it well to benefit from a healthy U.S. housing market. Lowe's competitive advantages include its large scale that enables it to negotiate advantageously with vendors, while a low-cost position is supported by an automated distribution network that integrates its vendors, distribution centers, and stores. Morningstar believes Lowe's brand is a strong intangible asset, as evidenced by a loyal customer base that relies on the expertise and knowledge of its store-based employees. The company’s low Business Risk (score 3/10) reflects these attributes, which is supported by a wide economic moat as assigned by Morningstar’s Equity Research Group. Lowe’s profitability improvement over the past several years has also been aided by a strong home improvement market, which is expected to continue to benefit from growth in real disposable income, a low unemployment rate, rising home prices, and increased housing turnover. The company has further added to growth from acquisitions, such as the 2016 purchase of Rona that created one of Canada's leading home improvement retailers and the 2017 acquisition of Maintenance Supply Headquarters that expanded its position in the maintenance, repair, and operations market. Lowe’s moderate Solvency Score (score: 5/10) reflects ongoing improvement in the company’s return on invested capital, which was 19% in 2017 compared with a low-teens return a few years ago.

Lowe’s maintains an adjusted leverage target of 2.25 times EBITDA (adjusted for 6 times rent). Morningstar calculates the company’s adjusted debt leverage (8 times rent) at 2.4 times at the end of the first quarter of 2018, consistent with the last couple years. The quarter-end adjusted debt balance of $21 billion is largely composed of $15 billion of unsecured notes, a $5 billion adjustment for operating lease commitments, and modest capital lease obligations. Liquidity includes $1.8 billion in cash and short-term investments and full availability under its $1.75 billion revolver that matures in 2021. The credit facility supports Lowe’s commercial paper program, and there were no borrowings outstanding under the commercial paper program at the end of the first quarter. Net adjusted debt leverage was 2.2 times in the most recent quarter. Lowe’s moderate Cash Flow Cushion (score: 5/10) reflects steady cash flow generating capacity and a laddered debt maturity schedule, offset by substantial shareholder distributions. Debt maturities extend over 30 years with near-term debt maturities for the next five years approximating 25% of total long-term debt. Morningstar forecasts that with growing EBITDA and free cash flow, adjusted debt leverage could decline modestly over the next several years.

A stable outlook on Lowe’s rating reflects Morningstar’s expectation for continued solid operating performance, a healthy U.S. housing market, and maintenance of a modestly leveraged capital structure. Lowe's rating could be raised if the company generates higher margins and return on invested capital along with a lower targeted adjusted debt level, which could lead to a better Solvency Score and Cash Flow Cushion. The company’s credit rating could be lowered if weaker profitability and higher leverage impair the Solvency Score and competitive position of the company.

Morningstar Credit Ratings Releases Updated Ratings for The Home Depot Inc
Morningstar Credit Ratings, LLC is affirming Home Depot’s corporate credit rating at A+ and maintaining a stable outlook. Home Depot’s credit rating continues to be supported by competitive advantages, accelerating free cash flow, and the maintenance of a moderately leveraged balance sheet.

Home Depot is the world's largest home-improvement retailer with an approximate 17% share of the estimated $600 billion U.S. market, which includes the $200 billion home services market and the $50 billion maintenance, repair, and operations market. Home Depot’s competitive strengths include its large scale, breadth of product offerings, and low-cost operations that allow it to provide everyday low pricing. Home Depot’s low Business Risk (score 3/10) reflects these attributes and is supported by a wide economic moat as assigned by Morningstar’s Equity Research Group. The company generates over $100 billion of revenue, providing it with a strong negotiating position with merchandise vendors and other suppliers. Productivity improvements continue to expand operating margins, as supply chain optimization programs have improved distribution center efficiency, reduced lead times with suppliers, lowered transportation costs, and improved inventory turns. Going forward, further margin expansion will be somewhat tempered by accelerated investment in new distribution facilities, including direct fulfillment centers and local hubs that will support its growing online business and expand faster direct delivery to customers. Home Depot’s strong Solvency Score (score: 4/10) reflects further expected improvement in the company’s return on invested capital, which was 32% in 2017 and compares with a return that was in the high-teens only five years ago. Morningstar forecasts low- to mid-single-digit revenue growth over the next several years driven by additional market share gains and a continued healthy housing market that has translated into strong 6% average comparable sales increases over the past three years.

Management at Home Depot maintains an adjusted debt to EBITDA target of 2 times. Morningstar calculates that adjusted leverage has remained within a range of 1.7-2.0 times for the past several years, including 1.9 times at the end of the first quarter ended April 29. The quarter-end adjusted debt balance of $34 billion is largely composed of approximately $25 billion of senior unsecured notes, an $8 billion adjustment for operating lease commitments, and modest capital lease debt and commercial paper borrowings. In December 2017, the company extended the maturity for its existing $2.0 billion credit facility to December 2022 and it also added a new 364-day $1.0 billion credit facility. Liquidity is supported by $3.6 billion in cash, most of which is held outside U.S., $1.65 billion of availability under its $2.0 billion credit facility (including $350 million drawn under its commercial paper program), and full availability under its new 364-day $1.0 billion facility. The credit facilities are used as commercial paper backup and contain various restrictive covenants. At the end of the first quarter adjusted net leverage was 1.7 times. Home Depot's moderate Cash Flow Cushion (score: 6/10) reflects its accelerating cash flow generating capacity offset by substantial shareholder distributions, along with a laddered debt maturity schedule. The weighted average maturity of the company's debt is about 14 years, and maturities extend nearly 40 years. Near-term debt maturities over the next five years approximate only 30% of total long-term debt. Morningstar forecasts that with growing EBITDA and free cash flow, adjusted debt leverage could decline modestly over the next several years.

A stable outlook reflects the company's maintenance of prudent debt leverage, management's focus on continued productivity improvements that support strong return on invested capital, and Morningstar's expectation that the housing market will remain favorable for the next few years. Additional margin and return on invested capital improvement along with lower debt leverage targets and shareholder distributions could result in a better Solvency Score and a higher credit rating. Alternately, Home Depot's rating could be lowered if margins and returns decline over the next several years, most likely from a slowdown in the housing market as opposed to increased competition. These factors could lead to a deterioration in any one of Home Depot's pillar scores.

Morningstar Credit Ratings Releases Updated Ratings for Franklin Resources Inc

Morningstar Credit Ratings, LLC has affirmed Franklin Resources, Inc.'s consolidated corporate credit rating of AA- and revised the outlook to stable from negative. Franklin's credit rating reflects the strength of its balance sheet and the profitability of its business despite a challenging business environment.

Franklin Resources is one of the strongest credits in Morningstar's financial services universe. The firm's size gives it the advantage of scale relative to most other asset managers. Franklin's product mix is diverse, with its $724 billion in assets under management as of June 30 spread across equity (43%), fixed-income (37%), multi-asset (19%), and cash-management (1%) strategies. While product distribution is weighted more toward less-sticky retail investors (74% of AUM at fiscal year-end 2017), the firm has strong relationships with financial advisors. Franklin's global operations provide positive diversification benefits, with about 50% of AUM invested in global/international strategies and one third of managed assets sourced from clients domiciled outside the United States.

Our credit rating reflects Franklin's continued financial strength despite the negative business trends it faces, which include sustained net asset outflows and the underperformance of its value-driven asset management strategies. Over the past decade, the firm's debt/total capital has averaged around 11%, and debt/EBITDA has averaged around 0.4 times. Franklin's balance sheet was further bolstered in May by the company's redemption of $350 million in debt due 2020, which reduced its debt/EBITDA ratio to 0.3 times. Franklin remains very profitable, with an operating margin in the mid-30s and adjusted returns on invested capital projected to remain above 30% throughout our five-year forecast.

Franklin performs very well in our credit risk assessment. Its low Business Risk score reflects its large size, wide economic moat assigned by Morningstar's Equity Research Group, and very low dependence on capital markets, but it is limited by the company's focus on active investment strategies and the cyclicality of its business. Franklin's $6.4 billion of cash and cash equivalents as of June 30 is more than 9 times its $0.7 billion debt balance, which supports the company's strong Cash Flow Cushion score. Franklin receives a very strong Solvency Score in our credit rating model due to stellar ROIC and fixed-charge coverage as well as reporting a low ratio of total liabilities to total assets and a very high quick ratio. The company's Distance to Default score is also very strong.

Our stable outlook implies that we do not expect to change our rating over the next 1-2 years, as we expect Franklin's credit metrics to remain stable even if the current negative business trends continue. However, we could take a negative rating action if the company's debt/EBITDA increases to 1.5 times, possibly as a result of a debt-funded acquisition or large and sustained AUM outflows that lead to a significant decrease in earnings, or if Franklin loses its wide Economic Moat rating. In contrast, we may consider a positive rating action if Franklin reports sustained net AUM inflows that lead to a material increase in revenue and free cash flow.

Recent Notes Published by Credit Analysts

NOV Reports Solid 2Q Results Led by Strong Uptick in Rig Technologies Segment07/30/2018

MCR Credit Risk Assessment

On July 27, National Oilwell Varco, or NOV, (rating: BBB+, stable) reported second-quarter revenue of $2.1 billion, a solid $347 million (20%) increase over the $1.8 billion reported in the year-ago quarter. Commensurate with revenue, operating income was $52 million, a $114 million increase from an operating loss of $62 million in second-quarter 2017.

On a sequential basis, company revenue across all three business segments--Wellbore Technologies, completion and production solutions, and rig technologies--rose in the second quarter (20% increase), primarily driven by the continuing surge in North American land-based activity and, secondarily, reviving activity across most international land markets. However, demand for NOV's products and services related to offshore remains lethargic. On the earnings conference call, management stated that the rate of decline for offshore activity is moderating and, with tendering increasing, expect offshore to bottom in the second half of this year. For second-quarter 2018, NOV reported $176 million free cash flow, after capital expenditures of $63 million, but before cash dividends of $19 million and $280 million spent on four bolt-on acquisitions.

On June 28, the rig technologies segment finalized creation of a joint venture with Saudi Aramco that resulted in an order for 50 onshore drilling rigs (delivered over a 10-year period, first rig in 2021) for the Kingdom of Saudi Arabia. The company reports that this is the single largest land-rig order ever placed by anyone. After steadily declining for nearly the past three years, the backlog for Rig Technologies jumped to $3.5 billion at the end of the quarter, including $1.8 billion associated with the new Saudi Aramco joint venture and the highest backlog for this segment since fourth-quarter 2015. A leaned-out cost structure and improving equipment utilization position the company to benefit from a broader upturn in demand for oilfield services, assuming the oil price continues to rise. We continue to project that cash flow less total capital expenditures and dividends will be approximately $250 million for full-year 2018.

At June 30, NOV's liquidity remains excellent, with $1.1 billion in cash and equivalents and full availability on its $3.0 billion revolving credit facility (matures June 2022). We estimate full-year 2018 capital expenditures to be $250 million, 30% more than $192 million spent in 2017. Long-term borrowings include $1.4 billion due in December 2022 and $1.1 billion in 2042, so the near-term debt maturity schedule is not a concern.

At the end of June, total debt was $2.7 billion and net debt $1.6 billion. We estimate last 12-months debt/adjusted EBITDA for NOV to be 3.6 times and net leverage 2.1 times, incorporating reported trailing 12-month adjusted EBITDA of $750 million. The total debt ratio has declined by 6.4 turns and net leverage by 3.5 turns since the end of 2016, mostly resulting from rebounding cash flow and, to a lesser extent, the reduction in short-term borrowings last year.

Market Data
NOV can be compared with Halliburton (BBB+, positive), which is a larger, more diversified oilfield-services peer. According to pricing service Interactive Data, NOV's 2.60% notes due in 2022 recently traded at +114 basis points over the nearest Treasury. By comparison, the 3.25% notes due in 2021 from Halliburton recently traded at +48 basis points. Another key comparable within oilfield services is Baker Hughes, a GE Co. (BBB+, stable), for which the 2.77% notes due in 2022 recently traded at +68 basis points over the nearest Treasury.

Pfizer (AA-, Stable) Accelerated Revenue Growth in 2Q; Returned $10.1 Billion to Shareholders in 1H
MCR Credit Risk Assessment
On July 31, Pfizer Inc. (AA-, stable) saw improving top-line growth in the second quarter of 4% on a reported basis (2% on an operational basis) that drove up adjusted net income growth by 19%. This compares with the modest first-quarter sales performance of 1% on a reported basis (2% decline operationally) mainly due to the U.S. patent expiration of erectile dysfunction medication Viagra in December 2017. While Pfizer still faces the loss of U.S. market exclusivity for top-selling Lyrica (nerve pain) in 2019, we estimate that the firm can successfully navigate its patent cliff and generate revenue and EBITDA growth over the next five years, which informs our stable outlook.

Pfizer's revenue growth in the second quarter comprised an 8% rise in reported sales (up 5% operationally) from the innovative health segment and a 1% decline in sales (down 4% operationally) from the essential health division. Overall growth was bolstered by strong growth of key pharmaceuticals—cancer treatments Ibrance (up 19% operationally) and Xtandi (rose 21%), blood thinner Eliquis (jumped 42%), and autoimmune disorder medicine Xeljanz (increased 37%). With foreign exchange rates acting as a sustained headwind, Pfizer revised its sales expectations downward for 2018 to $52 billion-$55 billion (from $53.5 billion to $55.5 billion previously), which represents a 2.8% increase at the midpoint of the range from 2017. Thanks to a lower tax rate of 16% (down from 17%) and extra income from asset sales and equity gains, the firm revised its target for adjusted EPS in 2018 to $2.95-$3.05 compared with $2.90-$3.00. We anticipate that Pfizer may produce sales and EBITDA growth in the mid-single digits compounded annually, including continued strong demand for Xeljanz stemming from additional indications, and cancer treatments Ibrance and Bavencio from expanded clinical utility. We also expect contributions from commercialization of a broad late-stage research pipeline to enhance the firm's growth prospects after annualizing the Lyrica patent lapse in 2020.

Since Pfizer does not offer balance sheet details with its quarterly releases, we estimate that Pfizer's total debt leverage was relatively consistent with the first-quarter 2018 level of 2.0 times even though the firm could have reduced its commercial paper borrowings ($4 billion on March 31). Moreover, if the firm repaid around $2.3 billion of unsecured debt that matured in June, gross debt leverage would have only slightly moderated because of its large debt load of $40.8 billion at the end of the first quarter. Pfizer does have the financial flexibility to manage more than $11.0 billion in debt maturing in 2019 to 2022 with free cash flow that we forecast may average over $17 billion annually through 2022 together with its cash and investments balance ($11.4 billion as of March 31). But, we see Pfizer prioritizing shareholder rewards and tuck-in business development over debt reduction as exemplified by $10.1 billion of dividends and share repurchases in the first half of 2018. As such, we continue to expect increasing EBITDA as the main lever for leverage improvement over the intermediate term, which is reflected in our stable outlook.

Market Data

For closest comparison to Pfizer's bonds, we look to similarly rated companies, Roche Holding AG (AA-, stable) and Bristol-Myers Squibb Co. (AA-, stable). Adjusted for bond maturities, Pfizer's bonds due 2026 traded tighter than the bonds of this similarly rated peer group. All the following bond data was sourced from Interactive Data.

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

Pfizer's 3.00% notes due 2023 at +38 basis points;
Roche's 1.75% notes due 2022 at +51 basis points; and
Bristol Myers Squibb's 2.00% notes due 2022 at +59 basis points.

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

Pfizer's 2.75% notes due 2026 at +56 basis points;
Roche's 2.38% notes due 2027 at +70 basis points; and
Bristol Myers Squibb's 3.25% notes due 2027 at +76 basis points.

For comparison to the approximate 10-year maturities, Morningstar Inc.'s Corporate Bond Index is at +67 basis points in the AA category.

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

Pfizer's 4.40% notes due 2044 at +104 basis points;
Roche's 4.00% notes due 2044 at +98 basis points; and
Bristol Myers Squibb's 4.50% notes due 2044 at +103 basis points.

Vulcan Materials (BBB-, stable) Posts 13% Increase in 2Q Adjusted EBITDA

MCR Credit Risk Assessment

Vulcan Materials Company (BBB-, stable) reported second-quarter results today that had its quarterly adjusted EBITDA increasing to $325 million from $288 million in the year-ago period, a 13% increase. Top-line revenue increased 16% to $1.2 billion for the quarter. Shipments for aggregates increased 15% over the prior year and its selling price rose 3% compared with last year's level. Debt was approximately $3.2 billion at the end of June and we estimate that latest 12-month adjusted EBITDA was $1 billion resulting in debt/LTM adjusted EBITDA of slightly over 3 times. We forecast that leverage will decrease to under 3 times by the end 2018 driven by a modest increase in adjusted EBITDA in the second half of the year. Free cash flow for the first six months of 2018 was approximately $30 million and cash on hand at the end of the quarter was $55 million.

Vulcan's rating reflects its moderate risk profile for its Business Risk and Solvency Score, a constrained Cash Flow Cushion, and a strong Distance to Default score. While the firm's Business Risk benefits from a narrow economic moat as assigned by Morningstar's Equity Research Group, it is somewhat adversely affected by product concentration and long-term industry cyclicality. The company's Cash Flow Cushion is supported by good operating cash flow but constrained by principal maturities, capital spending, operating lease payments, dividend requirements, and other miscellaneous items. Vulcan's Solvency Score is supported by moderate leverage and good interest coverage, and its Distance to Default reflects its large equity market capitalization relative to its debt balance.

Market Data
According to Interactive Data, Vulcan Materials' 3.9% notes due April 1, 2027, recently traded at a spread of +160 basis points to the nearest Treasury. Meanwhile similarly rated competitor Martin Marietta's (BBB-, stable) 3.45% notes due June 1, 2027, recently traded at a spread of +152 basis points. For an index comparison, we look to the Morningstar BBB- Corporate Bond Index, which is quoted at a spread of +167 basis points.

ArcelorMittal (BB+, Stable) Boosted by Higher Steel Prices;28.6% Increase in 1st Half EBITDA YoY
MCR Credit Risk Assessment
ArcelorMittal Posts (BB+, Stable) reported today that first-half 2018 EBITDA increased to $5.6 billion from $4.3 billion, a 28.6% increase. The results were driven by higher steel prices (+16.7% year over year) and a 1.3% increase in steel shipments. Free cash flow for the first half was negligible largely because of working capital usage ($3.1 billion). Gross debt ended June 30 was $13.6 billion and cash and equivalents on hand was $3.1 billion. We estimate latest 12-month EBITDA at approximately $9.5 billion, which is the highest level since 2011. Resulting debt/LTM EBITDA is 1.4 times. The company is further burdened by approximately $9 billion of underfunded pension and other postretirement obligations, which raises its adjusted leverage another turn of EBITDA. ArcelorMittal's liquidity is further supplemented by $5.5 billion in aggregate availability in revolving credit facilities due December 2019 and December 2021. Debt maturities are $3.3 billion yet in 2018, $1.4 billion in 2019, $2.1 billion in 2020, $1.7 billion in 2021, and $3.3 billion in 2022.

In terms of capital allocation, the company maintains deleveraging as its priority with a net debt target of $6 billion. After that, priorities are to invest in its assets and growth and, third, shareholder returns. ArcelorMittal aims to increase shareholder returns once its net debt target is achieved.

ArcelorMittal's credit rating reflects its high Business Risk credit pillar, combined with moderate risk profiles for its Cash Flow Cushion, Solvency Score, and Distance to Default credit pillars. Its Business Risk is burdened by the industry in which it operates--steel--which is characterized by overcapacity, cyclicality, and a lack of product diversification. The company's Cash Flow Cushion reflects good operating cash flows offset by necessary capital spending levels and a heavy near-term debt maturity schedule. Its Solvency Score is supported by moderate leverage and interest coverage, and its Distance to Default risk profile is evidenced by market capitalization of its equity of $33 billion, compared with balance sheet debt balance of $13.6 billion.

Market Data

According to pricing from Interactive Data, ArcelorMittal's 6.125% notes due June 1, 2025, recently traded at 108.3 to yield 4.69%. For comparison, we look to Arconic Inc. (rating: BB+, stable) and its 5.125% notes due Oct. 1, 2024, which recently traded at 99.8 to yield 5.17%. For index comparison, we reference the BofA Merrill Lynch High Yield BB Index (Yield to Worst) which is at 5.27%.

Anadarko Petroleum (BBB-, Stable) Posts 43% Increase in 2Q Operating Cash Flow Versus Year Ago

MCR Credit Risk Assessment

After the market closed on July 31, Anadarko Petroleum (rating: BBB-, stable) reported second-quarter revenue and other of $3.3 billion, a $575 million (21%) increase relative to $2.7 billion in the second quarter of 2017, largely reflecting growth in U.S. onshore oil sales volumes and higher global oil price realizations. Commensurate with this, net cash provided by operating activities was $1.2 billion, a large $368 million (43%) increase from $857 million in the year-ago quarter (adding back impairments of $128 million and $10 million, respectively). After total capital expenditures of $1.8 billion (includes $301 million spent by Western Gas Partners, LP, not rated), we estimate Anadarko's second-quarter free cash flow was negative $575 million. Total liquidity of $7.3 billion remains very good, in our view, including $2.3 billion in cash and equivalents and full availability on an aggregate $5.0 billion unsecured revolving credit facilities. The next significant debt maturities include $350 million due in August 2018, $900 million in 2019, $1.3 billion in 2021, and $670 million in 2022.

Actual second-quarter 2018 oil-equivalent sales were 58 million barrels of oil equivalent, or boe, slightly higher than the guidance midpoint of 57 million boe. The second quarter was characterized by better-than-expected oil production from the Delaware Basin (Texas) and, secondarily, the DJ Basin (Colorado). The third-quarter sales guidance midpoint is 62.5 million boe (excludes Alaska and offshore Ram Powell due to divestitures), which is about an 8% increase, sequentially. The recent startup of two oil treating facilities by Anadarko and its access to expanding crude oil pipeline transportation capacity to higher-priced Gulf Coast markets are key components that facilitate the company’s drive to increase oil output from the Delaware Basin. Based on actual first-half 2018 results and third-quarter guidance, Anadarko's new full-year 2018 production guidance is 240 million-250 million boe (post-disposition), unchanged from prior, which we think is achievable.

Anadarko increased full-year 2018 capital investment guidance by $250 million for operated and non-operated activities, and non-consents, for a new range of $4.5 billion to $4.8 billion. Including $1.35 billion-$1.45 billion capital investment guidance by Western Gas Partners, LP, we now estimate total 2018 capital expenditures for Anadarko to be $6.05 billion. For the first six months of 2018, the company repurchased about $2 billion of common stock and has announced a new share buyback increment of $1 billion, authorized to June 30, 2019. For full-year 2018, we now estimate cash flow less total capital expenditures, dividends, and share repurchases, plus $500 million net proceeds from dispositions to be negative $300 million.

At the end of June, Anadarko's consolidated debt was $16.3 billion and net debt $14.0 billion. Anadarko's ratio of total debt-to-trailing, 12-month adjusted EBITDAX is 2.6 times and net leverage 2.2 times, the ratios having declined by 1.2 turns and 0.8 turns, respectively, since the end of 2016. As of June 30, we estimate trailing 12-month adjusted EBITDAX to be $6.4 billion.

Anadarko has more debt than Apache Corp. (rating: BBB-, positive outlook), a smaller, U.S.-centric exploration and production peer. At March 31, Apache had gross leverage of 2.2 times. Pioneer Natural Resources (rating: BBB) is a similarly sized Texas Permian-focused E&P comparable. At the end of March, Pioneer had gross leverage of 1.0 time, also less than Anadarko.

Market Data
According to pricing service Advantage Data, the 2.63% notes due Jan. 15, 2023, from Apache recently traded at +99 basis points over the nearest Treasury. By comparison, Anadarko's 3.45% notes due in 2024 recently traded at +111 basis points. Additionally, the 3.95% notes due July 15, 2022, from Pioneer Natural Resources recently traded at +78 basis points over the nearest Treasury.

AmerisourceBergen (A, Stable) Beats 3Q Expectations and Maintains Guidance Despite Ongoing Challenges

MCR Credit Risk Assessment
On Aug. 2, AmerisourceBergen Corp. (A, stable) turned in fiscal third-quarter operating results that beat consensus on the top and bottom lines. Although healthcare supply chain players face operating challenges, such as the ongoing Amazon threat and potential changes to pharmaceutical pricing, we are pleased to see positive operating trends in its core distribution business, and we believe distributors, including AmerisourceBergen, can defend their turf in a more challenging environment. Considering these dynamics and the firm's easily manageable leverage after the recent H.D. Smith acquisition, we maintain a stable view of AmerisourceBergen's credit profile.

In the quarter, revenue grew 11.5% to $43.1 billion (above consensus of $42.9 billion), adjusted operating income rose 0.7%, and adjusted earnings per share increased 7.7% to $1.54 (above consensus of $1.46), reflecting continued solid results in the core distribution business and tax-reform-related benefits. In its core distribution business, adjusted operating income grew 3.3%, and the company noted strength in its anchor clients and specialty business. Specifically, the Walgreens Boots Alliance Inc. (BBB, stable) relationship remains strong, and the distributor is benefiting from the first full quarter of onboarding Walgreens' recently acquired Rite Aid stores. Also, AmerisourceBergen recognized its 18th consecutive quarter of double-digit growth in its specialty distribution business, which offers oncology and physician-administered therapies. The Other segment’s adjusted operating income declined 9.9%. While the World Courier business (transportation and logistics for the biopharmaceutical industry) continued to perform well, the other businesses in this segment, specifically Lash consulting and MWI animal health, remain drags on the segment. Overall, though, the company maintained its outlook for fiscal 2018. Guidance still includes revenue growth of 8%-11%, flat operating income growth, free cash flow of $1.35 billion to $1.60 billion, and 10% to 13% adjusted earnings per share growth to $6.45-$6.65 in fiscal 2018.

On the call, management also addressed several internal and external factors that could influence its results over time. First, PharMEDium's Memphis facility, which represents about half of that business' sterile compounding production capacity, is now back open and operational. The company anticipates that the facility will begin shipping commercially later this month, assuming regulators approve, which should remove that headwind going forward. Externally, distributors generally face a changing operating landscape, but we think AmerisourceBergen can manage through these challenges. After Amazon's recent acquisition of online pharmacy PillPack, volumes at more traditional retailers could be siphoned off, assuming Amazon can successfully expand PillPack's reach. Eventually, that may negatively influence volume at distributors such as AmerisourceBergen, but we believe this threat will remain on the margins for distributors in the intermediate term. Also, the debate about pharmaceutical pricing and rebates rages on, and there is a concern that distributors could suffer if manufacturers lower prices to the net rather than gross list price. However, management reiterated that most of its business actually comes from a fee-for-service model rather than being dependent on price inflation. Also, the AmerisourceBergen team believes that its manufacturer customers appreciate the value that it brings to the pharmaceutical marketplace. Therefore, management expects future contract negotiations to reflect the ongoing value it provides to manufacturers and will properly adjust for the changing pricing dynamics going forward. While uncertainty surrounds this situation, we suspect that distributors have enough power in the supply chain to receive a fair value for their services to manufacturers.

From a credit perspective, AmerisourceBergen maintains a conservative balance sheet relative to its key distribution peers, Cardinal Health Inc. (A-, stable) and McKesson Corp. (A-, stable), supporting our one-notch-higher rating for the company. Pro forma for the recent H.D. Smith acquisition, we estimate AmerisourceBergen's lease-adjusted leverage stands around 2 times, which remains roughly a turn lower than its key distribution peers, by our estimates. These leverage differences reinforce our higher credit rating on AmerisourceBergen, and our outlook on its rating remains stable.

Market Data
We use AmerisourceBergen's drug distribution peers as its credit comparables. AmerisourceBergen's bonds recently traded roughly in line with its peers on a spread basis, but in the 10-year maturity bucket, its bonds traded well wide of the A category of Morningstar Inc's Corporate Bond Index. We sourced all the following bond data from Interactive Data:

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

AmerisourceBergen's 3.45% notes due in 2027 at +147 basis points
Cardinal's 3.25% notes due in 2027 at +156 basis points

McKesson's 3.95% notes due 2028 at +146 basis points

For comparison to the 10-year maturity bucket, Morningstar, Inc.'s Corporate Bond Index is at +91 basis points in the A category and +103 basis points in the A- category.

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

AmerisourceBergen's 4.30% notes due in 2047 at +194 basis points
Cardinal's 4.34% notes due in 2047 at +203 basis points
McKesson's 4.88% notes due in 2044 at +182 basis points

Teva (BB, Stable) Raises 2018 EBITDA and Cash Flow Outlook at 3Q Call; Debt Reduction Remains Top Cash Priority

MCR Credit Risk Assessment

On Aug. 2, Teva Pharmaceutical Industries Ltd. (BB, stable) was able to generate free cash flow in the second quarter despite sustained revenue pressures from a difficult pricing environment in the U.S. generic drug market and ongoing generic U.S. competition to its top-selling multiple sclerosis medicine Copaxone. The firm aims to direct cash flow to reducing its currently high financial leverage as it executes upon its operating strategy to recover flailing operational performance. While Teva faces a rough road ahead over the next year or so, our stable outlook reflects the firm’s commitment to debt reduction while it repairs its operations.

Teva's operational woes were evident in the second quarter as total revenue dropped 17.8% to $4.7 billion, mainly from continued tough pricing within the U.S. generic market and erosion of Copaxone sales by 39.6%, including a 46.0% fall in U.S., due to generic competition. This sales drop pressured EBITDA down to $1.4 billion in the second quarter from $1.7 billion in the prior-'year period. While facing generic versions of Copaxone from Mylan (BBB-, negative) and Novartis' (AA, stable) Sandoz, Teva still thinks it can reach revenue in the range of $18.5 billion to $19.0 billion in 2018 (a decrease of 16% from 2017 at the midpoint). Moreover, the firm now plans to achieve EBITDA of $5.0 billion to $5.3 billion (up from $4.9 billion to $5.2 billion expected previously) and free cash flow to $3.2 billion to $3.4 billion (increased from $3.0 billion to $3.2 billion previously). Management’s expectation is helped by early success (more than $1 billion already achieved in the first half) against its restructuring plan that looks to obtain $3 billion of annual savings by 2019 with more than half during this year. We estimate a moderation of revenue and EBITDA declines into the low single digits compounded annually over the next five years, assuming solid execution of its restructuring plan and successful commercialization of novel medicines. Recovery of top-line growth in the intermediate term may be supported by continued uptake of specialty drug Austedo for Huntington’s disease and tardive dyskinesia and the U.S. launch of migraine drug candidate fremanezumab by the end of 2018 (given a FDA action date in mid-September).

Despite Teva's debt load dropping to $30.2 billion on June 30 from $32.5 billion at the end of 2017, gross debt leverage ticked up to 5.5 times for the latest 12 months versus 5.3 times in 2017 from earnings compression. With cash and investments of $1.9 billion on June 30, net leverage was 5.0 times, by our estimates. Debt reduction remains the highest priority for cash deployment and the firm still expects to decrease net leverage to below 4 times EBITDA by 2020 and under 3 times within three to five years. Along these lines, Teva plans to reduce debt by at least $3.5 billion in total during 2018 and between $2.5 billion and $3 billion in 2019 through free cash flow generation and potential minor divestitures. This demonstrated commitment gives us conviction that Teva can materially reduce high financial leverage, which helps inform our stable outlook. Teva is still about a turn away from reaching its current leverage target, which we see requiring a combination of substantial debt reduction and increasing profitability, which depends on solid execution against its restructuring program together with successful commercialization of new products. Teva has some financial flexibility to address its debt burden with free cash flow that we see averaging around $3 billion annually over the next five years.

Market Data

We compare Teva's unsecured bonds to another peer that is rated in the general BB category in the healthcare industry, healthcare provider HCA Healthcare Inc. (BB+, stable). Teva's unsecured bonds due in 2026 recently traded slightly wider than those of HCA. All the following bond data is sourced from Interactive Data.

Teva's (BB, stable) 3.15% unsecured notes due in 2026 were recently indicated at 85.05, a yield to maturity of 5.44%, and a spread to maturity of +248 basis points.

HCA's (BB+, stable) 5.88% unsecured notes due in 2026 were recently indicated at 103.25, a yield to worst (2025 call date) of 5.31%, and a spread to worst of +237 basis points.

Following the Bard Acquisition, Becton Dickinson (BBB, Stable) Continues Deleveraging in Fiscal 3Q

On Aug. 2, Becton, Dickinson and Co. (BBB, stable) reported fiscal third-quarter results and raised its fiscal 2018 guidance slightly on solid operating trends across its business segments. Following the C.R. Bard acquisition that raised leverage substantially in late calendar 2017, management also revealed slight deleveraging during the quarter and reiterated its long-term leverage target. Given these trends that are largely in line with expectations, our outlook on BD’s rating remains stable

In the quarter, BD reported slightly higher-than-anticipated results, and with those trends, management increased its guidance modestly for fiscal 2018. BD turned in $4.3 billion in quarterly sales, or growth of 5.5% on a comparable basis and slightly above consensus ($4.2 billion), and adjusted earnings per share of $2.91, or growth of 11% on a comparable basis and slightly above consensus ($2.86). Given these trends reflecting ongoing momentum across its business segments, the company slightly raised its top- and bottom-line guidance for fiscal 2018, implying an acceleration of growth in the fourth quarter. Specifically for fiscal 2018, it now expects underlying sales growth of over 6% (versus 5.5%-6.0% in May and 5.0%-6.0% prior to that). BD also raised the bottom end of its adjusted EPS growth expectation to $10.95 to $11.05 (up from $10.90-$11.05 in May and $10.85-$11.00 prior to that).

By segment, BD's medical segment grew 6% on an organic constant-currency basis to $2.2 billion. Within this segment, the medication management solutions division led the way with 8% growth after reaching its one-year anniversary of the U.S. dispensing-model change and recognizing solid adoption of the new Pyxis ES system. The medication delivery solutions division delivered 6% growth driven by its vascular access and care products. The other divisions of this segment (diabetes care and pharmaceutical systems) lagged from a growth perspective because of order timing issues that we expect to smooth out in the long run. BD's life sciences segment grew 6% on a constant-currency basis to $1.1 billion, including 5% growth in diagnostic systems, 5% growth in preanalytical systems, and 7% growth of biosciences in constant currency. The interventional segment (largely the acquired Bard business) turned in 5% comparable growth to $954 million of sales on 8% peripheral intervention growth, 6% growth in the urology and critical care division, and 2% surgery division growth, which was negatively affected by a continued hold on ProGel.

On the call, management highlighted that pro forma gross leverage had declined to 4.2 times at the end of June from 4.5 times at the end of March and 4.7 times at the end of December directly after the Bard acquisition. The company continues to aim for a leverage goal of less than 3 times within three years of Bard's closure. However, given BD's recent acquisition track record, including recent tuck-in acquisitions and the CareFusion merger in early 2015 that pushed leverage up to the mid-4s before declining to the low-3s in early 2017, we recognize that its leverage goal may be more of a floor than a target likely to be sustained over a long period. These factors are reflected in our BBB rating and stable outlook for BD.

Market News and Data

From a credit perspective, BD's closest comparable is Zimmer Biomet Holdings Inc. (BBB, stable). In the 10-year maturity bucket, BD's bonds recently traded tighter than the BBB category of the Morningstar Corporate Bond Index. All the following bond data is sourced from Interactive Data.

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

Becton, Dickinson's 2.89% notes due 2022 at +90 basis points.
Zimmer Biomet's 3.70% notes due 2023 at +104 basis points.

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

Becton, Dickinson's 3.70%% notes due 2027 at +132 basis points.
Zimmer Biomet's 3.55% notes due 2025 at +132 basis points.

For comparison with the approximate 10-year maturities, the Morningstar Corporate Bond Index is at +145 basis points in the BBB category.

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

Becton, Dickinson's 4.67%% notes due 2047 at +157 basis points.
Zimmer Biomet's 4.45% notes due 2045 at +171 basis points.

US Steel (B, Positive) Posts 20% Increase in 2Q Adjusted EBITDA Year Over Year

MCR Credit Risk Assessment

US Steel (B, Positive) reported second-quarter results today that showed adjusted EBITDA increasing to $451 million for the quarter compared with $376 million in the same period a year ago, a 20% increase. The results were driven by higher steel prices and higher shipments. Balance sheet debt ended June 30 was approximately $2.5 billion and the firm guided that adjusted EBITDA for all of 2018 would be $1.85 billion-$1.9 billion that we forecast will result in debt/adjusted EBITDA of 1.4 times at year-end 2018. This would be one turn lower relative to 2017's level of 2.4 times. The company has also underfunded pension and other postretirement liabilities that are approximately $700 million, and we calculate approximately $1 billion of obligations for operating leases (at 8 times rent).

Liquidity is strong with total availability of $3.0 billion with cash and equivalents constituting $1.2 billion of the total with the remaining be available revolving credit facilities. US Steel's maturity profile has lengthened over the last couple of years with the company's refinancings. Debt maturities now are $2 million due yet in 2018, $59 million in 2019, $405 million due in 2020, $4 million in 2021, and $10 million in 2022. In total, only $480 million is due within the next four and a half years.

Market Data

According to Interactive Data, US Steel's 6.875% notes due Aug. 15, 2025, recently traded at a price of 101.8, resulting in a yield to worst of 6.37%. For comparison, we look to Summit Materials' (B+, stable) 5.125% notes due June 1, 2025, which recently traded at 93.9 for a yield to worst of 6.24%. For an index comparison, we look to BofA Merrill Lynch's High Yield B Semi-Annual Yield to Worst Index, which is quoted at 6.54%.

Concho Resources (BBB-, Positive) Posts Strong 2Q Results; Integration of RSP Permian Acquisition Under Way

MCR Credit Risk Assessment

After the market closed on Aug. 1, Concho Resources (rating: BBB-, positive) reported second-quarter operating revenue of $945 million, a whopping $378 million (67%) increase relative to $567 million in the second quarter of 2017, largely reflecting growth in Texas Permian oil sales volumes and higher oil price realizations. Commensurate with this, net cash provided by operating activities was $602 million, a $204 million (51%) increase from $398 million in the year-ago quarter. After total capital expenditures of $472 million plus $6 million in net proceeds from asset dispositions, we estimate Concho's second-quarter free cash flow was $136 million.

On July 19, Concho closed the acquisition of RSP Permian (not rated) in an all-stock transaction and assumed RSP's net debt. We continue to believe the transaction has positive strategic implications for Concho. In particular, much of RSP's acreage in the Permian Basin is contiguous with or located in close proximity to Concho's holdings. This should allow Concho to generate significant operational synergies, including more multiwell drill pad sites, longer lateral drilling, and shared support and midstream infrastructure. On the second-quarter earnings conference call, management stated that it will continue to allocate capital only to projects that provide the highest economic return. Therefore, as time goes on, we anticipate the company will cull some acreage that is unlikely to meet economic return criteria from the enlarged, newly combined portfolio of oil and gas holdings.

Despite a negligible cash balance at the end of the June quarter (pro forma for the RSP Permian acquisition), we think Concho’s liquidity remains very good, supported by $1.84 billion available on its $2.0 billion unsecured revolving credit facility (matures May 2022). Furthermore, using the midpoint of the company's updated guidance range for 2018 capital expenditures of $2.5 billion-$2.6 billion plus $261 million of proceeds from noncore asset sales realized in the first quarter, we estimate $300 million in net cash flow for the “new” Concho in full-year 2018. Therefore, we do not anticipate the company needing to make significant additional draws on its credit facility. Long-term borrowings now include $600 million due in 2025, $1.0 billion in 2027, $1.0 billion in 2028, $800 million in 2047, and $600 million in 2048.

At the end of June, pro forma for RSP, Concho's total debt was $4.16 billion, which includes $160 million drawn on Concho’s revolver. Therefore, we estimate the “new” Concho's ratio of total debt/trailing, 12-month EBITDAX to be 1.4 times at June 30 (excluding any synergies between Concho and RSP). By itself, we calculate Concho's gross leverage was 1.1 times at June 30, which incorporates total stand-alone debt of $2.4 billion and reported trailing, 12-month EBITDAX of $2.1 billion.

Compared with Anadarko Petroleum (BBB-, stable), the “new” Concho has much less debt. Anadarko is a larger, U.S.-centric exploration and production company, which had gross leverage of 2.6 times at the end of June. Pioneer Natural Resources (BBB, stable) is a larger Texas Permian-focused E&P company. At the end of March, Pioneer had gross leverage of 1.0 times, less than for Concho.

Market Data

According to pricing service Interactive Data, the 5.55% notes due March 15, 2026, from Anadarko recently traded at +140 basis points over the nearest Treasury. By comparison, Concho’s 3.75% notes due in 2027 recently traded at +133 basis points. Additionally, the 4.45% notes due Jan. 15, 2026, from Pioneer Natural Resources recently traded at +103 basis points over the nearest Treasury.

Camden Property Trust (A-, Stable) Reports Another Good Quarter Despite Pressures From New Supply

Camden Property Trust (A-, stable) reported solid operating results in the second quarter, with good increases in same-store net operating income both sequentially at 2.4% and year over year at 3.2%. The quarter’s 3.2% year-over-year increase in same-store revenue was a good result, given the number of markets experiencing slow rent growth because of the pace of new apartment development. By market, the year-over-year NOI growth leaders were Houston at 9.9% (aided by lower expenses), Corpus Christi at 8.5%, Phoenix at 5.5%, and Tampa at 5.3%. The growth laggards were Atlanta at negative 3.9% (hurt by a surge in expenses), Dallas at negative 0.4%, Austin at 1.0%, and Southeast Florida at 1.4%.

Camden's second-quarter funds from operations of $116 million was 9.6% higher than in 2017, helped by a 6.2% increase in revenue. Management increased its guidance for 2018 FFO growth to 4.6% from 4.2% at the midrange, based on its assessment of its markets and general economic conditions. Given its greater diversity of markets, we view Camden as less exposed to the prospect of increased competition from new apartment supply in comparison with some of its peers, such as Equity Residential and AvalonBay Communities, particularly in the Washington, D.C., metro area where rent growth has slowed considerably. Despite those challenges coming from the supply side in some key markets, we believe the company should remain among the better credits in the apartment real estate investment trust sector, given its moderate- to high-quality portfolio in a variety of markets and price points.

For the same-store portfolio in the first half of 2018, the companywide year-over-year increases were 3.3% for revenue and 3.6% for NOI, while occupancy of 95.8% was 10 basis points higher compared with year-end 2017. Effective rents increased to an average of $1,456 per month in the second quarter, a 2.5% increase over the year-earlier quarter. Full-year 2017 NOI growth was hurt by the effects of hurricane damage, most significantly in fourth-quarter results, though Hurricane Harvey struck in August and Hurricane Irma in September.

For 2018, we expect that several markets will continue to experience relatively high levels of new supply, which will put further pressure on rents. However, generally favorable economic conditions, particularly with respect to employment and wages, should continue to support demand and mitigate some of the effects of supply pressure. Based on this view and the first half's reported rent growth at a solid 3.3% annual rate, we increased our projected rent growth to a conservative 2.5% for 2018, still lower than the portfolio's 2.9% growth in 2017. Updated management guidance for 2018 indicates slightly higher expectations for same-store revenue growth of 2.9%-3.4%, while NOI growth was also revised higher to 2.5%-3.5%.

The company estimates the completion of three communities with 800 new units in 2018, plus openings in two other communities with 806 units scheduled for completion in 2019. Total communities in active development are projected at 2,013 units for $633 million through 2020, of which $350 million has been spent. On the second-quarter earnings call, management said acquisitions will be limited and selective because increased investor competition for apartment complexes has put more upward pressure on prices.

First-half FFO of $227 million is slightly higher than our forecast. Leverage as measured by debt/last 12 months recurring EBITDA of 4.2 times is better than our forecast. Debt maturities total $1.4 billion through 2022, with the highest amounts in 2019 and 2022; the company has a credit facility with a capacity of $645 million with no outstanding balance as of June 30. Liquidity is also supported by a portfolio in which 81% of $8.1 billion of gross operating assets are unencumbered. Management anticipates a $400 million unsecured note issuance later in 2018; presumably some of this will be used to retire higher-cost secured debt with maturities in 2019, along with proceeds from select property sales. The plan is to continue to replace secured debt with unsecured debt as secured debt matures, a credit positive.

Market Data

Camden Property Trust apartment REIT peers are AvalonBay Communities, Inc. (A-, stable), Equity Residential (A-, stable), and Essex Property Trust (BBB+, stable). The following spread data is from Interactive Data as of Aug. 2.

In the 10-year area, spreads over the nearest Treasury from these issuers are as follows:

Camden's $250 million 3.50% bonds due 2024 at +103 basis points.
AvalonBay's $450 million 3.20% bonds due 2028 at +95 basis points.
Equity Residential's $500 million 3.50% bonds due 2028 at +97 basis points.
Essex's $350 million 3.625% bonds due 2027 at +125 basis points.

The A- Morningstar Corporate Bond Index is currently at a spread over the nearest Treasury of +104 basis points.

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