Morningstar Corporate Credit Research Highlights

Corporate Credit Spreads Largely Unchanged as Supply Equals Demand

Morningstar Credit Ratings, LLC
23 April 2018

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Credit Rating Actions

- Rating Changes

Issuer/Ticker	Current Issuer Credit Rating	Previous Issuer Credit Rating
HCA Healthcare **HCA**	BB+	BB
Cisco Systems **CSCO**	AA-	AA
Bed Bath & Beyond **BBBY**	BB+	BBB-

- Rating Affirmations

Issuer/Ticker	Current Issuer Credit Rating	Previous Issuer Credit Rating
Wynn Resorts **WYNN**	BB-	BB-
Oracle **ORCL**	AA-	AA-

Recent Notes Published by Credit Analysts

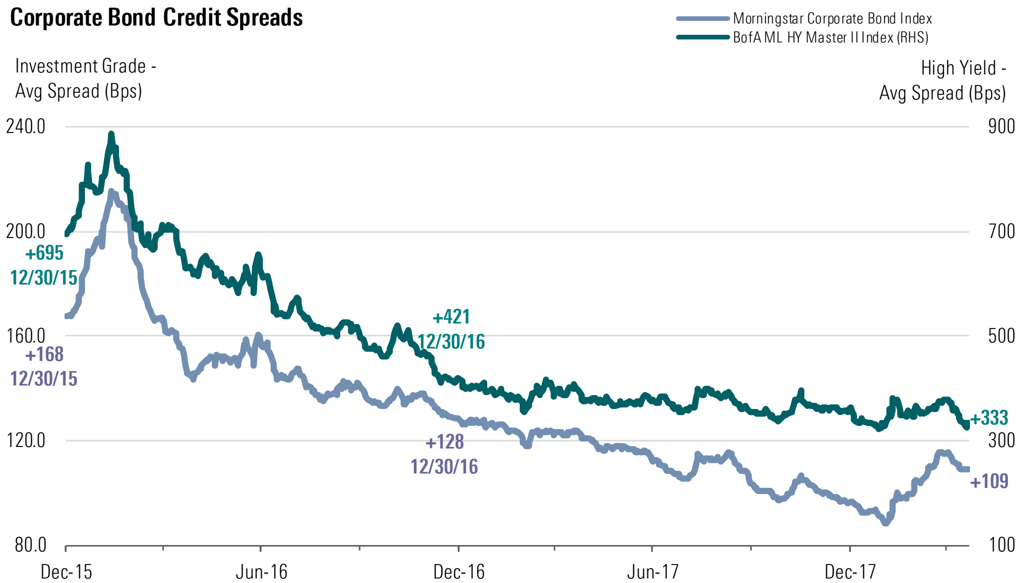
- **Wells Fargo** (A, Stable) Posts Mediocre 1Q Results, Compounded by Threat of $1 Billion Fine
- **Bank of America** (BBB+, Stable) Reports Record 1Q Profits on Revenue Growth, Lower Tax Rate
- **Citigroup** (A-, Stable) Reports 1Q Profit Growth on Modest Revenue Expansion, Lower Tax Rate
- **Johnson & Johnson**'s (AAA, Stable) Strong 1Q Results Prompt Increase in 2018 Sales Guidance
- **Prologis** (A-, Stable) Posts Another Strong Quarter in 1Q as Industrial Property Strength Continues
- **Abbott** (A-, Positive) Highlights Ongoing Deleveraging Progress Along With 1Q Results
- **CSX** (BBB+, Stable) Delivers Impressive 1Q Profitability
- **Morgan Stanley** (BBB+, Stable) Posts Strong 1Q on Higher Revenue, Lower Taxes
- **Quest**'s (BBB+, Stable) Operating Results on Target in 1Q While Leverage Remains Steady
- **Novartis**' (AA, Stable) 1Q Performance Aligns With 2018 Expectations; Dividends Stress Net Leverage
- **PPG** (BBB+, Stable) Repurchases $600 Million of Shares in 1Q
- **Bank of New York Mellon** (A+, Stable) Starts 2018 With Strong Results, Supporting Rating

Credit Market Insights

Corporate Credit Spreads Largely Unchanged as Supply Equals Demand

Although the stock market eked out a gain last week, the S&P 500 is muddling along near the middle of its year-to-date trading range. Corporate credit spreads in the investment-grade market ended the week unchanged. In the high-yield market, credit spreads tightened slightly but lagged far behind their prior-week performance. The average spread of the Morningstar Corporate Bond Index ended the week at +109, and the average spread of the BofA Merrill Lynch High Yield Master Index tightened 5 basis points to +333 basis points. At this level, high-yield credit spreads are near the low end of the 90-basis-point range that they have traded in since the beginning of 2017. While credit spreads in the high-yield market are near the lows they hit in January, credit spreads in the investment-grade market remain well wide of the levels they hit earlier this year.

Corporate Bond Credit Spreads



Source: Morningstar,Inc., BofA Merrill Lynch Global Indexes. Data as of 4/20/2018.

According to one Wall Street bond trader, supply and demand in the investment-grade bond market were balanced as the amount of new issue supply was evenly matched with investors with a limited amount of cash that needed to be put to work. According to this trader, the demand from international investors has mostly dried up and the real underlying demand in the marketplace has been from domestic buyers. He said the massive selling in short-duration corporate bonds that occurred earlier this year (which was what pushed investment-grade credit spreads wider) has subsided, and the market has "kinda sorta stabilized." Some front-end buyers have begun to emerge as the higher all-in yield on shorter-duration paper has attracted attention, but the trader noted that the buyers are a different investor base than those seen last year. In addition to the re-emergence of buyers in the short end, he said many institutional investors have been looking to improve the quality of their portfolios by swapping out of lower-rated issuers and into higher-rated issuers.

In the high-yield market, the continued rise in oil prices has helped to propel the index to within 10 basis points of the tightest levels it has reached this year and the tightest that it has traded since before the 2008-09 global credit crisis. The average spread of the energy sector has tightened to inside +400, the tightest it has traded since early January. In addition to oil prices charging higher, other commodity prices, such as aluminum, in the metal market have surged. The prices have helped propel the average spread of bonds in the metals and mining subsector tighter. The average spread of the metals and mining sector tightened 13 basis points last week to +334, the tightest it has traded since mid-February.

Interest rates continued their march higher, and the yield on the 10-year Treasury bond ended the week within spitting distance of 3%. Last week, we noted that both headline and core CPI were running near the Federal Reserve's inflation goal and that with inflation running at the Fed's preferred rate, investors are pricing in several more hikes to the federal-funds rate this year. The yield on the U.S. 2-year Treasury bond increased 10 basis points to 2.46%, its highest since August 2008. The yield on the 5-year Treasury bond rose 13 basis points to 2.80%, its highest since August 2009. The yield on the 10-year rose 13 basis points to 2.96%, its highest since it hit 3% at end of 2013. Although the 10-year Treasury bond yield touched 3% in 2013, it has not traded above 3% on a sustainable basis since 2011. Along the longest end of the curve, the 30-year bond rose 12 basis points to 3.15%. According to the CME FedWatch Tool, the market-implied probability that the federal-funds rate will end the year at 200 basis points or higher rose by 6%, to 90%. The probability that the federal-funds rate will end the year at 225 basis points or higher rose by 9%, to 45%.

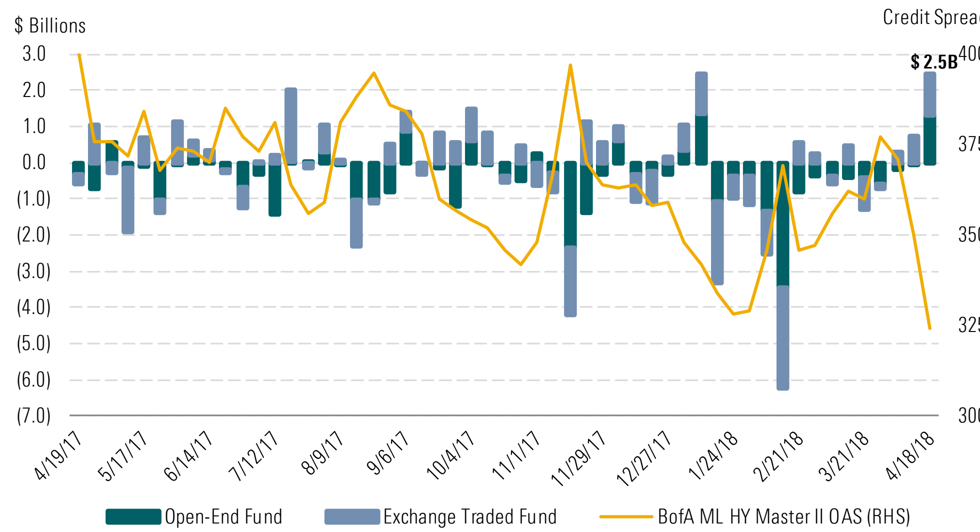
Weekly High-Yield Fund Flows Surge, but Inflows May Be Short-Lived

Two weeks ago, we noted that investors were just starting to dip their toes back into the waters of the high-yield market after staying on dry land for the past three months. Investors plunged headfirst into the deep end last week as net inflows into high-yield open-end mutual funds and exchange-traded funds totaled $2.5 billion for the week ended April 18. This amount of inflows tied for greatest weekly inflow over the past 52 weeks and tied for the 10th-greatest amount of weekly inflows since the beginning of 2014. Inflows were evenly split between $1.3 billion of deposits into open-end funds and $1.2 billion of net unit creation among the exchange-traded funds.

However, volatility is still the name of the game in the high-yield market. On April 19, the day after our weekly high-yield fund flows amount was calculated, there was a net unit redemption of $685 million out of the high-yield sector. Those redemptions were driven in $531 million of new unit redemptions among the high-yield ETFs and $155 million of outflows reported by open-end funds that report daily fund flows.

Through April 18, even after incorporating for the surge of inflows, there has been a total of $10.3 billion of outflows across the high-yield sector, consisting of $6.7 billion of outflows among the open-end high-yield mutual funds and $3.6 billion of net unit redemptions among the high-yield ETFs.

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 April 20, 2018

(000,000s $ unless otherwise noted)

Issuer			Issue				
Name	Ticker	Morningstar Corporate Rating[1]	Size	Coupon	Description	Maturity	Approx Spread to US Treasuries
Bank of America	BAC	BBB+	€ 2,000	Euribor+70	Senior Unsecured	2024	NA
Bank of America	BAC	BBB+	€ 1,250	VAR	Senior Unsecured	2028	+80[2]
Citigroup	C	A-	$2,000	VAR	Senior Unsecured	2029	+125
Commercial Metals	CMC	BB+	$300	5.75%	Senior Unsecured	2026	+285
Goldman Sachs	GS	BBB+	$3,500	VAR	Senior Unsecured	2029	+135
Goldman Sachs	GS	BBB+	$1,500	VAR	Senior Unsecured	2039	+135
JPMorgan Chase	JPM	A	$2,200	VAR	Senior Unsecured	2021	+65
JPMorgan Chase	JPM	A	$1,300	L+34	Senior Unsecured	2021	NA
JPMorgan Chase	JPM	A	$1,750	VAR	Senior Unsecured	2024	+88
JPMorgan Chase	JPM	A	$500	L+73	Senior Unsecured	2024	NA
JPMorgan Chase	JPM	A	$2,250	VAR	Senior Unsecured	2029	+118
Morgan Stanley	MS	BBB+	$2,750	VAR	Senior Unsecured	2024	+98
Morgan Stanley	MS	BBB+	$1,000	VAR	Senior Unsecured	2039	+135

Source: Bloomberg, company Securities and Exchange Commission filings

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

(2) Spread over midswaps

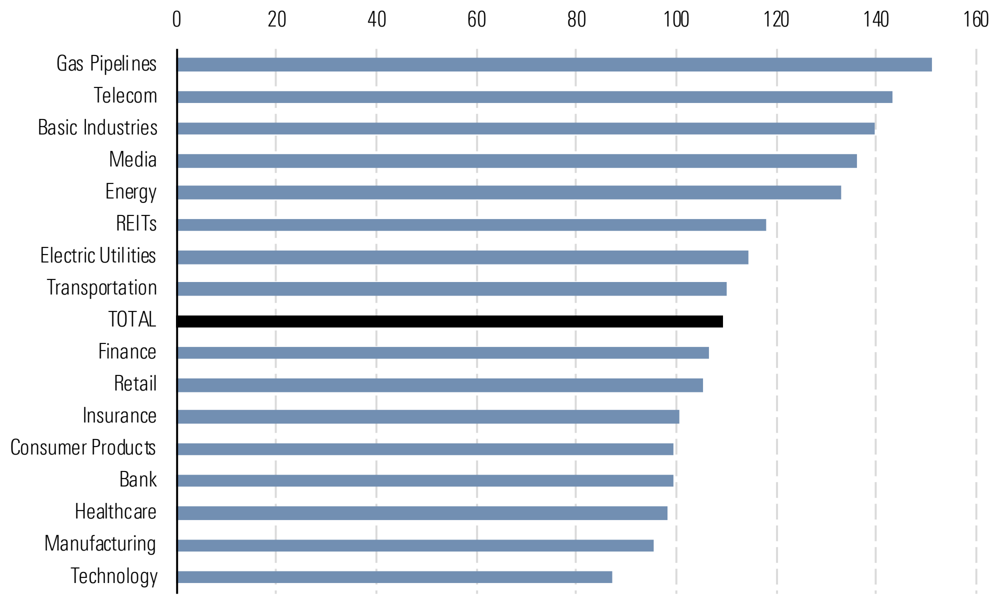
Exhibit 2 Morningstar Corporate Bond Index Sector Summary

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-**	**5,028**	**6.9**	**109**	**(5)**	**13**	**(0.89)**	**(3.11)**
FINANCIAL	**A-**	**1,484**	**5.3**	**101**	**(6)**	**18**	**(0.67)**	**(2.73)**
Bank	A-	902	4.9	99	(7)	18	(0.58)	(2.47)
Finance	A	271	5.5	106	(5)	19	(0.77)	(3.18)
Insurance	A	219	7.9	101	(5)	15	(0.89)	(3.56)
REITs	BBB+	84	5.9	118	0	14	(1.05)	(3.07)
INDUSTRIAL	**A-**	**2,925**	**7.5**	**112**	**(5)**	**11**	**(0.99)**	**(3.28)**
Basic Industries	BBB	246	7.6	140	(3)	11	(0.89)	(3.24)
Consumer Products	A-	329	7.5	99	(9)	15	(1.05)	(3.82)
Energy	A-	416	7.3	133	(6)	11	(0.78)	(2.79)
Healthcare	A-	402	7.7	98	(5)	10	(1.14)	(3.82)
Manufacturing	A-	465	6.0	95	(6)	14	(0.80)	(2.90)
Media	BBB+	187	8.4	136	(6)	7	(0.97)	(3.49)
Retail	A-	167	7.8	105	3	19	(1.10)	(3.69)
Technology	A+	357	7.2	87	(5)	10	(1.02)	(3.24)
Telecom	BBB+	148	9.2	143	(5)	0	(1.23)	(2.34)
Transportation	BBB+	155	9.0	110	(3)	12	(1.19)	(4.07)
UTILITY	**BBB+**	**580**	**8.6**	**130**	**(6)**	**10**	**(1.05)**	**(3.59)**
Electric Utilities	A-	335	9.1	114	(5)	11	(1.20)	(3.99)
Gas Pipelines	BBB	232	7.9	151	(7)	8	(0.83)	(2.92)
Rating Bucket								
AAA Bucket		113	8.0	54	(4)	6	(1.17)	(3.48)
AA Bucket		470	5.6	66	(6)	8	(0.68)	(2.39)
A Bucket		1,960	6.7	90	(6)	16	(0.93)	(3.33)
BBB Bucket		2,485	7.2	138	(6)	11	(0.88)	(3.05)
Term Bucket								
1-4	A-	1,616	2.3	70	(9)	13	(0.09)	(0.67)
4-7	A-	1,169	4.7	98	(5)	18	(0.64)	(2.33)
7-10	A-	920	7.0	122	(3)	16	(1.04)	(3.68)
10PLUS	A-	1,323	13.7	154	(3)	9	(1.86)	(5.94)

Data as of 04/20/2018

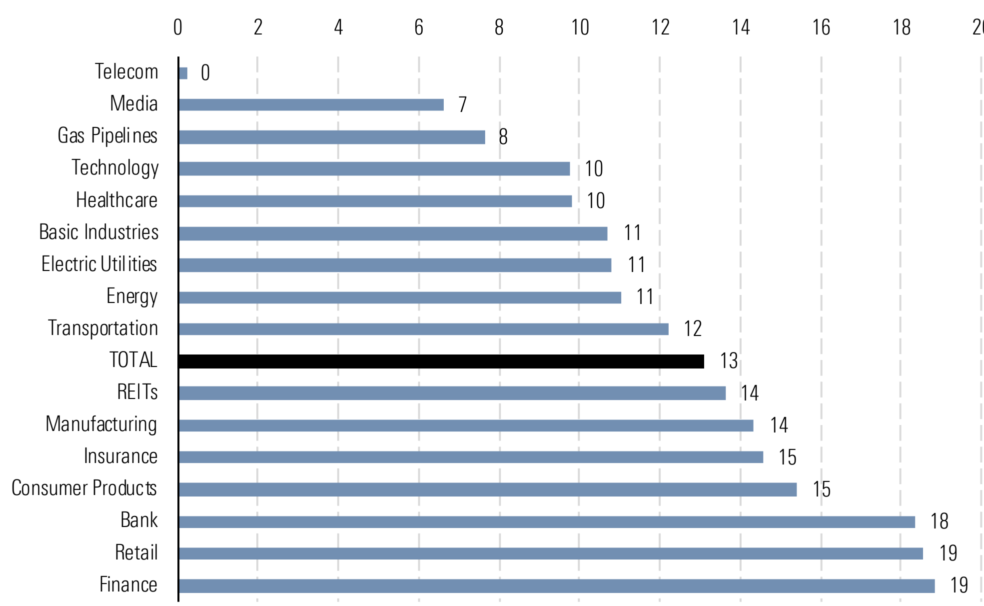
Source: Morningstar, Inc.

Exhibit 3 Morningstar Corporate Bond Index Spread by Sector



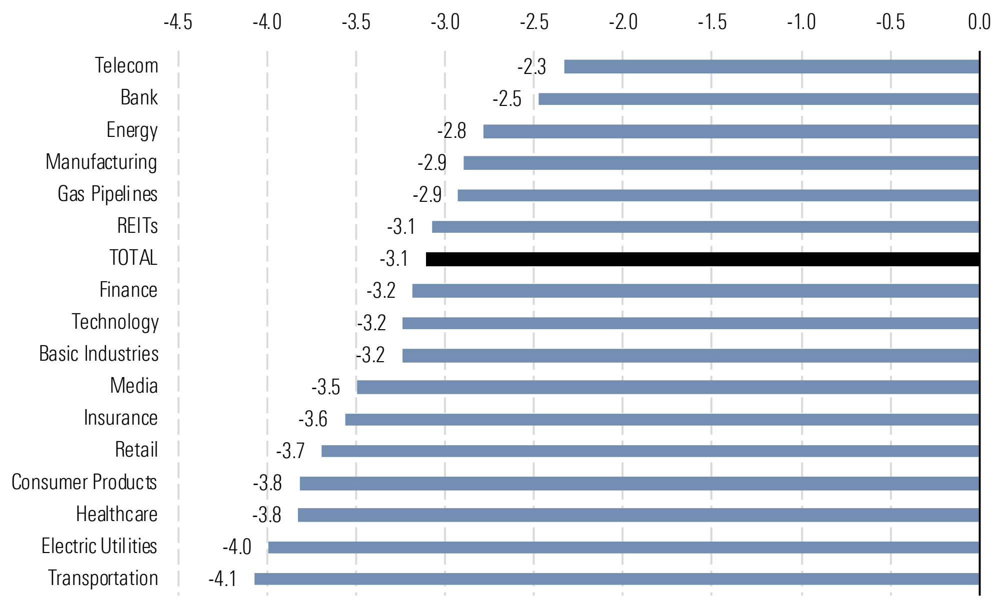
Source: Morningstar, Inc.

Exhibit 4 Morningstar Corporate Bond Index YTD Spread Change



Source: Morningstar, Inc.

Exhibit 5 Morningstar Corporate Bond Index YTD Return



Source: Morningstar, Inc.

Credit Rating Actions

Rating Changes

Issuer/Ticker	Current Issuer Credit Rating	Previous Issuer Credit Rating
HCA Healthcare **HCA**	BB+	BB
Cisco Systems **CSCO**	AA-	AA
Bed Bath & Beyond **BBBY**	BB+	BBB-

Rating Affirmations

Issuer/Ticker	Current Issuer Credit Rating	Previous Issuer Credit Rating
Wynn Resorts **WYNN**	BB-	BB-
Oracle **ORCL**	AA-	AA-

HCA's Rating Upgraded One Notch to BB+ on Improved Business Risk Pillar; Outlook Stable

Morningstar Credit Ratings, LLC is upgrading the credit rating for HCA Healthcare Inc to BB+ from BB to reflect a better view of two factors that affect HCA's Business Risk pillar: the economic moat and uncertainty assessments. With those better assessments, our Business Risk pillar has improved enough to upgrade. However, the company continues to manage its balance sheet as expected, and we believe HCA remains a high-quality high-yield issuer.

On April 4, Morningstar's Equity Research Group increased its moat assessment on HCA to narrow from none and reduced its uncertainty score to high from very high after taking a fresh look at both HCA and the hospital industry. On the moat, HCA's returns on invested capital exceed its capital costs, and given those returns combined with HCA's substantial local market share, we believe the equity group's decision to raise its moat assessment to narrow from none has merit. Also, considering HCA's relatively steady results within healthcare services, reducing the uncertainty score to high from very high appears appropriate as well. When considering those two factors, HCA's Business Risk pillar has improved enough for us to upgrade one notch.

HCA's other pillars (Cash Flow Cushion, Solvency Score, and Distance to Default) remain influenced by its substantial debt obligations and ongoing outflows to stakeholders. With gross debt/adjusted EBITDA of 4.0 times as of December 2017, HCA operates in the middle of its leverage target of 3.5-4.5 times debt/adjusted EBITDA. Given its current debt leverage compared with historical norms and its target range, HCA's obligations remain manageable as long as the firm has access to external financing. With significant financial resources at its disposal, including $732 million in cash on hand to more than cover its current debt ($200 million as of December), we have no concerns about its short-term liquidity. The company's obligations are large in the long run, though. As of December 2017, HCA owed $33 billion in debt, and it may need to refinance some of those obligations as they come due, especially given ongoing outflows to stakeholders that include share repurchases, distributions to noncontrolling interests, and a recently initiated dividend.

Our stable outlook reflects HCA's solid fundamental outlook along with our view that the company will be able to access external financing for the foreseeable future. We probably would need to see substantial deleveraging and a commitment to operating in investment-grade territory by management to consider an upgrade. Given plans to return substantial cash to stakeholders, we view that scenario as unlikely in the near future. Our rating could fall if the firm's leverage increases substantially on a sustainable basis, as that could negatively influence its leverage-sensitive pillars. This scenario could occur if profits grow slower or even decline while the firm keeps pushing cash out to stakeholders at a fast clip. A large, debt-funded acquisition could also cause leverage to rise substantially as well.

Downgrading Cisco's Rating to AA-, Outlook Negative on Expected Cash Flow Cushion Pressure
Morningstar Credit Ratings, LLC is downgrading its corporate credit rating on Cisco Systems Inc. by one notch to AA- and shifting the outlook to negative from stable. Our revised rating reflects our expectation of increasing pressure on both the Cash Flow Cushion and Solvency Score over the next two years as a result of management's intention to depart from its historically conservative capital policy through a reduction in cash and investment balances to support a higher volume of share repurchases. The negative outlook incorporates the risk that pressure on Cisco's credit pillars may prove more persistent than we currently project. We continue to view Business Risk as low, supported by Morningstar's Equity Research Group's narrow economic moat assessment which is based on leading share in enterprise routing and switching and high customer switching costs. Business Risk also reflects a low dependence on capital markets, modest cyclical exposure, and medium operating uncertainty.

In the years ahead, we expect Cisco's organic revenue growth to remain low as stronger growth from network security, data center, and collaboration are offset by modest secular declines in Cisco's legacy network switching and routing driven by mounting competition from both white-box and software-based substitutes. Cisco has been highly acquisitive in the past, but the dollar volume of acquisitions has been subdued in recent years as Cisco has focused its efforts on buying smaller firms focused on niche products in software and the cloud. Management has indicated that it expects to maintain recent levels of acquisition spending despite proposed accelerated share repurchases.

Cisco's total debt was $39.4 billion at the end of January, or just under 2.6 times trailing EBITDA, up $4.4 billion from a year ago on an increase in commercial paper borrowing. Meanwhile, cash and short-term investments ended the January quarter at $73.7 billion, a decrease of $2.6 billion from a year ago, excluding the impact of additional borrowing during the past 12 months. At present, Cisco maintains ample reserves of excess cash over debt, equivalent to 2.2 times EBITDA, and its strong and consistent free cash flow generation has historically provided solid support to its credit profile.

However, management's recently announced plan to repatriate $67 billion of non-U.S. cash reserves during the third fiscal quarter (ending April) to pay shareholders marks a dramatic departure from its historically conservative capital policy. In preparation, Cisco's board of directors added $25 billion of additional repurchase capacity in the January quarter, bringing the total remaining authorization to $31 billion, which management expects to utilize fully within 18-24 months. Pro forma for this repurchase activity, we project cash on hand to decline toward $50 billion by the end of calendar 2019, with cash in excess of debt contracting to roughly 0.9 times our 2020 EBITDA estimate. As a result, we expect that the reduction in cash and less retained cash flow will likely weaken the Cash Flow Cushion over the next year or two.

Our rating is based on average revenue growth between 1% and 2% over the next five years and a stable GAAP operating margin in the mid-20s. Given our expectation of growing pressure on the Cash Flow Cushion over the next two years, we currently do not anticipate an upgrade to the rating. We may consider a downgrade of the rating if management continues to increase its use of debt or if operating fundamentals begin to trend meaningfully below our forecast.

Bed Bath & Beyond's Rating Downgraded to BB+; Outlook Revised to Negative

Morningstar Credit Ratings, LLC is downgrading Bed Bath & Beyond Inc.'s corporate credit rating one notch to BB+ and revising the outlook to negative from stable. The lower rating reflects our expectation that the decline in profitability appears likely to continue over the next two years at a more severe pace than previously anticipated, further stressing cash flow and credit protection measures. The negative outlook reflects greater uncertainty and reduced operating visibility over this period which may limit the effectiveness of initiatives undertaken by the company to stabilize operations.

Bed Bath & Beyond's Solvency Score remains weak, based in part by lower projected margins and return on invested capital over the next several years. EBITDA margins have steadily declined, falling to 8.7% in fiscal 2017 from a peak of 18.4% in 2011. Return on invested capital declined to 10.3% from 21.3% over the same period. While management forecasts a return to positive comparable-store sales growth in fiscal 2018, we believe that ongoing investments in growth, efficiency, and cost-saving initiatives are likely to keep pressure on gross margins and drive higher operating expenses for the next two years. To drive higher same-store sales performance, Bed Bath & Beyond is investing in its online operations, which has posted annual revenue growth rates of over 20%. Management is also targeting $150 million in inventory reduction through additional optimization and supply-chain management. Morningstar forecasts EBITDA margins to contract by more than 200 basis points over the next two years, with return on invested capital settling into the mid-single-digit range.

Adjusted debt was $6.1 billion at year-end 2017 and included a $4.7 billion operating lease commitment. Debt levels have remained relatively stable following $1.5 billion of debt issued in fiscal 2014 primarily to fund share repurchases. However, adjusted debt leverage continues to rise as EBITDAR declines. Adjusted gross debt leverage, including operating leases, was 3.7 times at year-end 2017, marking a considerable increase from leverage of 2.6 times at the time of the 2014 bond issuance. Cash and short-term investments totaled $724 million, resulting in net leverage of 3.3 times. Bed Bath & Beyond maintains an undrawn, $250 million committed revolver with a maturity date that was recently extended to 2022. The company's Cash Flow Cushion benefits from the absence of any debt maturities until 2024 but has deteriorated over the past year due to a decline in our projection for cash flow over the next five years. Over the past two years, free cash flow has exceeded shareholder distributions.

Bed Bath & Beyond's Business Risk pillar remains fair, supported by an estimated 11% share of the $100 billion-plus U.S. retail home furnishing industry with over 1,500 stores in operation under five core brands plus additional online-only brands. The company strives to offer differentiated products, services, and solutions to better compete in what has become an increasingly transparent retail price environment. In addition, key areas of focus remain in bridal and baby registry, home moves, back to college, and decorating. Sustained investments in its digital platform promote integration with its store base and distribution, which includes about 50% of its capital spending budget on technology projects. However, the company operates in a very competitive retail sector that is increasingly penetrated by online rivals that exert pricing pressure. Bed Bath & Beyond does not have an economic moat as assigned by Morningstar's Equity Research Group.

The negative outlook reflects heightened uncertainty and a lack of visibility into the company's market environment over the next year or two. We believe the company may continue to experience substantial pricing and margin pressure, which could limit the effectiveness of initiatives undertaken by the company to stabilize operations and lead to a downgrade. While an upgrade is unlikely over the next several years given the negative outlook, we may revise our outlook to stable if management's initiatives to increase sales and margins prove sufficiently effective to drive improvement in the Solvency Score and Cash Flow Cushion.

Wynn Resorts' Rating Affirmed at BB-; Stable Outlook Maintained

Morningstar Credit Ratings, LLC is affirming Wynn Resorts, Ltd.'s rating at BB- and maintaining a stable outlook. Morningstar's affirmation is based on Wynn's strong market position in high-end gaming, offset by uncertainty regarding ongoing reviews by gaming commissions and the impact of Steve Wynn's departure as CEO.

Wynn's high Business Risk score is supported by its well-known brand and its Macau gaming license, which is somewhat offset by a lack of cash flow diversity, inherent cyclicality in the gaming industry, and uncertainty related to the departure of Steve Wynn. The company operates two resorts in the Macau region of China, one resort in Las Vegas, and is constructing a fourth property in the Boston market. Wynn's resorts are positioned at the high end of the market, offering luxury hotel rooms integrated with high-end retailing, dining, entertainment, conference halls, and gaming. The company's Macau operations enjoy competitive advantages due to its award of one of only six gaming licenses in the region, where government regulations provide barriers to entry from new competition and limit additional growth. The Macau operations now generate over 70% of property level EBITDA, following the August 2016 opening of the Wynn Palace in Cotai. In the U.S., Wynn is expanding beyond its Las Vegas presence with a new Boston-area resort that is expected to open in mid-2019. Morningstar's Equity Research Group has assigned Wynn a narrow economic moat. Wynn's rating considers the potential negative impact and uncertainty connected to Steve Wynn's departure, including a potentially weakened brand and ongoing reviews by gaming regulators. Longer term, the rating incorporates Morningstar's expectation that Wynn will successfully extend its concession agreement with the government of Macau that is due to expire in 2022.

Wynn has significantly reduced debt leverage over the past year, as operating results rebounded in Macau in 2017 following a period of weakness related to government actions to reduce corruption. The company's strong Solvency Score reflects significant profitability and cash flow improvement related to the opening of the Wynn Palace, which added to EBITDA as capital spending on the project concluded. In 2017 Wynn generated nearly $1 billion in free cash flow, following a deficit in each of the previous three years. Following modest debt repayment, the company's debt totaled $9.6 billion at year-end, including $3.3 billion in term loan facilities, $4.6 billion of senior secured notes, and a $1.9 billion note due to a former Wynn owner. The company's adjusted EBITDA increased 46% in 2017, supporting a decrease in debt leverage to 5.8 times at year-end, compared with 8.9 times one year earlier. Liquidity included a total $1.6 billion in committed senior secured revolver availability and $3.0 billion of cash and short-term investments that reduced net leverage to 4.0 times. Future liquidity will be bolstered by a recent agreement to sell land that it owns on the Las Vegas Strip for $336 million. In March 2018, Wynn paid a total of $2.4 billion to its prior equity owner under a settlement agreement, which included the $1.9 billion note, following Steve Wynn's departure. Also, in April 2018, the company sold a 4.9% equity stake to Galaxy Entertainment Group, generating net proceeds of $916 million. Wynn's weak Cash Flow Cushion score reflects existing capital spending plans and significant debt maturities over the next five years. After additional capital spending to complete the Boston resort due to open in 2019, along with the development of Paradise Park near its Las Vegas resort, Wynn may generate modest free cash flow in 2018. Longer term, while current capital plans may be adjusted under new management, the company had previously indicated an intention to pursue additional projects, including the Japan market. Retained cash flow will be further affected by the company's recent decision to raise its annual cash dividend by 50% to $324 million.

The stable outlook reflects the expectation that gaming commission reviews and the departure of Steve Wynn will have negligible credit impact on Wynn and that Macau's gaming market will continue to grow and absorb the new capacity. Wynn's rating could be raised if the company's Business Risk improves because of successful resolution of these uncertainties, along with further meaningful EBITDA growth that leads to additional modest debt leverage reduction. The rating could be lowered if the departure of Steve Wynn or the imposition of penalties by any of the gaming commissions negatively affect Wynn's cash flow or leverage profile.

Oracle's Rating Affirmed at AA-, Outlook Stable

Morningstar Credit Ratings, LLC is affirming its AA- corporate credit rating on Oracle Corp. and maintaining a stable outlook. The rating reflects Oracle's strong market share, cash flow generation, and financial flexibility, which supports low Business Risk and a strong Solvency Score. Cash Flow Cushion has remained stable over the past year as a stronger outlook for cash flow partially offset an increase in cash obligations due within the five-year forecast period.

The Business Risk pillar remains supported by Morningstar's Equity Research Group's wide economic moat, derived from the company's dominant market share in enterprise database as well as strong middleware and industry-vertical product solutions. These attributes influence high switching costs for customers and encourage long-term relationships, which support a stable stream of high-margin license and support revenue. However, we expect demand for its higher-margin, on-premises data products to decline over time in favor of higher-growth but lower-margin cloud solutions.

Oracle reported total debt of $60.7 billion at the end of February, a net increase of $6.7 billion from a year ago. However, total debt/EBITDA ended the quarter slightly higher at 3.6 times, with new debt issuance mostly offset by improvement in EBITDA. Cash and short-term investments ended the quarter at $70.4 billion, up $11.4 billion from a year ago, including net new debt proceeds.

Acquisition volume has been minimal over the most recent 12 months, following a brisk pace in 2017. Instead, management increased net share repurchases by 26% and dividends by 22% year over year. Trailing 12-month shareholder payout is running at just under 54% compared with 50% a year ago, with $3.9 billion and $3.2 billion of net repurchases and dividends, respectively. Management has not yet announced whether it will repatriate non-U.S. cash reserves to support its share-repurchase program, though we believe it has the flexibility to do so following changes to U.S. tax laws that took effect in January. At the end of February, the company reported $22.8 billion of capacity remaining on its repurchase program, which carries no expiration date. Oracle faces maturities on about a third of its debt ($19.5 billion) between now and 2022, which we view as manageable based on our projected cash flow after dividends between $10 billion and $11 billion per year over this period.

Our rating is based on our forecast for revenue growth of around 3% annually over the next five years, driven by cloud growth of 30% and offset by ongoing net declines of 8%-9% per year for on-premises software and a 4% annual decline in hardware revenue. We also expect operating margin to remain stable around 36%, despite a modest softening in gross margin over the period. In the context of these assumptions, we expect free cash flow to gradually expand toward $14 billion by 2022. We may consider upgrading Oracle's credit rating if its Cash Flow Cushion materially improves, particularly if driven by sustainably higher free cash flow or reduced intermediate-term maturities. We may consider downgrading the rating in the event of a significant decline in operating performance, particularly if coupled with a shift to a more-aggressive capital policy.

Recent Notes Published by Credit Analysts

Wells Fargo (A, Stable) Posts Mediocre 1Q Results, Compounded by Threat of $1 Billion Fine

MCR Credit Risk Assessment

Wells Fargo's (A, stable) first-quarter results showed the negative impact of the series of misconduct allegations the company has faced in recent quarters. Results were further tarnished by management's disclosure that the Consumer Financial Protection Bureau and the Office of the Comptroller of the Currency have approached the company with concerns about its compliance risk management program and past practices regarding sales of auto insurance and mortgage interest rate lock extensions. The CFPB/OCC have asked Wells Fargo to pay $1 billion in civil penalties to resolve these issues. However, any agreement to do so has not been finalized and therefore is not reflected in Wells Fargo's reported results.

First-quarter net revenue was $21.9 billion, down 1.8% from the trailing quarter and 1.8% from the year-ago quarter. Net interest income of $12.2 billion was down 0.6% sequentially, reflecting Wells Fargo's flat net interest margin of 2.84%. Wells Fargo was not able to benefit from the improvement in loan yields during the quarter as it was fully offset by losses on hedging and lower loan swap income. Loans fell 1.0% sequentially, driven by a decline in consumer loans and the reclassification of $1.6 billion of auto loans as held for sale.

While Wells Fargo's overall credit quality remained robust in the first quarter, with charge-offs steady at 0.32% of loans, reserve releases in some categories offset deterioration in others. Like many competitors, Wells Fargo is showing early signs of stress in its consumer portfolios. While the 3-basis-point sequential increase in Wells Fargo's credit card net charge-offs to 3.69% looks benign compared with the 35-basis-point increase reported by JPMorgan (A, stable), Wells Fargo saw a 26-basis-point increase to 1.64% in automobile charge-offs and a 14-basis-point increase to 1.60% for other revolving consumer loans.

Despite its challenges, Wells Fargo's profitability remained solid with a return on equity of 12.4%, down modestly from the 12.5% reported in the trailing quarter and 12.0% reported in the year-ago quarter. This reflects both Wells Fargo's cost/income ratio of 64.9%, down from 76.2% in the trailing quarter but up modestly from 62.0% in the year-ago quarter, as well as a drop in the effective tax rate to 18.8%.

Bondholders will note that Wells Fargo's capital levels were resilient despite the pressure on revenue. The group's fully phased common equity Tier 1 ratio held steady with the trailing quarter at 12.0%, up 80 basis points from the year-ago quarter. We estimate that the looming CFPB/OCC matter, if resolved with the proposed $1 billion fine, would have an immaterial 10-basis-point negative impact on Wells Fargo's common equity Tier 1 ratio.

Market Data

We compare Wells Fargo with large U.S. global banks including JPMorgan, Citigroup (A-, stable), and Bank of America (BBB+, stable), as well as with large regional banks like U.S. Bancorp (AA-, stable). Wells Fargo's 3.584% senior notes due 2028 are indicated by pricing service Interactive Data at +118 basis points over the nearest Treasury as of April 12, while JPMorgan's 3.782% senior notes due 2028 are indicated at +113 basis points. U.S. Bancorp's 2.375% notes due 2026 are indicated at +92 basis points. Among lower-rated banks, Citigroup's notes due 2028 are indicated at +125 basis points and Bank of America's 3.248% notes due 2027 are indicated at +119 basis points.

Bank of America (BBB+, Stable) Reports Record 1Q Profits on Revenue Growth, Lower Tax Rate
MCR Credit Risk Assessment
Bank of America (BBB+, stable) reported a very strong first quarter with net income applicable to common shareholders of $6,490 million for the first quarter, up 34.2% from the year-ago quarter. While the bank's bottom-line results benefited from a sharply lower effective tax rate, which fell 9 percentage points to 17.6%, results were also supported by good revenue growth and cost control. Return on equity was solid at 10.8%, the bank's first double-digit return since 2011.

Revenue grew 3.9% compared with the year-ago quarter, as net interest revenue grew 5.0% and noninterest revenue grew 2.9%. Net interest yield held steady at 2.39%, flat with both the year-ago and trailing quarters, but quarter-over-quarter results were boosted by 3.1% growth in loans. While Bank of America's interest-rate-sensitive portfolio means that interest income is likely to benefit from higher rates, the impact may be damped if the recent slowdown in loan growth continues; net lending fell slightly in the first quarter. Positively, revenue growth outpaced cost increases, as Bank of America's noninterest expense fell 1.4% compared with the year-ago quarter, leading to an impressive 60% cost/income ratio, down 3 percentage points quarter over quarter.

Asset quality remained solid, with charge-offs equaling 0.40% of loans. Like competitors, Bank of America has seen manageable but sustained increases in credit card charge-offs, which rose to 3.01% from 2.78% in the linked quarter and 2.74% in the year-ago quarter. However, the impact of this was largely offset by improvements in other consumer credit categories. Moreover, allowances for loan losses remain sizable, at 161% of nonperforming loans.

Bank of America's capital levels remained near or slightly below what we see as average for large global banks. Common equity Tier 1 was 11.3% under the advanced approach, up 30 basis points compared with the year-ago quarter but down 20 basis points compared with the trailing quarter. During the quarter, management returned $6.1 billion in capital to shareholders, equivalent to 94.0% of income applicable to common shareholders. We expect capital to remain near current levels as management emphasizes controlled growth and capital returns to shareholders.

Market Data
We compare Bank of America with large U.S. global banks including JPMorgan Chase (A, stable), Wells Fargo (A, stable), and Citigroup (A-, stable). Because of the company's presence in investment banking and investment management, we also consider Goldman Sachs (BBB+, stable) and Morgan Stanley (BBB+, stable). Bank of America's senior 3.248% notes due 2027 are indicated by pricing service Interactive Data at +117 basis points over the nearest Treasury as of April 13. Among higher-rated companies, JPMorgan's 3.782% notes due 2028 are indicated at +111 basis points, Wells Fargo's

3.584% notes due 2028 are indicated at +119 basis points, and Citigroup's 3.52% notes due 2028 are indicated at +123 basis points. Goldman Sachs' 3.814% notes due 2029 are indicated at +124 basis points while Morgan Stanley's 3.625% notes due 2027 are indicated at +113 basis points.

Citigroup (A-, Stable) Reports 1Q Profit Growth on Modest Revenue Expansion, Lower Tax Rate
MCR Credit Risk Assessment
Citigroup (A-, stable) reported modest improvements in results for the first quarter, with revenue up 3% compared with the year-ago quarter and net income up 13%. Return on equity remained below 10%, rising 230 basis points to 9.7%.

Within global consumer banking, the international segment led revenue growth, posting revenue of $2,376 million, up 8% from the year-ago quarter, with particularly strong results in both Latin America and Asia. The North America segment reported revenue of $5,157 million, up 4% over the same period. Positively, revenue in both segments grew faster than costs, leading to 15% expansion in earnings before tax, to $1,847 million. Segment-level charge-offs were essentially flat at 0.78% of loans but declines in Latin America offset a 14-basis-point year-over-year increase in charge-offs in North America, to 2.77%. As with peers, much of this decline in credit quality stemmed from the lower end of the market, with Citi's white-label credit cards showing a 52-basis-point year-over-year increase in charge-offs, to 5.18% for the first quarter compared with a 7-basis-point decrease in charge-offs to 3.04% for Citi-branded cards.

In the institutional client group, first-quarter revenue of $9,848 million was up 6% compared with the year-ago quarter, led by strong results in treasury and trade solutions (up 8%), private bank (21%) and equity markets (38%), which were partially offset by a 7% drop in fixed-income markets. Costs remained reasonably well-controlled despite higher investment spending, resulting in a cost/income ratio of 56%, up 1 percentage point from the year-ago period but down 3 percentage points sequentially.

Compared with more domestically focused banks, Citigroup saw a smaller positive impact from the Tax Cuts and Jobs Act of 2017. Citigroup's effective tax rate fell to 24% from 31% in the year-ago quarter and management expects it to remain near 25%. Competitors like Bank of America (BBB+, stable) and JPMorgan Chase (A, stable) saw their effective tax rates fall to sub-20%.

Citigroup continued to nudge its common equity Tier 1 ratio downward toward its 11.5% target, reporting a CET1 ratio of 12.1% compared with 12.4% in the trailing quarter and 12.8% in the year-ago quarter. During the quarter, Citigroup returned over $3 billion to shareholders, or 65% of earnings, through dividends and share buybacks. Management said that it had reviewed the recent proposal from the Federal Reserve to adjust capital requirements and does not expect an impact to its 11.5% CET1 target.

Market Data
We compare Citigroup to large U.S. global banks including JPMorgan Chase, Wells Fargo (A, stable), and Bank of America. Because of the company's presence in investment banking and investment

management, we also consider Goldman Sachs (BBB+, stable) and Morgan Stanley (BBB+, stable). Citigroup's 3.52% notes due 2028 are indicated by pricing service Interactive Data at +123 basis points over the nearest Treasury as of April 13. Among higher-rated companies, JPMorgan's 3.782% notes due 2028 are indicated at +111 basis points and Wells Fargo's 3.584% notes due 2028 are indicated at +119 basis points. Among lower-rated companies, Bank of America's senior 3.248% notes due 2027 are indicated at +117 basis points over the nearest Treasury, Goldman Sachs' 3.814% notes due 2029 are indicated at +124 basis points, and Morgan Stanley's 3.625% notes due 2027 are indicated at +113 basis points.

Johnson & Johnson's (AAA, Stable) Strong 1Q Results Prompt Increase in 2018 Sales Guidance
MCR Credit Risk Assessment
On April 17, Johnson & Johnson (AAA, stable) announced operating results in the first quarter with strong performance across all business segments: pharmaceutical, consumer, and medical device. The firm's well-diversified corporate portfolio generates exceptional financial flexibility and affords the firm time to rebuild its cash position after the $30 billion purchase of Actelion, which helps inform our stable outlook on the firm's credit rating.

In the first quarter, reported revenue jumped 12.6% (8.4% operationally) helped by the purchases of Abbott Laboratories' (A-, positive) vision care business in February 2017 and Actelion in June 2017. Adjusting for these businesses as well as recent divestitures, global sales grew more moderately at 4.3% operationally. Company sales performance was driven by 5.3% reported revenue growth (1.3% operationally) from the consumer segment, a 19.4% rise (7.5% operationally and excluding acquisitions and divestments) generated by the pharmaceutical business, and a reported increase of 7.5% (1.1% operationally and excluding acquisitions and divestments) from the medical device segment. On the back of better-than-expected results from the pharmaceutical segment, the firm raised its guidance for reported sales to $81.0 billion-$81.8 billion from $80.6 billion-$81.4 billion in 2018 despite ongoing biosimilar erosion of Remicade (declines pacing 16%) and increasing generic competition to Procrit and Tracleer. This raised expectation also considers no generic competition to Invega Sustenna, Prezista, Risperdal Consta, and Zytiga during the year. Longer term, we see sustained overall revenue growth approaching the midsingle digits compounded annually through 2022, further supported by the launches of promising medicines over the past few years, most notably oncology medicine Darzalex and next-generation psoriasis treatment Tremfya. Aided by cost initiatives in its medical devices business, we expect EBITDA growth pacing slightly ahead of revenue compounded annually through 2022. Our assumptions include losses of market exclusivity for multiple blockbuster drugs—Velcade, Invega Sustenna, Zytiga, and Prezista (collectively representing around 12% of total revenue)—over the next three years.

J&J demonstrated financial discipline with its use of tax-advantaged foreign cash to consummate the $30 billion purchase of Actelion in June 2017, which held gross leverage relatively steady and helped maintain its very strong Solvency Score and Distance to Default pillars. But, the firm lost its net cash position after the acquisition and held $18.3 billion of cash and owed $34.6 billion in debt at the end of 2017. While J&J does not detail its balance sheet at its quarterly conference calls, we expect little deviation from year-end 2017 gross leverage and net leverage levels of 1.4 times and 0.7 times, respectively. We see J&J easily managing well-laddered debt maturities totaling $9.3 billion from 2018 to 2022 with free cash flow averaging around $20 billion annually over the next five years, in our estimation. We expect gross leverage to ease to more historical levels of 1.0 time or less within the next two years through a combination of modest debt reduction and steady operational performance, as the firm uses external sources to refinance most of these maturities, by our estimates. We also anticipate that capital deployment may return to its traditional balance between asset purchasing and returning value to shareholders through dividends and share repurchases, allowing J&J to build its cash holdings and approach a net cash position in the next few years.

Market Data

For closest comparisons to J&J's notes, we look to lower-rated Eli Lilly and Co (AA, stable), Novartis AG (AA, stable), and Merck & Co Inc (AA, stable). Within this comparable group and adjusted for bond maturities, J&J's 10-year bonds recently traded tighter than the lower-rated firms and close to the Morningstar Corporate Bond Index at AAA. All data is sourced from Interactive Data.

In the approximate 5-year maturity bucket, bonds from these issuers recently traded over the nearest Treasury as follows:
Johnson & Johnson's 2.25% notes due 2022 at +29 basis points.
Eli Lilly's 2.35% notes due 2022 at +48 basis points.
Merck's 2.40% notes due 2022 at +40 basis points.
Novartis' 2.40% notes due 2022 at +48 basis points.

In the approximate 10-year maturity bucket, bonds from these issuers recently traded over the nearest Treasury as follows:
J&J's 2.95% notes due 2027 at +55 basis points.
Eli Lilly's 3.10% notes due 2027 at +66 basis points.
Merck's 2.75% notes due 2025 at +55 basis points.
Novartis' 3.10% notes due 2027 at +64 basis points.
For comparison to the approximate 10-year maturities, the Morningstar Corporate Bond Index is at +54 basis points in the AAA category and 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:
J&J's 3.75% notes due 2047 at +73 basis points.
Eli Lilly's 3.95% notes due 2047 at +84 basis points.
Merck's 3.70% notes due 2045 at +85 basis points.
Novartis' 4.00% notes due 2045 at +84 basis points.

Prologis (A-, Stable) Posts Another Strong Quarter in 1Q as Industrial Property Strength Continues

MCR Credit Risk Assessment

Prologis, Inc. (A-, stable) continued to report strong rent growth and occupancy performance in the first quarter. The company's portfolio benefits from locations in the nation's strongest warehouse markets in which growing e-commerce activity and a strengthening economy are producing some of the strongest demand for industrial space on record. The Prologis management team has amassed a very large international portfolio which includes extensive holdings in Europe totaling more than 180 million square feet, plus meaningful presences in Asia, Canada, Mexico, and Brazil. The highly efficient portfolio continues to produce solid performance metrics and is driving higher scoring for its Business Risk and Cash Flow Cushion.

For the first quarter, core funds from operations were up 27.8% over the previous year's first quarter, driven by a $76 million increase in revenue from strategic capital, solid increases in industrial rents on new and renewing leases, and same-store net operating income growth of 5.3%. Quarter-end occupancy dipped by 40 basis points from year-end to 96.8%, though was 20 basis points higher than a year earlier. Occupancy has averaged 96.4% over the past five year-ends while trending higher. During the first quarter, Prologis completed $440 million of developments, mostly in Europe, following $2.0 billion for full-year 2017. In its first-quarter earnings call, management indicated that planned dispositions of land and buildings for 2018 have been increased by 44% to a midpoint of $1.55 billion. Proceeds from asset sales and contributions of properties to investment funds are expected to cover most or all of this year's new investments.

In its 2018 updated guidance, management indicated that it pushed its expected same store NOI growth higher to 6.0% at the midpoint, again fueled by strong industrial rent growth; in the first quarter, rents on new and renewing leases increased by an average 9.2% on a cash basis. Prologis also anticipates midrange development starts of $2.35 billion and building acquisitions of $400 million. We project growth of revenue and NOI of between 3.5% and 4.0% for 2018, with leverage remaining a little above 6.0 times and interest coverage slightly lower because of rising interest rates but still above 5.0 times.

Market Data

Prologis' industrial REIT peers are Duke Realty Corporation (BBB+, stable), DCT Industrial Trust Inc. (BBB, stable), and Liberty Property Trust (BBB, stable). The following pricing data is from Interactive Data as of April 16.

In the 10-year area, spreads of the nearest Treasury from these issuers are:
Prologis' $500 million 3.00% bonds due 2029 at +112 basis points.
Duke Realty's $300 million 3.375% bonds due 2027 at +119 basis points.
DCT's $275 million 4.50% bonds due 2023 at +136 basis points.
Liberty's $400 million 3.25% bonds due 2026 at +122 basis points.

The BBB Morningstar Corporate Bond Index is currently priced at +137 basis points.

Abbott (A-, Positive) Highlights Ongoing Deleveraging Progress Along With 1Q Results

MCR Credit Risk Assessment

On April 18, Abbott Laboratories (A-, positive) turned in first-quarter operating results that modestly beat consensus expectations, and its forecast for 2018 operating results remains solid. While Abbott does not release balance sheet or cash flow data with its earnings releases, management reported ongoing progress on its 2018 deleveraging plans on the call. This ongoing deleveraging contributes to our positive rating outlook.

In the first quarter, Abbott's financial results slightly beat expectations, and management's outlook for 2018 remains in line with consensus expectations. During the quarter, sales grew 7% organically to $7.4 billion (versus consensus of $7.3 billion), and adjusted earnings per share grew about 23% to $0.59 (versus consensus of $0.58). Considering this performance and the company's momentum with new product launches, management continued to endorse a solid outlook for 2018. Specifically, Abbott's management still expects 6%-7% organic top-line growth and adjusted EPS growth of 14% at the midpoint of $2.80-$2.90 in 2018 versus consensus of $2.85.

By segment during the quarter, medical devices led the way, while nutrition trends improved after Chinese food safety regulations changed at the beginning of the year. Specifically, the medical devices segment grew 9% organically (near the top end of management's outlook for mid- to high-single-digit growth for 2018), including organic growth in all divisions except rhythm management, which was flat. The diabetes care division (33% organic growth) was particularly strong on the expansion of FreeStyle Libre, a glucose monitor that does not require routine finger sticks, while the electrophysiology and neuromodulation divisions grew in the high teens organically. The established pharmaceutical business decelerated to 7% organic growth in the first quarter from 14% in the fourth quarter on continued expansion in emerging markets such as Brazil, India, and China but slower-than-anticipated growth in Russia and other markets such as Mexico. The diagnostics segment slightly lagged Abbott's overall growth, with 6% year-over-year growth in the quarter. Nutrition segment trends improved, with 5% organic growth (versus 2% growth in the fourth quarter), as Chinese results improved after new regulatory standards started on Jan. 1. Those standards appear to have ushered in a more stable pricing and demand environment after noncompliant competitors were forced out of the market.

From a credit perspective, Abbott's management continued to endorse an ambitious deleveraging plan by the end of 2018, which has been helped by much improved access to its overseas cash after U.S. tax reform. At the end of 2017, Abbott owed $28 billion in debt, and management noted on the call that it has already paid down $6 billion of debt in early 2018. The company intends to redeem another $2 billion by the end of 2018. With these actions, we estimate that pro forma gross leverage has declined by nearly a turn from the end of 2017 to the low 3s and could decline to about 3 times by the end of the 2018 with expected debt reduction and profit growth. The company still projects that net leverage will fall to about 2 times by the end of 2018. Overall, we appreciate management's focus on achieving a more flexible financial position after the St. Jude Medical and Alere acquisitions in 2017. If the company follows through on these goals and looks likely to sustain this lower leverage, we could even see room for improvement in our A- rating on Abbott, which is reflected in our positive outlook.

Market Data
We use Baxter International (A, stable) and Agilent Technologies (A-, stable) as key comparables for Abbott's bonds. All of following bond data is sourced from Interactive Data.

In the roughly 10-year maturity bucket, bonds from these issuers recently traded as follows:
Abbott's 3.75% notes due in 2026 at +102 basis points.
Baxter's 2.60% notes due 2026 at +109 basis points.
Agilent's 3.05% due 2026 at +113 basis points.
For comparison, the Morningstar Corporate Bond Index is at +89 basis points at A and +100 basis points at A-.

CSX (BBB+, Stable) Delivers Impressive 1Q Profitability
MCR Credit Risk Assessment
CSX Corp (BBB+, stable) reported strong first-quarter earnings, as the implementation of scheduled railroading produced meaningful operational benefits, which help slash operating costs by 10%. Although volume declined 4% in the quarter, management indicated positive momentum heading into the second quarter and expects revenue to finish slightly higher for 2018. The boost to profitability mitigates the increased leverage and added share repurchases and contributes to our stable outlook.

Revenue was essentially unchanged from the year-ago period, as a 4% increase in revenue per carload was offset by a 4% decline in volumes. Volume losses were in part a consequence of CSX's overhaul to revamp its operations and focus on profitable business, including taking 7% of its intermodal business off the railroad last summer, but also inclement weather and self-inflicted wounds. As a result, volume declined in half of the rail's commodity lines, including a 12% decline in agricultural and food products (7% of volume). Still, revenue per unit increased 4% versus the year-ago period, with all segments except coal (13% of volume) generating higher rates. Impressively, operating expenses declined 8% versus the year-ago period from improved railroad routing—metrics like train velocity and length all improve from last year—and a 3,000 reduction in head count. As a result, the adjusted operating ratio fell 570 basis points to 63.7%. Adjusted EBITDA grew 14% to $1.4 billion. Free cash flow of $630 million was nearly $30 million higher due to a $70 million reduction in capital spending.

In the quarter, CSX paid $194 million in dividends (the dividend was increased 10% in February) and repurchased $836 million in shares. Management plans to repurchase $5 billion in shares over the next five quarters and raised $2 billion in debt during the quarter. CSX ended the quarter with $2 billion in cash and total debt of $13.8 billion, which pushed up rent-adjusted leverage 0.2 turn to 2.6 times. Management alluded to higher leverage levels during its March analyst day and appears comfortable with higher levels if the cost of capital remains low and its share price remains attractive.

We compare CSX with rails Canadian Pacific Railway Ltd (BBB+, stable), Norfolk Southern Corp (BBB+, stable), and Kansas City Southern (BBB, stable). CSX's rent-adjusted leverage of 2.6 times is comparable with Canadian Pacific's, but it is higher than Norfolk Southern's (2.3 times), and Kansas City Southern's (2.4 times). With its recent operating ratio performance, CSX has now shrunk this gap among its peers and is no longer the profitability laggard. Overall, our BBB+ issuer rating reflects CSX's favorable Business Risk pillar stemming from the firm's strong competitive advantage, balanced by substantial cash investment demands.

Market Data
The following spreads over the nearest Treasury are provided by Interactive Data.

The CSX 3.80% notes due 2028 are indicated at +104 basis points.
The Canadian Pacific 3.70% notes due 2026 are indicated at +99 basis points.
The Norfolk Southern 3.15% notes due 2027 are indicated at +96 basis points.
The Kansas City Southern 3.125% notes due 2026 are indicated at +111 basis points.
For comparison, the Morningstar Corporate Bond Index is at +89 basis points at A and +100 basis points at A-.

Morgan Stanley (BBB+, Stable) Posts Strong 1Q on Higher Revenue, Lower Taxes
MCR Credit Risk Assessment
Like its global banking peers, Morgan Stanley (BBB+, stable) posted very strong first-quarter results, supported by revenue growth, well-managed cost controls, and a lower effective tax rate. The bank earned net revenue of $11,077 million, up 13.7% from the year-ago period, and pretax income of $3,420 million, up 21.8%. Expenses remained well controlled, and the efficiency ratio fell to 69% from 71% in the year-ago quarter, well below the firm's 73% target. A fall in the effective tax rate to 20.9% from 29.0% in the year-ago quarter helped to boost earnings applicable to common shareholders by 40.0% to $2,575 million. As a result, return on equity rose to 14.9% from 10.7%, comfortably exceeding management's 10%-13% target.

Morgan Stanley's institutional securities segment led the quarter's rise in revenue, with equity sales and trading reporting particularly strong results, including net revenue of $2.6 billion compared with $2.0 billion in the year-ago quarter. The segment also benefited from strong advisory revenue, which increased to $574 million from $496 million in the year-ago quarter, reflecting Morgan Stanley's continued leadership in mergers and acquisitions.

Morgan Stanley's regulatory capital levels remained high during the quarter, a distinguishing factor relative to peers that supports our rating. The company's common equity Tier 1 capital ratio was 15.6% at quarter-end, down 90 basis points from the year-ago quarter but comfortably above the 11%-12% typically reported by peers.

Market Data
Given its business model as an investment bank, Morgan Stanley can be compared with close peer Goldman Sachs (BBB+, stable) as well as global banks that include significant investment banking operations. According to pricing service Interactive Data, Morgan Stanley's 3.625% notes due 2027 are indicated at +113 basis points as of April 16. Goldman Sachs' 3.814% notes due 2029 are indicated at +124 basis points. By comparison, Bank of America's (BBB+, stable) 3.248% notes due 2028 are

indicated at +117. Among higher-rated peers, JPMorgan Chase's (A, stable) 3.509% notes due 2029 are indicated at +111 basis points, while Citigroup's (A-, stable) 3.887% notes due 2028 are indicated at +123 basis points.

Quest's (BBB+, Stable) Operating Results on Target in 1Q While Leverage Remains Steady
MCR Credit Risk Assessment
On April 19, Quest Diagnostics Inc (BBB+, stable) reported first-quarter operating results that were roughly in line with top-line and slightly above bottom-line expectations, leading to limited balance sheet changes. With its U.S.-centric operations, Quest is benefiting substantially on the bottom line from recent tax reforms, so despite the headwinds from recent Medicare reimbursement cuts related to the Protecting Access to Medicare Act, the company's short- and intermediate-term earnings outlook appears strong. Given this fundamental outlook and the firm's stagnant leverage, our credit rating outlook for Quest remains stable.

Quest's first-quarter results do not change our credit view of the firm. Revenue grew 4% in the quarter to $1.9 billion (in line with consensus), and adjusted earnings per share grew 25% to $1.52 (slightly above consensus of $1.50). Including acquisitions, the company's 4% revenue growth was split almost evenly between revenue per requisition (price and mix) and volume. While adjusted operating income grew only 2% year over year, adjusted earnings per share grew at a much faster pace. This earnings growth primarily resulted from the company's lower tax rate, which was down to 23% in the quarter from 32% in the previous year on recent U.S. tax reform. From a credit perspective, Quest's leverage stayed stagnant. As of March, the company owed $3.9 billion in debt, or 2.5 times trailing 12-month EBITDA by our estimates, which is within its current comfort zone in the mid-2s.

Quest maintained its guidance for 2018, which continues to reflect the negative effects of PAMA-related Medicare reimbursement cuts and the positive effects of tax reform. Based on the final reimbursement decision announced in November and trends in the first quarter, Quest still expects rate cuts of 4% in 2018, which have added a 50-basis-point headwind to its diagnostic lab business in 2018 (Medicare only represents 12% of Quest's business), and approximately 10% cuts in both 2019 and 2020 on its Medicare business. However, the tax reform benefits are expected to significantly exceed the reimbursement cuts on Quest's bottom line in 2018. Therefore, management continues to expect 4%-5% top-line growth and more than 20% adjusted EPS growth to $6.50-$6.70. The company also expects free cash flow of $900 million-$950 million in 2018, or similar to 2017 as capital expenditures are rising substantially. Creditors should be aware that Quest's rollup strategy could accelerate, as many laboratories may prefer to sell out to the larger labs like Quest rather than struggle in the new PAMA reimbursement environment, which creates some event risk at the firm. However, the company's leverage remains stagnant for now, which keeps our rating outlook at stable. Key comparable Laboratory Corp of America Holdings' (BBB+, negative) outlook is negative related to elevated leverage after recent acquisitions of contract research organizations; LabCorp's gross leverage stood at 3.3 times at the end of 2017.

Market Data

Quest and LabCorp are close comparables from both a business and credit perspective. All of the following bond data is sourced from Interactive Data.

In the approximate 10-year maturity bucket, bonds from these two issuers recently traded over the nearest Treasury as follows:
Quest's 3.45% notes due in 2026 at +112 basis points.
LabCorp's 3.60% notes due in 2027 at +120 basis points.
For comparison with the roughly 10-year maturities, the Morningstar Corporate Bond Index at BBB+ was recently at +130 basis points.

In the approximate 30-year maturity bucket, bonds from these two issuers recently traded over the nearest Treasury as follows:
Quest's 4.70% notes due in 2045 at +144 basis points.
LabCorp's 4.70% notes due in 2045 at +171 basis points.

Novartis' (AA, Stable) 1Q Performance Aligns With 2018 Expectations; Dividends Stress Net Leverage

MCR Credit Risk Assessment

On April 19, Novartis AG (AA, stable) reported solid operating results while it continues to battle global generic competition to its once top-selling cancer medicine pharmaceutical Gleevec. This performance reinforces our expectations that overall revenue bottomed in 2017 and that sales may grow in the low-single-digits compounded annually over the next five years, which informs our stable outlook.

First-quarter sales matched Novartis' present outlook with revenue increasing 4% at constant currency compared with the firm's 2018 guidance of low- to mid-single digit sales growth. Performance of the Innovative Medicines segment (sales increased 6% at constant currency) and a healthier Alcon eye care business (revenue rose 7% at constant currency) helped offset depressed results from the Sandoz generic drug division (declined 4% at constant exchange rates) due to continued pricing pressure in the U.S. market. Key growth drivers, Entresto (chronic heart failure) and Cosentyx (autoimmune disorders), showed sustained solid uptake of 126% and 35%, respectively in the quarter. Though, sales of Cosentyx lagged the 53% growth in the fourth quarter of 2017 due to rebate concessions needed to expand access in the U.S. into earlier stages of treatment. The firm still sees sales of Innovative Medicines increasing in the mid-single digits, low- to mid-single-digit growth from Alcon, and steady to slightly declining performance at Sandoz during 2018. Longer term, we see Novartis overcoming the U.S. patent expirations of top-selling drugs—Gilenya in 2019 and Afinitor in 2020—to achieve low-single-digit sales growth compounded annually over the next five years. Our assumption includes the firm's recovered Alcon unit, which is currently under a strategic review with various options for the business ranging from a capital market transaction to keeping the segment. Novartis does not expect to finalize a decision for this segment before the first half of 2019. Including Alcon, we foresee decent sales growth leveraging a leaner operating cost base to drive EBITDA expansion in the low double-digits from 2017 to 2022, as the firm succeeds with its cost containment efforts.

Novartis has more than seasonally stretched its balance sheet, which typically elevates after the firm pays its annual dividend during the quarter. At the end of the first quarter, the company owed $34.1 billion in debt compared with $28.5 at the end of 2017 after Novartis distributed $7.0 billion in dividends and issued $2.8 billion of new debt to fund the acquisition of Advanced Accelerator Applications. The firm will gain additional financial flexibility from the sale of its share (36.5% ownership) of a consumer joint venture with GlaxoSmithKline PLC (A, stable) for $13 billion during the second quarter. This more than offsets the proposed near-term purchase of AveXis for around $8.7 billion. With only $6.4 billion of cash and marketable securities at the end of the first quarter though, net debt leverage was 1.8 times versus 1.2 times at the end of 2017. When we consider Novartis' investment in associates of $8.1 billion, specifically its 6% interest in Roche, net leverage falls by a half turn to 1.3 times, though. We see debt leverage easing over the long term from a combination of debt reduction and EBITDA growth while assuming Novartis may continue to return most of free cash flow to shareholders mainly through an increasing dividend. Annual free cash flow averaging around $12 billion over the next five years, by our estimates, along with divestment proceeds grant the firm enough financial flexibility to continue to generously satisfy shareholders while meeting long term maturities of $10.2 billion through 2022, which helps inform our stable outlook.

Market Data

For closest comparisons to Novartis' notes, we look to similar-rated Eli Lilly & Co. (AA, stable) and Merck & Co. Inc. (AA, stable). Within this comparable group and adjusted for bond maturities, Novartis' 10-year bonds recently traded close to those of Eli Lilly and at the level of the Morningstar Corporate Bond Index in the AA category. All of the following 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:

Novartis 2.40% notes due 2022 at +48 basis points.

Eli Lilly 2.35% notes due 2022 at +48 basis points.

Merck 2.35% notes due 2022 at +40 basis points.

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

Novartis 3.10% notes due 2027 at +66 basis points.

Eli Lilly 3.10% notes due 2027 at +69 basis points.

Merck 2.75% notes due 2025 at +56 basis points.

For comparison to the approximate 10-year maturities, the Morningstar Corporate Bond Index is at +66 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:

Novartis 4.00% notes due 2045 at +82 basis points.

Eli Lilly 3.95% notes due 2047 at +84 basis points.

Merck 3.70% notes due 2045 at +83 basis points.

PPG (BBB+, Stable) Repurchases $600 Million of Shares in 1Q

MCR Credit Risk Assessment

PPG Industries, Inc (BBB+, stable) reported first-quarter results that showed top-line revenue growth amounted to nearly 9% year over year with volume up less than 1% compared with the same period last year. We estimate latest 12-month EBITDA was roughly flat compared with year-end 2017 at approximately $2.5 billion, with rising raw material costs hampering EBITDA growth. PPG issued $1 billion in notes in the first quarter, raising balance sheet debt to $5.2 billion from $4.1 billion at the end of 2017 resulting in debt/EBITDA of 2.1 times (1.5 net) at the end of March. The company also repurchased $600 million of its common equity in the first quarter and paid $110 million in dividends and spent $75 million for capital expenditures. PPG said that it remains committed to spending at least $2.4 billion on share repurchases and acquisitions in 2018. It has about $3.0 billion in remaining share-repurchase authorization at the end of March. Management commented to an analyst question on the call that it believes it has significant balance sheet capacity for acquisitions and is committed to an investment-grade rating. Cash on hand at the end of the quarter was $1.3 billion, and we estimate free cash flow for 2018 to be approximately $1.5 billion.

The company's credit rating reflects its moderate Business Risk and Cash Flow Cushion risk profiles combined with low risk profiles for PPG's Solvency Score and Distance to Default scores. Its Business Risk is supported by its size as one of the world's largest coatings companies and its narrow economic moat rating as assigned by Morningstar's Equity Research Group. The company's pursuit of Akzo Nobel last year showed that management is willing to leverage its balance sheet to pursue large transactions. Had it been successful in acquiring Akzo Nobel its leverage would have roughly doubled from current levels.

Market Data

We compare PPG to similar-rated chemical sector peer Ecolab (BBB+, stable). All of the following 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:

PPG Industries' 3.75% notes due 2028 at +87 basis points.

Ecolab's 2.7% notes due 2026 at +77 basis points.

For index comparison, we note that the Morningstar Corporate Bond Index was recently at +138 basis points.

Bank of New York Mellon (A+, Stable) Starts 2018 With Strong Results, Supporting Rating

MCR Credit Risk Assessment

Bank of New York Mellon (A+, stable) reported a very strong first quarter, with revenue of $4,178 million and net income to common shareholders of $1,135 million, increasing 9% and 29% from the year-ago quarter, respectively. Higher revenue was supported by higher interest rates and strong equity market performance, while the bottom line was boosted by operating margin expansion and a reduction in the quarter's effective tax rate to 19.5% from 22.3% year over year. Return on equity was 10.7%, while return on tangible common equity was 25.9%.

BNY Mellon reported increases in revenue for the first quarter across its business lines. Investment Services, responsible for 80% of pretax income, benefited from double-digit year-over-year increases in revenue in both the asset servicing and Pershing business lines. These lines benefited from increases in both net interest income and fee income. Assets under custody and administration, a key driver of the segment's results, rose 9% over the same period. Investment management's operating margin increased 3 percentage points year over year to 37%, as cost growth was contained to 5%. In the investment management segment, revenue climbed 13% year over year, reflecting higher equity market values, the benefit of a weaker dollar, and higher performance fees.

Bondholders will note that capital levels remained solid despite $890 million of capital returns to shareholders through $644 million of share repurchases and $246 million in common dividends during the quarter. BNY Mellon's common equity Tier 1 rose 40 basis points sequentially to 10.7%, while its Tier 1 leverage ratio rose 10 basis points to 6.5%.

Market Data

We compare Bank of New York Mellon with peers State Street (A+, stable) and Northern Trust (A+, stable). We also compare BNY Mellon with JPMorgan Chase because of JPMorgan Chase's large market share in custody banking. BNY Mellon's 3.442% senior notes due 2028 are indicated by pricing service Interactive Data at +89 basis points over the nearest Treasury as of April 19. In comparison, State Street's 2.65% notes due 2026 are indicated at +83 basis points, Northern Trust's 2.65% notes due 2025 are indicated at +69 basis points, and JPMorgan Chase's 4.005% notes due 2029 are indicated at +117 basis points.

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