Morningstar Corporate Credit Research Highlights

Volatility-induced turbulence subsides.

Morningstar Credit Ratings, LLC
20 February 2018

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Issuer/Ticker	Current Issuer Credit Rating	Previous Issuer Credit Rating
General Dynamics **GD**	A+/UR-	A+
AstraZeneca **AZN**	BBB+	A-

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Issuer/Ticker	Current Issuer Credit Rating	Previous Issuer Credit Rating
Texas Instruments **TXN**	AA-	AA-
Intel **INTC**	AA-	AA-
GlaxoSmithKline **GSK**	A	A

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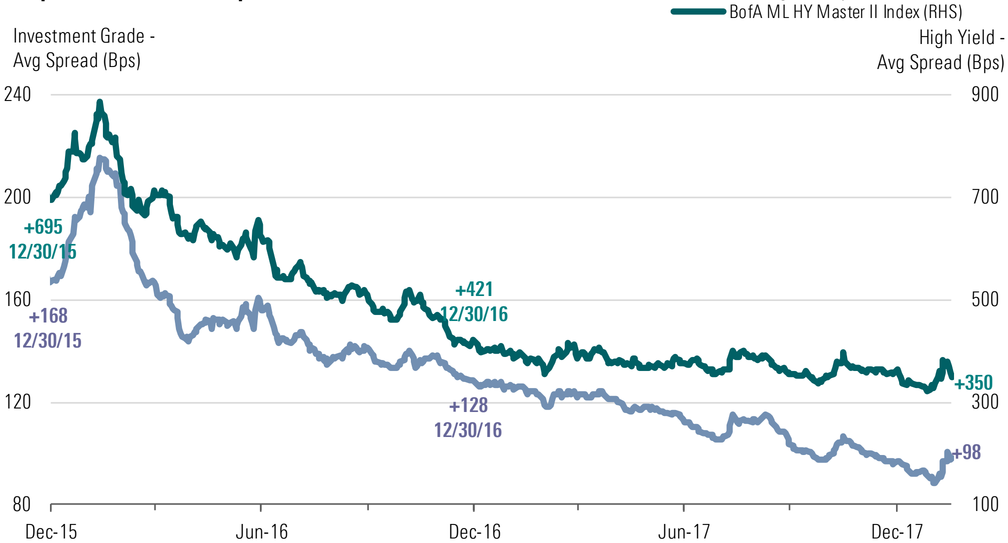
Credit Market Insights

Volatility-Induced Turbulence Subsides

The volatility-induced turbulence that spread into the corporate bond market in early February subsided last week as equity prices rebounded sharply. The S&P 500 rallied 4.30% and recovered well over half of its recent downturn. As the equity markets soared and volatility dwindled, investors exited flight-to-safety trades, which pushed short-term interest rates higher. In the corporate bond market, investment-grade corporate credit spreads generally held their ground while high-yield spreads tightened considerably. In the investment-grade market, investors balanced the desire to purchase corporate bonds at wider spreads with wanting to avoid the negative impact of rising interest rates, which will offset the benefit of the wider corporate credit spreads.

The average spread of the Morningstar Corporate Bond Index (our proxy for the investment-grade bond market) widened 1 basis point to +98 basis points. In the high-yield market, the BofA Merrill Lynch High Yield Master Index tightened significantly as the average spread of the index declined 32 basis points to end the week at +350. As the markets normalized throughout the week, it drove a risk-on sentiment, which prompted investors to chase riskier assets higher. Whereas the investment-grade market is more correlated with the Treasury bond market in the short term, the high -yield market has historically been much more correlated with the equity markets. High-yield bonds are much less sensitive to movements in underlying interest rates because a significantly larger portion of the total return in the high-yield market is driven by credit spreads. High-yield credit spreads represent a much larger portion of total return for the asset class as opposed to the investment-grade sector, where much less of the total return is driven by the credit spread.

Corporate Bond Credit Spreads



Source: Morningstar,Inc., BofA Merrill Lynch Global Indexes. Data as of 2/16/2018.

Hotter-Than-Expected Inflation Sends Short-Term Rates Higher

At 0.5%, the headline month-over-month increase in the consumer price index was much higher than consensus expectations. Even the core CPI, which excludes notoriously volatile food and energy prices, rose at a 0.3% rate on a month-over-month basis. On an annualized basis, the increase in the core CPI equates to a 2.9% inflation rate, the highest in six years. While the year-over-rate rate held steady at 2.1%, the market began to price in higher near-term inflation expectations. This resulted in an increase in the market-implied probability that the Federal Reserve will increase the federal-funds rate at the March meeting as well as through the remainder of the year. According to the CME FedWatch Tool, the probability that the Fed will lift rates after the March meeting rose to 83% from 72% the prior week. After declining during the market sell-off, the probability of further rate hikes through the rest of the year bounced higher. For example, by the end of last week, the probability that the fed-funds rate at the end of 2018 will be greater than 1.75% increased to 90% from 81%, and the probability that the fed-funds rate will be 2% or higher increased to 61% from 48%.

Compounding the inflationary headwinds in the short-term bond market, as the markets recovered from the volatility-induced sell-off earlier this month, investors no longer felt the need to hide in the safe haven of short-term U.S. Treasuries. As investors dumped short-term Treasuries, the prices fell and thus interest rates rose across the shorter end of the yield curve. The yield on the 2-year Treasury note rose 12 basis points to 2.19% and the 5-year Treasury note increased 9 basis points to 2.63%. The yields on both of these notes ended the week at their highest levels since 2008 and 2010, respectively.

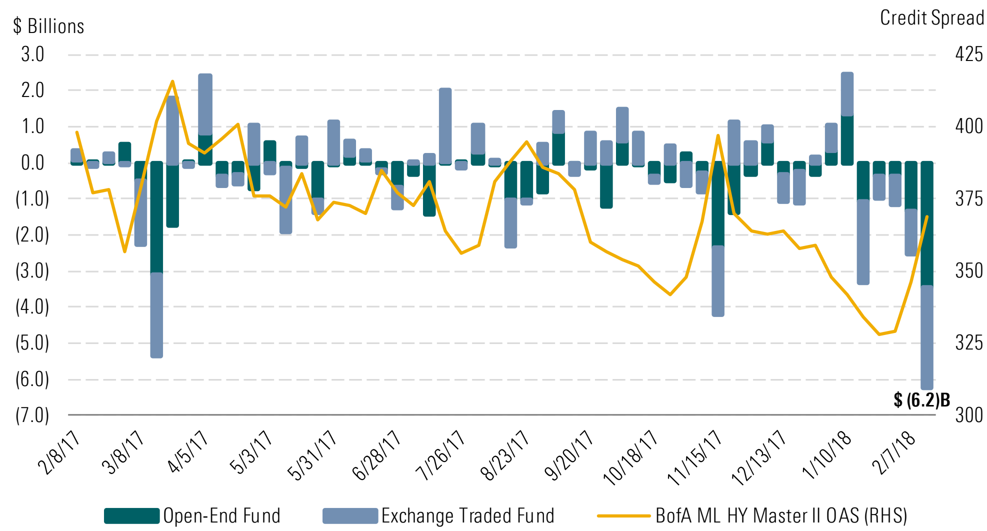
The movement at the long end of the yield curve was much more muted, as those bonds were not as affected by the flight-to-safety trades as the short end. The yield on the 10-year Treasury bond rose 2 basis points to 2.87% and the 30-year Treasury bond decreased 3 basis points to 3.13%.

The March Federal Open Market Committee meeting will be especially closely watched as newly elected Federal Reserve Chairman Jerome Powell will hold a press conference and take questions following the meeting. The market will scrutinize his answers for any changes in his view of monetary policy compared with the prior Fed chair. In addition, investors will be looking for any changes in the Fed's updated Summary of Economic Projections. According to projections from the Fed's December 2017 meeting, the average projected federal-funds rate of the board members for the next three years is 2%, 2.70%, and 3% for the years ended 2018, 2019, and 2020.

Second-Greatest Weekly Outflows Among High-Yield Funds and ETFs

Investors continued to flee from high-yield bonds. For the fifth consecutive week this year, investors pulled assets out of the high-yield market. For the week ended Feb. 14, high-yield open-end funds and exchange-traded funds experienced a net outflow of $6.2 billion. This consisted of $3.4 billion of withdrawals from open-end funds and $2.8 billion of unit redemptions from ETFs.

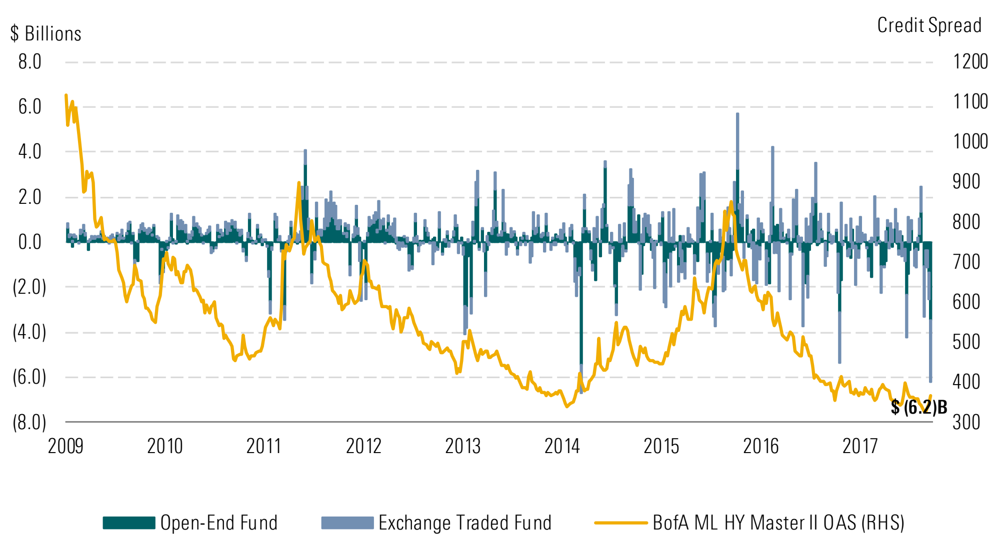
Estimated Weekly High-Yield Bond Fund Flows and High Yield Credit Spreads



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

Since June 2009 (when we first began measuring high-yield fund flows), there has been only one instance in which weekly fund outflows were greater. That record outflow of $6.7 billion occurred in August 2014, when oil prices began to plunge. On a rolling four-week basis, fund outflows are currently at $10.9 billion. Over our historical data, there are only two instances in which a rolling four-week period suffered even greater outflows. Those were at the beginning of August 2014, which experienced a four-week outflow of $12.3 billion, and the end of June 2013, which recorded an outflow of $11.5 billion.

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



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

Exhibit 1 Morningstar Credit New Issue Monitor

Week ended Feb. 16, 2018

(000,000s $ unless otherwise noted)

Issuer			Issue				
Name	Ticker	Morningstar Corporate Rating[1]	Size	Coupon	Description	Maturity	Approx Spread to US Treasuries
CSX Corp.	CSX	BBB+	$800	3.80%	Senior Unsecured	2028	+90
CSX Corp.	CSX	BBB+	$850	4.30%	Senior Unsecured	2048	+115
CSX Corp.	CSX	BBB+	$350	4.65%	Senior Unsecured	2068	+150
Ingersoll-Rand	IR	BBB+	$300	2.90%	Senior Unsecured	2021	+65
Ingersoll-Rand	IR	BBB+	$550	3.75%	Senior Unsecured	2028	+95
Ingersoll-Rand	IR	BBB+	$300	4.30%	Senior Unsecured	2048	+120
Norfolk Southern	NSC	BBB+	$500	4.15%	Senior Unsecured	2048	+105

Source: Bloomberg, company Securities and Exchange Commission filings.

(1) Morningstar's issuer credit rating is assigned at the holding company level.

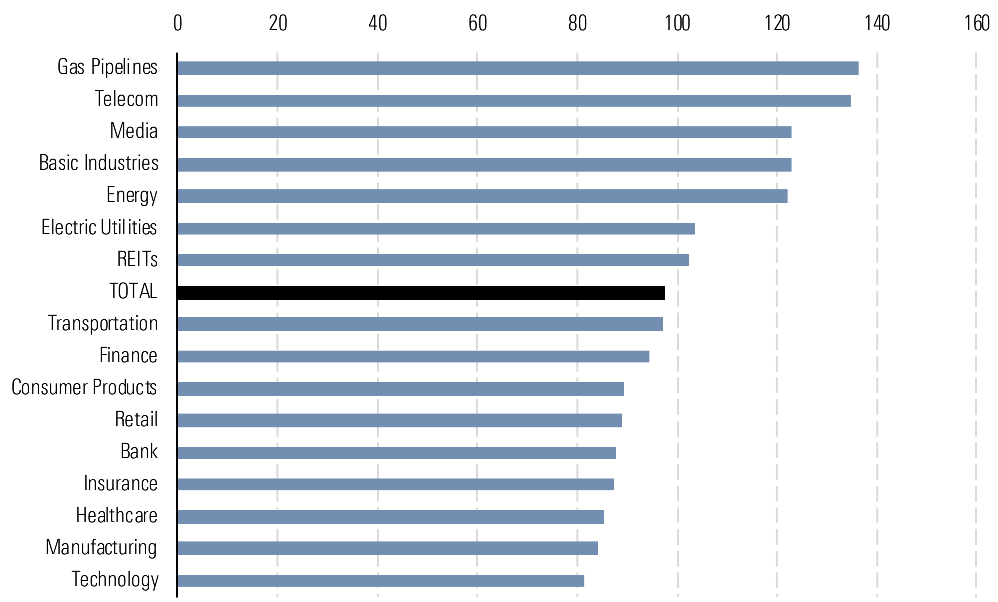
Exhibit 2 Morningstar, Inc. Corporate Bond Index Sector Summary

Sector	Average Rating	Number of Issues	Modified Duration	Spread (bps)	MTD Spread Chg (bps)	YTD Spread Chg (bps)	MTD Total Return (%)	YTD Total Return (%)
TOTAL	**A-**	**4,993**	**6.9**	**98**	**8**	**2**	**(1.42)**	**(2.34)**
FINANCIAL	**A-**	**1,502**	**5.4**	**89**	**9**	**6**	**(1.07)**	**(2.05)**
Bank	A-	921	4.9	88	10	7	(1.01)	(1.84)
Finance	A	271	5.6	95	8	7	(1.15)	(2.46)
Insurance	A	216	7.7	87	5	1	(1.32)	(2.76)
REITs	BBB+	85	6.0	102	7	(2)	(0.99)	(1.91)
INDUSTRIAL	**A-**	**2,889**	**7.6**	**101**	**8**	**(0)**	**(1.57)**	**(2.49)**
Basic Industries	BBB	241	7.7	123	11	(6)	(1.84)	(2.18)
Consumer Products	A-	322	7.6	89	9	5	(1.62)	(2.82)
Energy	A-	411	7.3	122	11	(0)	(1.82)	(2.34)
Healthcare	A-	404	7.8	85	3	(3)	(1.61)	(2.77)
Manufacturing	A-	462	6.1	84	7	3	(1.11)	(2.12)
Media	BBB+	187	8.3	123	6	(6)	(1.70)	(2.48)
Retail	A-	160	7.7	89	10	2	(1.75)	(2.82)
Technology	A+	354	7.3	81	8	4	(1.38)	(2.68)
Telecom	BBB+	147	9.2	135	4	(8)	(1.49)	(1.82)
Transportation	BBB+	149	8.8	97	9	(1)	(2.09)	(3.02)
UTILITY	**BBB+**	**564**	**8.6**	**117**	**8**	**(2)**	**(1.82)**	**(2.63)**
Electric Utilities	A-	330	9.2	104	6	0	(1.77)	(3.10)
Gas Pipelines	BBB	222	7.8	136	10	(7)	(1.88)	(1.89)
Rating Bucket								
AAA Bucket		115	8.1	49	3	1	(1.37)	(2.89)
AA Bucket		478	5.6	60	7	2	(0.99)	(2.01)
A Bucket		1,957	6.8	79	8	6	(1.38)	(2.57)
BBB Bucket		2,443	7.2	125	8	(2)	(1.55)	(2.18)
Term Bucket								
1-4	A-	1,606	2.3	64	9	7	(0.25)	(0.58)
4-7	A-	1,161	4.6	83	8	3	(0.73)	(1.64)
7-10	A-	932	7.0	107	9	1	(1.42)	(2.78)
10PLUS	A-	1,294	13.8	141	8	(4)	(3.22)	(4.48)

Data as of 02/16/2018

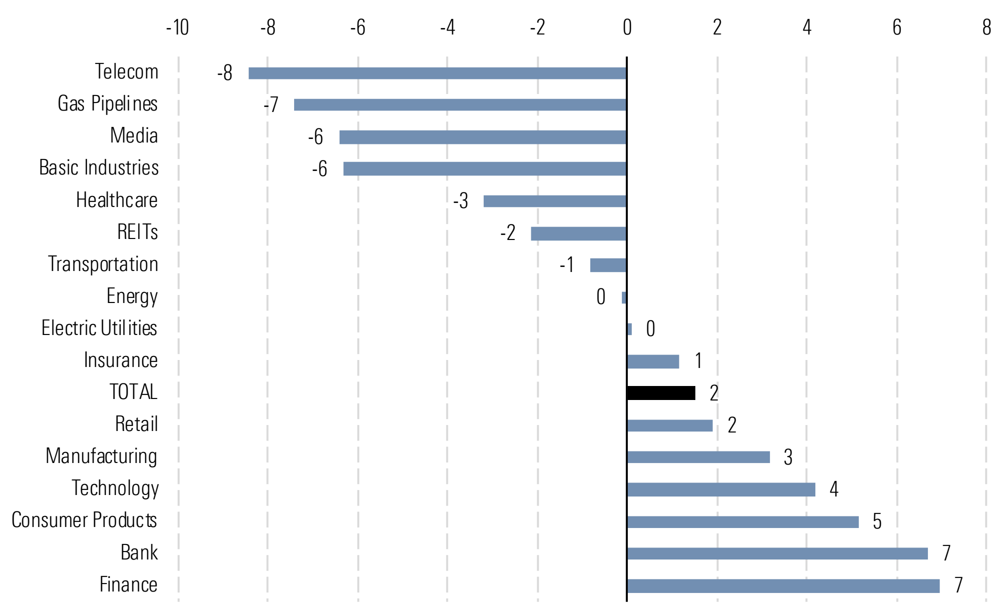
Source: Morningstar, Inc.

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



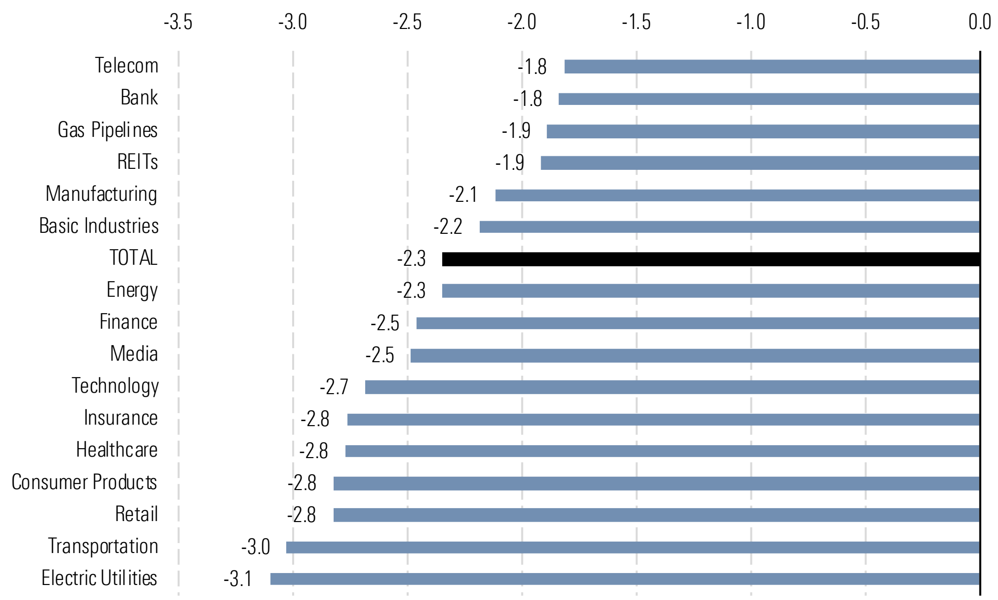
Source: Morningstar, Inc.

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



Source: Morningstar, Inc.

Exhibit 5 Morningstar, Inc. Corporate Bond Index YTD Return



Source: Morningstar, Inc.

Credit Rating Actions

Rating Changes

Issuer/Ticker	Current Issuer Credit Rating	Previous Issuer Credit Rating
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AstraZeneca **AZN**	BBB+	A-

Rating Affirmations

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Intel **INTC**	AA-	AA-
GlaxoSmithKline **GSK**	A	A

General Dynamics' A+ Rating Under Review Negative on CSRA Acquisition

Morningstar Credit Ratings, LLC is placing its A+ corporate credit rating on General Dynamics Corp under review negative following its announced agreement to acquire IT solutions provider CSRA for a total enterprise value of $9.6 billion. We estimate this will increase its net debt/EBITDA to 2.0 times from 0.2 times, excluding underfunded pensions. We expect to conclude our review before the closing of the deal in the first half of 2018.

The deal reflects ongoing consolidation in the federal IT services space. Before this transaction, General Dynamics' IT unit was a $4.5 billion business based on forecast 2018 sales provided by GD while CSRA was at $5.4 billion, both among the top seven competitors in the space. The deal will launch them into the number-two position behind Leidos. Other defense contractors have chosen to exit the space by selling or spinning off assets, including Lockheed Martin (A-, stable) and L3 Technologies (not rated) over the past couple of years. General Dynamics is choosing to go big and compete with greater scale. CSRA brings in EBITDA margins around 15%, similar to GD's in aggregate. The transaction will increase the IT segment of GD's business portfolio to 25% of sales, with aerospace (24%), combat (16%), marine (23%), and new segment mission systems (12%) composing the remainder.

General Dynamics finished 2017 with total debt of $4 billion, consisting almost entirely of a series of senior unsecured public bonds maturing 2021 ($500 million) to 2042. We expect the company to fund its $9.6 billion acquisition of CSRA with cash, new investment-grade bonds, and possibly commercial paper or bank debt. GD had $3 billion of cash on hand at year-end. It has guided to closing the transaction with net debt of $10.5 billion. The company has committed to using free cash flow for rapid deleveraging, and thus we expect a fair amount of shorter-maturity debt to be part of the financing package. In 2017, GD produced about $2.5 billion of free cash flow after dividend payments. Management has indicated a commitment to mid-A credit ratings, which would support Tier 1 commercial paper ratings.

Our review will take into consideration the expansion of GD's business portfolio and the overall competitive advantages the firm will maintain as a result. We will also assess management's commitment to retiring debt and better understand its desired longer-term financial leverage. We expect the transaction to adversely affect our Solvency Score, given the higher leverage and weaker interest coverage, and potentially our Cash Flow Cushion given the higher debt obligations. Either of these could result in a rating downgrade. While we don't envision an upgrade scenario, the rating could be stabilized if we gain confidence that management will aggressively pay down debt and restore credit metrics to similar levels as today.

AstraZeneca's Rating Downgraded to BBB+ From A-; Stable Rating Outlook

Morningstar Credit Ratings, LLC is downgrading the credit rating of AstraZeneca to BBB+ from A- because the company's credit profile continues to deteriorate as it struggles to overcome one of the industry's most severe patent cliffs and because of the firm's generous dividend policy in light of weaker cash flow generation. We are revising our rating outlook to stable from negative, given our expectation that the firm may reach a trough of revenue and EBITDA in 2018 as it works through the end of its long-standing patent cliff.

Flagging operational performance exacerbated by the loss of market exclusivity of high-margin Crestor (about 10% of total current sales) in May 2016 has steadily stressed our Cash Flow Cushion pillar, especially as AstraZeneca's generous dividend has not been covered by internal cash flows for the past few years. This shareholder-friendly stance bodes poorly for our view of management's financial policy, which pressures the firm's Business Risk pillar. But we see a path toward operational growth via AstraZeneca's recent research productivity, exemplified by the firm's introduction of four novel medicines during 2017: Imfinzi (immuno-oncology agent for cancer), Fasenra (first biologic for severe asthma), Calquence (oral cancer drug), and Bevespi (COPD drug in a novel delivery device). We see the firm returning to top-line growth in 2019 on strong uptake of these new treatments along with sustained strong demand for promising pharmaceuticals Farxiga (diabetes) and Tagrisso (cancer). While the firm showed expense discipline since 2007 in light of its patent expiration period, we expect higher marketing costs to enable success of new medicines to weigh on profitability in the intermediate term. Given these assumptions, we see revenue and EBITDA increasing in the midsingle digits compounded annually in 2017-22 with earnings generation accelerating in the back of our forecast.

AstraZeneca's credit profile has deteriorated during its patent cliff, most notably from strained cash flow generation and shareholder distributions of these weaker flows. Management's commitment to a healthy dividend policy despite damped cash flows has led to cash deficits funded in part with debt. As a result, the firm's debt balance continued to creep up to $17.8 billion by the end of 2017. Before active business development over the past few years, including the acquisitions of ZS Pharma, a majority interest in Acerta Pharma, and the respiratory assets from Takeda Pharmaceutical, the debt load stood at $10.8 billion in 2014. Accordingly, the higher debt load together with flat earnings over the past two years has pushed gross leverage to 2.9 times at the end of 2017 from 0.8 times in 2014. Considering $4.6 billion in cash and investments held at the end of 2017, net debt/adjusted EBITDA stood at 2.2 times. We see limited relief on leverage from debt reduction as net free cash flow (after dividends) does not cover long-term debt maturities until around 2020, assuming the firm maintains its generous dividend. This cash flow deficit negatively influences our Cash Flow Cushion and Solvency Score for the foreseeable future. We think free cash flow may return to near historical levels as new product launches start to make significant earnings contributions helped by the end to the current patent cliff in 2018.

AstraZeneca's cash balance and other available resources ($3.0 billion bank facilities available through April 2021) could help it manage maturing long-term obligations representing around 38% of its debt balance through 2022. However, we expect upcoming long-term debt maturities may be refinanced, given constrained financial flexibility over the next few years. As such, we anticipate that leverage improving to a more historical level in the long term may primarily stem from strengthening operational performance.

With the stable outlook, we look to successful uptake of newly launched products since they represent a key determinant of the firm's recovery from its current patent cliff possibly beginning in 2019. Strengthening operational performance is needed to ease the present strain on our Cash Flow Cushion and Solvency Score pillars and prevent further negative rating action. On the other hand, we may upgrade the current rating over the next two years if AstraZeneca achieves stronger-than-anticipated revenue and earnings increases mainly from its refreshed product portfolio such that our Cash Flow Cushion and Solvency Score pillars reverse their negative trends.

Texas Instruments' AA- Rating Affirmed; Outlook Stable

Morningstar Credit Ratings, LLC is affirming its AA- corporate credit rating on Texas Instruments Incorporated and maintaining a stable outlook. The credit rating reflects the company's stable and healthy Business Risk and Cash Flow Cushion scores and a robust Solvency Score supported by high returns on invested capital and low leverage.

The Business Risk pillar is supported by Morningstar's Equity Research Group's wide economic moat assessment, which it bases on the intangible value provided by the company's portfolio of high-value analog and embedded semiconductor products as well as high customer switching costs. Texas Instruments remains the largest analog circuit manufacturer in the world, with a 17% share of a highly fragmented market. Its highest end-market concentrations are industrial at 35% of revenue and automotive at 20% of revenue. We expect growth in these markets to continue as manufacturers continue to expand their integration of analog semiconductors in products and factories.

At the end of December, Texas Instruments reported $4.1 billion of senior notes supported by cash and investments of $4.6 billion, which leaves it with a net cash position at 0.1 times EBITDA, compared with modest net debt positions among similar-rated peers. While we view the company's liquidity as ample, its maturity schedule still skews more heavily to the short term, which we believe limits the likelihood of upward migration in its Cash Flow Cushion. Notwithstanding recent changes to U.S. tax laws, management plans to continue with its current capital policy of paying to shareholders substantially all of its free cash flow while still targeting a net cash position near zero.

Our stable outlook reflects our expectation of revenue growth of 5%-6% over the next two years, trailing off to 3% thereafter. We also project further margin expansion as production shifts to its 300-millimeter wafer facilities, resulting in lower production costs. Meanwhile, we believe the company will continue to adhere to a disciplined capital policy conducive to maintaining a stable liquidity position and modest leverage.

We may consider an upgrade of the credit rating if the company can maintain stable operating performance and free cash flow through the semiconductor cycle while continuing to keep debt usage low. We may consider a downgrade of the rating in the event the company abandons capital discipline to pursue a significant debt-financed acquisition or undertakes a more aggressive capital policy that could meaningfully increase leverage.

Intel's Credit Rating Affirmed at AA-; Outlook Stable

Morningstar Credit Ratings, LLC is affirming its AA- corporate credit rating on Intel Corp. and maintaining a stable outlook. The credit rating reflects Intel's strong Business Risk and Solvency Score, which are well supported by the company's position as the world's largest semiconductor company. We also note a midscale Cash Flow Cushion ranking driven by solid cash flow and disciplined debt usage.

Morningstar's Equity Research Group assigns Intel a wide economic moat rating, given its leading research and development capabilities and investment in cutting-edge production facilities. Our Business Risk score also takes into consideration the rapidly shifting landscape for semiconductor technology demand. To combat a secular decline in PC sales and maintain its long-term growth, Intel continues to reposition its portfolio to focus on data centers and Internet of Things applications. Recent transactions include last year's acquisition of driver-assist technology company, Mobileye. Intel also recently completed a $4.2 billion spin-off and sale of Intel security (McAfee) to private-equity buyers.

Intel reported ample liquid cash reserves at year-end, despite depleting much of its non-U.S. cash earlier last year on acquisitions. Intel's total debt ended 2017 at $26.8 billion, supported by global cash and investments of $14 billion. Debt increased $1.5 billion from a year ago, but total debt/EBITDA declined slightly, ending the year at 0.9 times. Cash and short-term investments declined $3.1 billion due to Mobileye, offset by free cash flow. Intel ended the year with net debt equivalent to just under 0.5 times trailing 12-month EBITDA, only modestly higher from a year ago. Over the next two years, Intel faces $2.0 billion of debt maturities, which should be manageable in the context of $10 billion-$12 billion of annual free cash flow and a payout ratio between 60% and 70%. We expect net debt to remain in the range of 0-0.5 times.

Our stable outlook assumes revenue growth will remain in the low single digits over the next few years, though we continue to expect stable operating margins and free cash flow. While share repurchases are likely to remain an integral part of the firm's capital-allocation strategy, we do not believe management will pursue it at the expense of balance sheet integrity. We may consider an upgrade of the rating if the company is able to further diversify its revenue base and continues producing consistent and strong returns on invested capital. We may consider a downgrade if Intel is unable to maintain a leading share in x86 standard servers or other core markets. We may also consider a downgrade if operating margin begins to meaningfully contract due to persistently higher chip production and development costs.

GlaxoSmithKline's A Rating Affirmed With Stable Outlook

Morningstar Credit Ratings, LLC is affirming GlaxoSmithKline PLC's A rating and stable outlook, reflecting our estimation that the firm can successfully manage through the patent lapse of best-selling respiratory medicine Advair and generate solid sales and EBITDA growth with its diversified product offering.

GlaxoSmithKline's corporate infrastructure comprises three varied divisions—pharmaceuticals, vaccines, and consumer products—which limits dependence on any particular segment and supports a very good Business Risk pillar. The firm already contends with generic competition to Advair (representing around 10% of overall sales) in Europe and is likely to see copycat versions arise in the U.S. during 2018. We expect some pressure on revenue upon the entrance of Advair generics but see an avenue for a mid-single-digit revenue compound annual growth rate over 2016-21 through solid uptake of newer respiratory treatments (notably the Ellipta inhaler franchise) and HIV medicines (Tivicay and Triumeq) as well as newly launched pharmaceuticals. GlaxoSmithKline achieved solid research productivity during 2017, when it launched three novel treatments: Trelegy Ellipta (triple therapy for COPD), Juluca (two-drug regimen for HIV), and Shingrix (shingles vaccine). The firm's operating strategy focused on innovation and value, especially in the pharmaceutical business, may help boost profitability, considering successful cost-saving initiatives targeting GBP 4.4 billion of annual savings (GBP 3.7 billion including a currency benefit of GBP 400 million already achieved in 2017 and another GBP 700 million by 2020). As a result of a leaner operating cost base, we see EBITDA growth pacing slightly ahead of sales performance through 2021.

GlaxoSmithKline has demonstrated its commitment to strengthening cash flow generation by recently adding incentives for cash and capital discipline to its management compensation packages. In addition, before returning the dividend to growth, the firm plans to build free cash flow coverage of the dividend to 1.25-1.5 times. A healthy dividend still consumes much of the firm's free cash flow, but we no longer see a cash deficit created by these shareholder distributions, which could have been cause for new debt issuance. These cash preservation efforts may serve to maintain our Cash Flow Cushion while increasing financial flexibility to reduce the company's debt load, including long-term debt maturities totaling around GBP 3.1 billion in 2018-19. Currently, the firm owes GBP 17.1 billion in unsecured debt and holds GBP 3.9 billion of cash and investments at the end of 2017. Accordingly, GlaxoSmithKline's gross debt and net leverage were 2.0 times and 1.5 times, respectively, in 2017. The firm's net leverage remained as the outlier in its A rated pharmaceutical peer group, which typically maintains net cash positions or net leverage close to nil. While GlaxoSmithKline has flexibility to lower its debt balance, we expect moderate improvement in leverage over the long term to result from strengthening profitability.

Top priorities for capital allocation start with internal investment, including rebuilding a weak drug research pipeline, as well as potentially buying out consumer joint venture partner Novartis AG (AA, stable) and expanding vaccine manufacturing capacity. Then, the firm looks to maintain its dividend stream of around GBP 3.9 billion annually. The third priority is business development that may involve bolstering its consumer health business by targeting external opportunities, which could stress the balance sheet. We think free cash flow may rise over the next five years to average about GBP 6 billion per year as the firm executes its operating strategy, with net free cash flow (including dividends) fully covering annual debt maturities by 2019. External liquidity is provided by a GBP 1.9 billion five-year credit facility maturing in September 2021 and a $2.5 billion (GBP 2.0 billion) 364-day facility due in September 2018. We see our middle-of-the-road Solvency Score pillar improving in 2019 after the firm recovers from a temporary dip in return on invested capital in 2018 pressured by Advair generic competition in the U.S.

In the context of the stable rating outlook, we expect GlaxoSmithKline to overcome the loss of U.S. market exclusivity of Advair likely in 2018 and generate revenue and earnings growth in the midsingle digits on a compound annual basis through 2021, which helps maintain a fair Cash Flow Cushion pillar. If the firm is unable to achieve operational growth such that cash flows deteriorate and debt leverage rises such that our Cash Flow Cushion and Solvency Score pillars degrade, a downgrade may be appropriate. An upgrade may be warranted if we see a clear path toward significant leverage reduction as the firm successfully executes its operating strategy. We would need to see realization of targeted net cost savings and stronger-than-expected uptake of new medicines that yield improved Cash Flow Cushion and Solvency Score pillars before taking any positive rating action.

Recent Notes Published by Credit Analysts

DaVita's Leverage Ticks Up in 4Q, but DMG Divestiture Should Enable Deleveraging in 2018

MCR Credit Risk Assessment

On Feb. 13, DaVita Inc (BB+, negative) released fourth-quarter results that were overshadowed for creditors by its plans to sell the struggling DaVita Medical Group. During 2017, the company's net leverage continued to rise primarily on returns to shareholders to compensate for that division's weak results, which has informed our negative outlook on DaVita's rating. With DaVita's plans to exit that business in 2018 and deleverage with some of the proceeds, we see the potential for the company's credit trajectory to stabilize if management follows through on its plans.

For the fourth quarter, DaVita changed the way it reports operating results, given the pending DMG divestiture, and appeared to roughly meet expectations. DaVita generated $2.8 billion of net revenue, up 3% year over year, in the fourth quarter. This revenue now consists primarily of its dialysis operations, which generated $2.5 billion of net revenue and grew 4% year over year during the period. Fourth-quarter results just missed expectations on the bottom line, with the firm producing $0.92 of adjusted earnings per share versus consensus of $0.93. However, DaVita met its operating cash flow guidance for the fourth quarter. On its third-quarter call, the company stuck to its operating cash flow guidance of $1.75 billion-$1.95 billion for 2017, and for the full year, it generated $1.9 billion of operating cash flow ($343 million during the fourth quarter) and $1.0 billion of free cash flow. Going forward without DMG, DaVita expects to generate operating cash flow of $1.4 billion-$1.6 billion and spend $925 million on capital expenditures in 2018. Notably, those projections include a decline in the firm's tax rate to about 27% in 2018 from an adjusted 39% in 2017.

For creditors, the biggest event in the quarter was DaVita's plan to sell its DMG segment to UnitedHealth Group Inc (non-NRSRO rating: A-, negative) for $4.9 billion in cash. This transaction is still scheduled to close in 2018 and remains strategically sound, given the continued struggles of DMG under DaVita's ownership since the latter purchased Healthcare Partners in 2012 for $4.4 billion. With the proceeds from this planned divestiture, DaVita plans to reduce debt to get back into its net leverage target range of 3.0-3.5 times, make share repurchases ($1.1 billion authorized as of February 2018), and potentially pursue other tuck-in acquisitions. As of December 2017, net leverage stood at 3.6 times, above its target range and higher than 3.2 times at the end of 2016. DaVita's rising leverage during 2017 has informed our negative outlook on the credit rating. However, planned debt reduction with the DMG divestiture proceeds should push leverage down a bit in 2018 and strengthen DaVita's currently weak position in the BB+ rating category.

Market Data

In the healthcare services sector, we compare DaVita's bonds with bonds from HCA Healthcare Inc (BB, stable). DaVita's bonds recently traded at a tighter yield and spread than similar bonds from HCA. All of the following bond data was sourced from Interactive Data.

DaVita's 5.00% notes due 2025 at 97.47, a yield to maturity of 5.43%, and a spread to maturity of +267 basis points.
HCA's 5.88% notes due 2026 at 101.79, a yield to worst (2025 call date) of 5.58%, and a spread to worst of +282 basis points.

Owens & Minor's Struggles Continue in 4Q as Amazon Threat Emerges and Debt Leverage Rises
MCR Credit Risk Assessment
On Feb. 14, Owens & Minor Inc. (BB, stable) released full fourth-quarter operating results that suggest turnaround efforts are needed throughout its legacy business, just as debt leverage is rising to make two acquisitions. Although our current outlook is stable, we have previously noted that our rating could eventually change if leverage rises further because of operational weakness. Therefore, management needs to make some progress in its turnaround efforts to maintain its current credit rating and outlook in the long run.

In the fourth quarter, Owens & Minor generated $2.4 billion in revenue, or 1% reported growth, and pushed full-year revenue up to $9.3 billion, within the preliminary range announced last month of $9.20 billion-$9.35 billion (and below previous consensus of $9.4 billion). These top-line results were inclusive of the Byram Healthcare acquisition that was completed in August and added $209 million of sales to Owens & Minor's results. On an organic basis, Owens & Minor continued to produce weak results across the board, which creates the need to improve several areas of its business. In its domestic segment, efforts to reduce expenses were more than offset by ongoing price and margin constraints. In its international segment, the company continues to struggle with slower-than-expected onboarding of new clients, weak fee-for-service revenue, and lagging cost-reduction efforts. In proprietary products, the company recognized lower revenue and inventory write-offs in the quarter, as client losses continued to negatively influence this segment. All of these factors constrained Owens & Minor's top line and led to significant adjusted earnings per share declines in the quarter ($0.35 down from $0.52 in the prior-year period) and full year ($1.61 down from $2.17 in 2016).

Management declined to give guidance for 2018, citing the desire to close the pending Halyard Health surgical and infection prevention business acquisition first, which is expected by early April. When asked about its underlying business trends, management remained tight-lipped and said only that it expects improvement in the legacy business versus the weak 2017 results. Along with ongoing internal problems, the specter of Amazon.com Inc's (A, stable) entry into the medical supply chain continues to hang over Owens & Minor, with recent reports suggesting that Amazon may be directly targeting the company's hospital distribution market. Management also refused to give pro forma leverage guidance for after the Halyard acquisition. Including recent results, we now estimate that gross leverage will rise to around 5 times versus our previous estimate of mid-4s gross leverage initially after the Halyard acquisition. Leases add over half a turn to its gross leverage. This rising leverage has already cut into all of the firm's pillars and weakened Owens & Minor's credit profile, and if leverage continues to rise due to operational weakness, our currently stable outlook on its rating could prove too optimistic.

Market Data

We compare Owens & Minor's bonds to below-investment-grade healthcare service firms DaVita Inc (BB+, negative) and HCA Healthcare Inc (BB, stable). All of the following bond data is sourced from Interactive Data.

Similar bonds from these issuers were recently indicated as follows over the nearest Treasury:
Owens & Minor's 4.38% notes due 2024 were indicated at 100.31, a yield to maturity of 4.32%, and spread to maturity of +161 basis points.
DaVita's 5.00% notes due 2025 were indicated at 97.47, a yield to maturity of 5.43%, and a spread to maturity of +267 basis points.
HCA's 5.88% notes due 2026 were indicated at 101.79, a yield to worst (2025 call date) of 5.58%, and a spread to worst of +282 basis points.

For comparison, the Morningstar Corporate Bond Index was at +151 basis points at BBB-, and the BofA Merrill Lynch BB Index was recently at +237 basis points.

Federal Realty Reports Successful 2017 and Points to Further Solid Performance in 2018

MCR Credit Risk Assessment

Federal Realty Investment Trust (A-, stable) reported an increase in earnings for the year ended 2017 versus 2016, despite a fourth quarter for which the headline number had been marred by an early debt-extinguishment charge. We still believe Federal Realty offers a better Business Risk profile than its shopping center peers and most other real estate investment trusts, given the quality and location of its properties as well as the company's talented management team, which has generated consistent growth in annual funds from operations since the recession. The Cash Flow Cushion is underpinned by a very desirable institutional-class unencumbered portfolio.

In 2017, Federal Realty generated healthy same-store net operating income growth of 3.4% over 2016 and finished the year with occupancy of 93.9%, a 60-basis-point improvement over the prior year-end. These helped to drive FFO higher by 3.4% year over year. Other operational highlights included tenant-improvement costs that remained under control and the leasing of the first Maryland location for Uniqlo, a Japanese retailer with an international presence, at Federal Realty's Pike & Rose development. During the fourth quarter, the company raised $66 million via its ATM program, bringing the 2017 total to approximately $110 million, which further supports its solid balance sheet and reaffirms management's commitment to creditors.

While uncertainty in the retail industry will continue for the foreseeable future, we expect Federal Realty's innovative management team to provide flexibility and creativity in top locations that will appeal to a wide range of tenants, including users of office and residential space in its mixed-use properties. We project leverage to remain within our expectations for the company's rating, declining below 5.5 times by year-end 2018 as projects are completed, residential units are sold, and property cash flows increase.

Market Data

Federal Realty's shopping center REIT peers are Regency (BBB+, stable), Kimco Realty Corporation (BBB+, stable), and Weingarten Realty Investors (BBB, stable). The following pricing data is from Interactive Data as of Feb. 13.

In the 10-year area, spreads over the nearest Treasury from these issuers are:
Federal Realty's $475 million 3.25% bonds due 2027 at +92 basis points.
Regency's $350 million 3.60% bonds due 2027 at +123 basis points.
Kimco's $400 million 3.80% bonds due 2027 at +126 basis points.
Weingarten's $250 million 3.25% bonds due 2026 at +140 basis points.
The A- Morningstar Corporate Bond Index is currently at a spread of +91 basis points.

Summit Materials Reports 17% Revenue and EBITDA Gains for 2017

MCR Credit Risk Assessment

Summit Materials Inc. (B+, stable) reported fourth-quarter and full-year results that showed the company increased both revenue and adjusted EBITDA by 17% for the year. Organic growth contributed approximately one fifth of the growth in adjusted EBITDA. Volume, excluding acquisitions, for the year was up for the company's aggregates segment (3.4%), cement segment (5.8%), and asphalt segment (10.9%) but down slightly for its concrete segment (2.3%). Debt increased to $1.82 billion at the end of 2017 from $1.52 billion a year earlier, an increase of nearly 20%. Adjusted EBITDA was $436 million for the year, resulting in debt/adjusted EBITDA of approximately 4.2 times, within our expectations. Free cash flow for 2017 was $98 million, and the company made $375 million in acquisitions, financed by both debt and equity offerings during 2017. We continue to expect Summit to be acquisitive and manage its debt/EBITDA at approximately 4 times.

We view Summit's liquidity as good; it was provided by cash and equivalents of $383 million and $219 million in revolver availability at the end of 2017. Its nearest debt maturity is $250 million of senior notes due in April 2022.

Market Data

According to Interactive Data, Summit's 6.125% unsecured notes due July 15, 2023, were recently traded at 102.5 yielding 5.01%. For comparison, we look to U.S. Steel's (B, positive) 6.875% unsecured notes due Aug. 15, 2025, that recently traded at 102.7 yielding 6.18%. For an index comparison, we compare with the BofA Merrill Lynch High Index B Yield to Worst Index, which is indicated at 6.40%.

Agilent Boosts Fiscal 2018 Outlook on Strong 1Q Trends While Balance Sheet Remains Stagnant

MCR Credit Risk Assessment

Agilent Technologies Inc (A-, stable) reported fiscal first-quarter results Feb. 14 that beat consensus expectations on the top and bottom lines. The company increased its outlook for fiscal 2018 somewhat, and given ongoing trends, we would not be surprised if that outlook proves conservative. Overall, with these positive operating trends and the company's continued financial strength, our rating remains A- with a stable outlook.

In the fiscal first quarter, Agilent generated revenue of $1.21 billion, slightly above consensus of $1.2 billion and up 10% on a core basis (organic, constant-currency growth). That represented a sequential acceleration from a core growth rate of 6% in the fourth quarter. By segment in the quarter, growth was broad-based, with 11% core growth in the life sciences and applied markets group, 9% core growth from the CrossLab group, and 8% core growth in the diagnostic and genomics group. By industry end group, the pharmaceutical and biotechnology group rebounded from a decline in the fourth quarter to 8% core growth year over year. In other end markets, academia and government grew 11%, environmental and forensics grew 14%, food was up 8%, chemical and energy was up 14%, and diagnostic and clinical end markets grew 5% on a core basis. The company's solid growth trends and over 100 basis points of operating margin expansion year over year helped boost adjusted earnings per share 25% in the quarter to $0.66, well above $0.58 consensus and the midpoint of management's previous outlook of $0.56.

These positive operating trends led Agilent's management to boost its outlook for fiscal 2018. However, even these raised prospects appear conservative relative to recent momentum. For fiscal 2018, the company now expects revenue around $4.9 billion, or core growth of 5.5% at the midpoint, up from about $4.7 billion and core growth of 4.25% at the midpoint previously. Notably, the company's guidance implies a significant slowing through the rest of fiscal 2018 based on management's self-described conservatism to allow for uncertainties, rather than a specific catalyst. For example, the company expects 4.25% core growth in the second quarter, despite current momentum. Also, the firm is only calling for adjusted earnings per share of $2.62-$2.68, or 11%-14% growth, up from $2.50-$2.56, or 6%-8% growth, previously. If events in fiscal 2018 follow similar trends that occurred in fiscal 2017, including multiple guidance beats, we would not be surprised to see more quarterly results beat expectations throughout fiscal 2018.

From a credit perspective, Agilent's balance sheet remains flexible, with more cash than it owes in debt, and this low net leverage contributes to its strong Cash Flow Cushion, Solvency Score, and Distance to Default pillars. At the end of January, Agilent held $2.9 billion in cash compared with $2.1 billion in debt, or about 2 times gross debt/adjusted EBITDA. With shareholders clamoring to get their hands on some of that cash and ongoing free cash flow ($850 million now expected in fiscal 2018, up from $770 million expected previously), Agilent continues to increase its dividend (over $190 million annual run rate) and repurchase shares (currently authorized to repurchase $380 million of shares in fiscal 2018). Agilent also remains open to more acquisitions. Management even said it would consider larger acquisitions than its typical tuck-ins of up to $700 million, provided such an acquisition offers the right strategic fit and financial benefits. Overall, though, Agilent currently remains in fine financial shape, which contributes to our stable outlook on its rating.

Market Data

We use several life sciences companies, including Quest Diagnostics Inc (BBB+, stable), Laboratory Corp of America Holdings (BBB+, negative), and Thermo Fisher Scientific Inc (BBB, stable), to compare with Agilent. Despite its higher rating, Agilent's bonds recently traded at wider spreads than bonds from those peers. All of the following bond data is sourced from Interactive Data.

In the approximate 10-year maturity bucket, bonds from these issuers recently traded over the nearest Treasury as follows:
Agilent's 3.05% notes due 2026 at +118 basis points.
Quest's 3.45% notes due 2026 at +103 basis points.
LabCorp's 3.60% notes due 2027 at +109 basis points.
Thermo Fisher's 3.20% notes due 2027 at +91 basis points.

For comparison, the Morningstar Corporate Bond Index is at +91 basis points in the A- category, +121 basis points in the BBB+ category, and +128 basis points in the BBB category.

Waste Management Ends 2017 With Good Results, Guides Toward Brighter 2018

MCR Credit Risk Assessment

Waste Management Inc (BBB+, stable) finished 2017 with decent fourth-quarter results, as mid-single-digit revenue growth fueled a similar increase in EBITDA. Management provided its initial 2018 earnings guidance. Versus 2017, it expects to push up core pricing more than 4%, expand adjusted EBITDA dollars 6%, and increase free cash flow in the low teens. Overall, these results and 2018 guidance reinforce our stable outlook on the company's credit rating.

Revenue increased 5.5% versus the year-ago period, driven by 230 basis points from average yield (pricing) and 260 basis points from volume growth. Net growth from net acquisitions and foreign currency were responsible for the remaining 60 basis points. The continued commitment to increase price and focus on profitability helped operating margins expand 60 basis points to 18.6%, although EBITDA margins contracted 20 basis points to 28.7%. For 2017, Waste Management produced $4 billion in adjusted EBITDA, up 8.1% from last year. Meaningful year-end capital expenditures caused fourth-quarter free cash flow to decline $46 million to $342 million, but full-year free cash flow of $1.8 billion was nearly $100 million higher than last year. During the quarter, the company paid $184 million in dividends and spent $149 million on acquisitions, ending the year with cash of $22 million and total debt of $9.5 billion. Gross leverage of 2.4 times was essentially unchanged from the third quarter and down modestly from the start of 2017.

We compare Waste Management with similar-rated peer Republic Services Inc (BBB+, negative) and rails Canadian Pacific Railway Ltd (BBB+, stable) and Norfolk Southern Corp (BBB+, stable) because of the significant barriers to entry for both sectors, given the difficulty in replicating operating networks: landfills and rail. Republic operates with higher gross leverage of 3.0 times, which explains its negative outlook, while the rails operate with rent-adjusted leverage of around 2.5 times and benefit from better Business Risk scores because of their wide economic moat ratings from Morningstar's Equity Research Group.

Market Data

According to pricing service Interactive Data, bonds with similar maturities for Waste Management and key comparables are indicated over the nearest Treasury as follows:
Waste Management 3.125% notes due in 2027 are indicated at +75 basis points.

Republic Services 3.375% notes due in 2027 are indicated at +84 basis points.
Canadian Pacific Railway 3.70% notes due 2026 are indicated at +78 basis points.
Norfolk Southern 3.15% notes due in 2027 are indicated at +71 basis points.

Kimco Realty Reports Good 4Q Despite Retail Headwinds

MCR Credit Risk Assessment

Kimco Realty Corporation (BBB+, stable) reported 2017 earnings that showed a slight improvement over 2016, a satisfactory result given the considerable headwinds facing all participants in the retail industry. Kimco's decades of experience through several economic cycles and good-quality property portfolio support its midrange Business Risk position. Its substantial liquidity, bolstered by a credit facility with a $2.25 billion capacity, underpins its midrange Cash Flow Cushion.

Kimco's funds from operations for 2017 increased 2.3% to $644 million, while same-store net operating income rose by 1.7%. Fourth-quarter same-store NOI was negatively affected by 120 basis points because of Hurricane Maria in Puerto Rico (2.5% of base rent) in September, which contributed to Kimco's growth lagging that of peers Federal Realty Investment Trust and Regency Centers Corporation. Kimco's same-store occupancy ended 2017 at 96%, up 60 basis points from a year earlier. For the 8.6 million square feet of same space new and renewed leases signed during 2017, the blended average rent increase was a solid 11.5%, though the pace slowed to 9.2% in the fourth quarter. The company is guiding to modest 2018 same-store NOI growth of 1.25%-2.0%. The expectation is particularly weak for the early part of the year, as several tenants that were in place at the beginning of 2017 have since vacated because of bankruptcies.

Though Kimco acknowledges the impact of tenant bankruptcies in its guidance for 2018, it has made good progress in taking advantage of opportunities to replace failed tenants with better retailers paying higher rents. It has also announced its intent to be a net seller of properties this year, by $700 million-$900 million, with only highly selective property purchases. Planned development and redevelopment for 2018 is to range from $425 million to $525 million, with more than half of the total to come from redevelopment. We project Kimco to generate rent growth at an annual rate of about 2.0%-2.5% over the next 12-24 months, while maintaining debt at around 6.5 times EBITDA and 35%-40% of gross assets. We also project EBITDA coverage of interest to range around 4.0 times. The company has extended its weighted average maturity to 10.7 years from 5.3 years just since 2015, having issued $1.25 billion in lower-cost debt in 2017.

Market Data

Kimco's shopping center REIT peers are Federal Realty Investment Trust (A-, stable), Regency Centers Corporation (BBB+, stable) and Weingarten Realty Investors (BBB, stable). The following pricing data is from Interactive Data as of Feb. 14.

In the 10-year area, spreads over the nearest Treasury from these issuers are:
Kimco's $400 million 3.80% bonds due 2027 at +129 basis points.
Federal Realty's $475 million 3.25% bonds due 2027 at +97 basis points.

Regency's $350 million 3.60% bonds due 2027 at +125 basis points.
Weingarten's $250 million 3.25% bonds due 2026 at +143 basis points.
The BBB+ Morningstar Corporate Bond Index is currently at a spread of +120 basis points.

CenturyLink Guides 2018 EBITDA Higher on Cost Synergies, Indicating Further Decline in Revenue
MCR Credit Risk Assessment
CenturyLink Inc. (BB-, negative) reported its fourth-quarter and full-year results Feb. 14. Performance in the fourth quarter continued to feature net declines in revenue, though profit margins remained stable. During the quarter, CenturyLink completed its acquisition of Level 3 Communications, which limits comparability with prior-year results. For 2018, we expect revenue trends to remain under pressure, which supports our negative rating outlook. Over the long term, we believe CenturyLink's enterprise portfolio and its consumer broadband business are likely to remain under heavy pressure from competing cable and telecom carriers.

On a pro forma basis, including results from both CenturyLink and Level 3 for the fourth quarter and adjusted for CenturyLink's midyear sale of its colocation data business, revenue declined 1.6% year over year. This was the net product of a 4.2% comparable decline in CenturyLink's adjusted revenue and 3.8% growth from a year ago in Level 3's revenue. Weakness was consistent across most of CenturyLink's business lines in the quarter, with only enterprise and consumer broadband and IT and managed services registering year-over-year revenue gains. Meanwhile, the company reported a 50-basis-point expansion in pro forma combined EBITDA margin, including merger synergies of $75 million.

Management has guided full-year 2018 EBITDA of $8.75 billion-$8.95 billion, up 1.7% at the midrange from pro forma 2017. Most of the improvement reflected in this guidance appears to be from merger cost synergy realization. The company reported $75 million of realized synergies during the fourth quarter, which we believe represents an annualized rate of $450 million. Backing out from these figures, we estimate revenue for the year down 1%-1.5% for 2018.

Total debt ended the year at $37.7 billion, up $18.0 billion from 2016, which includes $11.1 billion of Level 3 debt assumed in the acquisition and $6.8 billion of net new debt to fund a portion of the acquisition. Meanwhile, cash ended the year at $551 million, up $329 million from a year ago. Net debt ended the year at 4.3 times trailing pro forma combined EBITDA. Based on free cash flow and dividend guidance, we estimate net debt improving modestly to around 4.2 times by year-end 2018.

We calculate that CenturyLink generated $773 million of free cash flow during 2017 and paid out $1.45 billion in dividends. We also note that Level 3 reported $773 million of free cash flow for its first three quarters of the year through Sept. 30. Management is guiding 2018 free cash flow of $3.15 billion-$3.35 billion, which we estimate includes around $3.8 billion of capital expenditures and a roughly $300 million benefit from an expected tax refund and lower working capital usage. The company is also guiding to dividend payments of $2.3 billion for the year (a nearly 60% increase over 2017), which should reduce the payout ratio to around 70% of free cash flow.

Market Data

According to pricing indicated by trades reported to Finra Trace on Feb. 15, CenturyLink's 5.63% notes due 2025 are indicated at a yield to maturity of 7.07% (+425 basis points over the nearest Treasury). For comparison, lower-rated Dish Network Corp.'s (B+, stable) 7.75% notes due 2026 traded earlier at a yield to maturity of 7.54% (+467 basis points) and lower-rated Sprint Corp. (B, negative) 7.63% notes due 2025 traded at a yield to maturity of 7.39% (+457 basis points). The spread to Treasury on the CenturyLink notes is 70 basis points tighter from the level Nov. 8, the last time CenturyLink reported its earnings. Over the same period, the Dish notes are 28 basis points wider and the Sprint notes are 7 basis points tighter. All three series of notes continue to trade wide to the BofA/Merrill Lynch High Yield B Rated Index, which reported a yield to worst of 6.43% on Feb. 14 and an option-adjusted spread to Treasuries of +377 basis points.

NetApp Reports Solid 3Q Results; Management Signals Further Debt Reduction

MCR Credit Risk Assessment

On Feb. 14, NetApp, Inc. (BBB, stable) reported fiscal third-quarter revenue up 8% year over year and a 110-basis-point expansion in gross margin. Results for the quarter were consistent with our stable rating outlook and our expectation for positive revenue trends in the near term as sales of flash array and converged storage systems gain momentum.

Revenue growth was supported in the quarter by solid customer demand for NetApp's flash cloud storage products as well as market share gains in legacy product segments. The company reported strategic revenue up 26% year over year and legacy revenue up 6%. Legacy businesses still account for 30% of product revenue, though we expect strategic lines to continue to gain traction over the next few years. EBITDA also strengthened 7% from a year ago, helped by an expanded gross margin but offset by higher operating expenses due to higher variable compensation. The company also recorded a one-time tax charge of $860 million related to the Tax Cuts and Jobs Act of 2017, including a tax on accumulated foreign earnings.

For its April fiscal fourth quarter, management is guiding to midpoint revenue up 6% year over year, excluding 2 percentage points from an expected currency benefit and shading gross margin slightly weaker, sequentially, on pressure from a higher mix of product revenue. Management also guided effective tax rate to be 18% for fiscal 2018, which represents a blend of eight months at the pre-reform tax rate and four months of the lower tax rate.

Supported by revenue and margin tailwinds, we calculate trailing 12-month free cash flow of $1.2 billion, up 53% from the comparable year-ago period. During the period, NetApp completed $400 million of net share repurchases and paid out $212 million in dividend payments, bringing the total shareholder payout to 50% of free cash flow, significantly lower from its 123% payout a year ago. Management remains committed to exhaust the remaining $344 million of its share-repurchase authorization by the end of May.

Total debt ended the January quarter at $2.2 billion, up $288 million from a year ago, including $50 million of net new senior debt and $632 million of commercial paper outstanding at the end of the quarter. Cash and investments were also up $980 million to $5.6 billion from a year ago, driven by net cash flow of $519 million after dividends and the aforementioned net proceeds from debt. At the end of January, total debt represented 1.4 times trailing 12-month EBITDA, compared with 2.4 times a year ago, while cash and investments in excess of debt expanded to 3.8 times EBITDA from 3.5 times a year ago. Management expects to repatriate $4 billion of foreign cash over the next 12 months and indicated it will use some of the cash to reduce leverage. In addition to the commercial paper, NetApp also has $400 million of senior notes due in September 2019.

Market Data

According to pricing source Interactive Data as of Feb. 14, BBB rated NetApp's 3.38% notes due 2021 are indicated at +71 basis points over the nearest Treasury, or 7 basis points tighter from Nov. 15, the date of NetApp's last earnings release. For comparison, same-rated Hewlett Packard Enterprise's (BBB, negative) 4.40% notes due 2022 are indicated at +95 basis points, 6 basis points wider from mid-November. Over the same period, Juniper Networks' (BBB+, stable) 4.60% notes due 2021 are indicated at +97 basis points, 15 basis points wider. The Morningstar Industrial Corporate BBB Index, quoted at +127 basis points as of Feb. 14, is 10 basis points tighter over the past three months.

Deere Cultivates Strong Organic Growth and Raises 2018 Guidance

MCR Credit Risk Assessment

Deere & Co (A, stable) reported robust first-quarter revenue, as the recovering farming economy propelled organic worldwide equipment sales nearly 20% higher versus the year-ago period. These strong conditions allowed management to increase its 2018 guidance. The company now expects 2018 revenue to expand 29% from 22% previously, implying organic growth of 13% compared with 7% at the start of the year. We estimate that this forecast could translate into EBITDA growth of more than 40% based on incremental gross margins somewhere between 24% and 29%.

For the quarter, manufacturing business revenue expanded 24.2%, as sales from the Wirtgen acquisition contributed 500 basis points to the top line. Deere said price realization was flat, so almost all the benefit was volume-based. Deere saw modest compression in its gross margin but was able to scale its selling, general, and administrative expenses. As a result, EBITDA margins expanded 130 basis points to 10.2%. However, first-quarter cash flow generation is historically negative due to meaningful inventory build: $1.1 billion this quarter. Deere thus far burned through $1.2 billion in free cash flow, $260 million worse than last year, which experienced a similar shortfall of 19% in sales. Deere paid $193 million in dividends and mostly used cash to fund the $5.1 billion Wirtgen tab. In total, cash decreased $5.6 billion to $2.6 billion while debt increased $700 million to $6.6 billion, pushing up gross leverage 0.1 turn to 1.8 times.

We compare Deere with peers Cummins Inc (A, stable) and Caterpillar Inc (A-, stable). Deere's gross leverage of 1.8 times is above Caterpillar's adjusted EBITDA leverage of 1.3 times and Cummins' 0.8 times. Even still, Deere's credit rating benefits from a better Cash Flow Cushion score compared with

Caterpillar, while its Business Risk is stronger than Cummins' because Deere has a medium uncertainty and wide moat rating from Morningstar's Equity Research Group versus high and narrow for Cummins.

Market Data
According to pricing service Interactive Data, bonds with similar maturities for Deere and key comparables are indicated over the nearest Treasury as follows:
The Deere 2.60% notes due in 2022 recently traded at +46 basis points.
The Cummins 3.65% notes due in 2023 recently traded around +21 basis points.
The Caterpillar 3.40% notes due in 2024 recently traded at +40 basis points.

Rising Debt and Event Risk Overshadow CBS' Solid 4Q Operating Performance
MCR Credit Risk Assessment
CBS Corp. (BBB, stable) reported its fourth-quarter and full-year operating results Feb. 15. Results for the quarter reflected strong growth trends in licensing and broadcast fees, muted somewhat by higher programming costs and weak ad revenue. While performance remains supportive of our stable rating outlook, CBS' debt usage continues to edge higher and management remains committed to high shareholder payouts. Event risk also remains elevated amid a renewal of discussions with Viacom Inc. (BBB, stable) over a potential remerger of the two companies. Strategically, we would view a merger as more beneficial for Viacom than for CBS, while the net impact on the credit profile of the combined companies depends heavily on the financing mix being considered.

For the fourth quarter, CBS reported 11.5% revenue growth year over year, led by 33% growth in content licensing fees backed by growing demand from video platforms for CBS' programming slate. Affiliate fees grew 20% year over year, including a 31% jump in retransmission and reverse comp fees, supported by strong subscriber trends across distribution channels. Overall advertising revenue remained down 2.8% year over year on lower political spending compared with 2016. Despite solid revenue performance, operating income was flat compared with a year ago, adjusted for the CBS Radio sale, which closed in the fourth quarter. Despite stronger revenue trends, the firm's EBITDA margin declined 50 basis points from a year ago to 20.3% on higher programming expenses. CBS reported 5 million combined subscribers to its CBS All Access and Showtime platforms, ahead of its prior guidance of 4 million by year-end 2017. Management is maintaining its longer-term target of 8 million subscribers globally by 2020.

Notwithstanding CBS' solid operating performance, we believe its capital policy represents a headwind to credit strength in the year ahead and provides less balance sheet flexibility in the event it reaches a merger agreement with Viacom. At year-end 2017, CBS reported total debt up $1.2 billion from the prior year, while cash on hand declined $313 million. Net debt ended the year up 0.7 turn to 3.2 times trailing 12-month EBITDA, marking the fourth consecutive quarter that the leverage has been on the rise. During the year, CBS raised $2.0 billion of new debt, including a $900 million private offering of senior notes in the fourth quarter, and made repayments of $1.3 billion. Most of the net increase in debt for the year was used to fund a $600 million voluntary pension contribution. Our rating and stable outlook is based on our assumption that CBS will continue to target net debt of 2.5-3.0 times EBITDA over time. For comparison, Viacom reported net debt of 3.3 times EBITDA at the end of its December quarter, with senior debt representing 2.9 times.

CBS reported $1.6 billion of free cash flow before pension contributions for the year, up 18% from 2016. Meanwhile, CBS paid out $1.3 billion in dividends and net share repurchases in addition to the pension contributions. For 2018, CBS is guiding share-repurchase volume of $800 million-$1 billion. Combined with around $300 million of dividend payments, total payout appears in line to slightly lower than 2017 activity. CBS also faces $698 million of debt maturities over the next 12 months, including $679 million of outstanding commercial paper that it reported at year-end.

Market Data

According to pricing indications supplied by Interactive Data as of Feb. 15, CBS' 3.38% notes due 2028 were indicated at +132 basis points over the nearest Treasury, 4 basis points tighter from CBS' third-quarter earnings release on Nov. 2. Over the same period, Omnicom Group Inc.'s (BBB+, stable) 3.60% notes due 2026 were indicated 6 basis points tighter at +118 basis points while Comcast Corp's (A-, stable) 3.30% notes due 2027, indicated at +82 basis points, are 9 basis points tighter. Viacom's 3.45% notes due 2026 are indicated at +132 basis points, or just 4 basis points wider than CBS' 4% notes due 2026. For comparison, this differential was 46 basis points on Nov. 4, prior to the news of renewed merger talks. Since then, Viacom's 2026 notes have tightened 32 basis points. Meanwhile, the BBB Morningstar Corporate Bond Index, currently quoted at +125 basis points, is only 5 basis points tighter since Nov. 4.

Vulcan Materials Reports Flat 4Q Adjusted EBITDA

MCR Credit Risk Assessment

Vulcan Materials (BBB-, stable) reported fourth-quarter and full-year results that showed full-year 2017 adjusted EBITDA of $982 million, up 2% from a year ago. Total revenue for the year was $3.9 billion, up 8% compared with the year-ago period. For the quarter, revenue was $977 million, up 12% compared with the same quarter a year ago, while adjusted EBITDA was essentially flat at $233 million. Fourth-quarter results were negatively affected by higher diesel fuel costs as well as lingering costs associated with the impact from hurricanes Harvey and Irma. Balance sheet debt was $2.9 billion as of Dec. 31 with cash and equivalents on hand of $142 million. As a result, debt/adjusted EBITDA was approximately 2.9 times. Free cash flow on a last-12-months basis was $185 million after capital spending of $460 million, and dividends and share repurchases were $193 million in 2017.

The company closed on its acquisition of Aggregates USA ($610 million net of divestitures) in December. In 2018, we expect Vulcan to maintain debt/adjusted EBITDA at under 3.0 times and to continue to be free cash flow positive.

For a comparable, we look to industry competitor Martin Marietta Materials (BBB-, stable), which is expected to close on its Bluegrass aggregates acquisition (approximately $1.6 billion) in the first half of 2018. Its debt/EBITDA was 3.0 times after it prefunded the Bluegrass acquisition in December. Cash and equivalents on hand at the end of 2017 was almost $1.5 billion.

Market Data

According to Interactive Data, Vulcan Materials' 3.9% notes due April 1, 2027, recently traded at a spread of +107 basis points to the nearest Treasury. Similar-rated competitor Martin Marietta's 3.45% notes due June 1, 2027, recently traded at a spread of +112 basis points. For an index comparison, we look to the BBB- Morningstar Corporate Bond Index, which is quoted at a spread of +147 basis points.

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