Morningstar Corporate Credit Research Highlights

Contagion from equity market volatility spreads to corporate bond market.

Morningstar Credit Ratings, LLC
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Issuer/Ticker	Current Issuer Credit Rating	Previous Issuer Credit Rating
Zions **ZION**	BBB	BBB-
Freeport-McMoRan **FCX**	BB-	B+
Regions Financial **RF**	BBB+	BBB
Mattel **MAT**	BB	BBB-

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Credit Market Insights

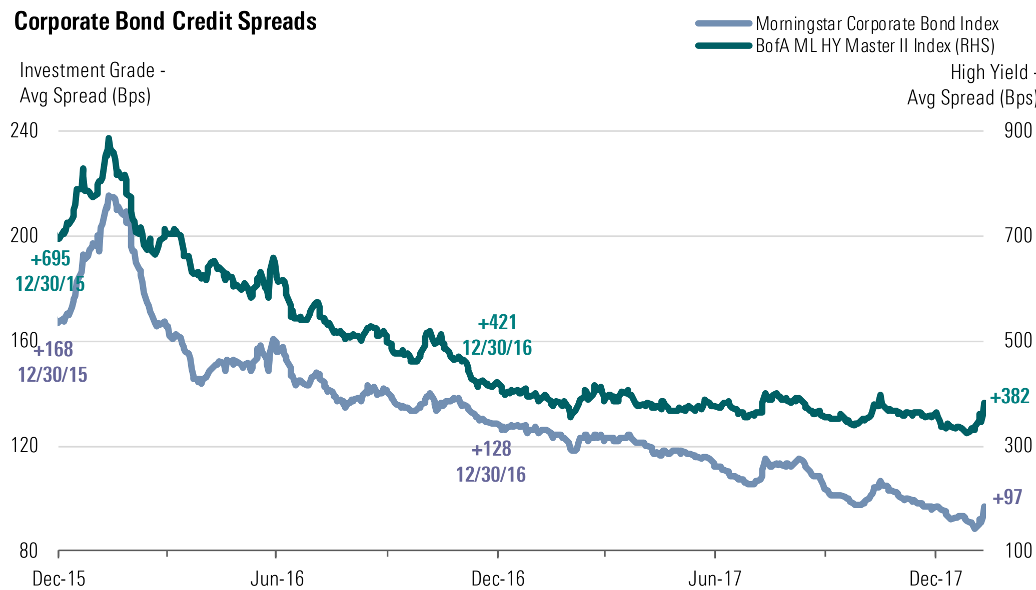
Contagion From Equity Market Volatility Spreads to Corporate Bond Market

Two weeks ago, we noted that the corporate bond market had sailed into increasingly choppy waters as contagion from the spike in equity volatility spread into other asset classes. Last week, the turbulence increased as equity market volatility continued to swing wildly and decimated exchange-traded funds that were created to short volatility. The spike in volatility drove a "risk off" sentiment among investors, which sent prices of risky assets down across the board.

The equity market took the brunt of the selling, sending the S&P 500 down 5.84% last week; this put the equity market into negative territory for the year. In the corporate bond market, the average spread of the Morningstar Corporate Bond Index (our proxy for the investment-grade bond market) widened 9 basis points to +97 basis points. In the high-yield market, the BofA Merrill Lynch High Yield Master Index widened 46 basis points to end the week at +382. Excluding the abnormal market action during the 2008-09 global financial credit crisis, this is one of the largest weekly swings in the high-yield index of the past 20 years.

While this sudden downturn has felt severe, it only brings the markets back to levels at which they were trading within the past few months. For example, even after this sell-off, the S&P 500 is still trading at the same level it was just 10 weeks ago, at the end of November 2017. The average credit spread of the investment-grade index is now only 1 basis point wider year to date, and it is still 31 basis points tighter than at the end of 2016. The high-yield index may be 19 basis points wider year to date, but it is still 39 basis points tighter than at the end of 2016.

Corporate Bond Credit Spreads



Source: Morningstar,Inc., BofA Merrill Lynch Global Indexes. Data as of 2/9/2018.

Risk Off Sends Investors to Short-Term U.S. Treasury Notes, but They Still Avoid Long-Term Bonds
As risk assets sold off, investors flocked to the safety of short-term, risk-free assets. The yield on the 2-year Treasury note declined 7 basis points to 2.07%, and the 5-year Treasury note fell 5 basis points to 2.54%. Even with these declines, the yield on these notes remained near their highest levels since 2008 and 2009, respectively. While yield on short-term notes declined, however, the yield on long-term bonds rose. The yield on the 10-year Treasury bond rose 1 basis point to 2.85%, and the 30-year Treasury bond increased 5 basis points to 3.16%.

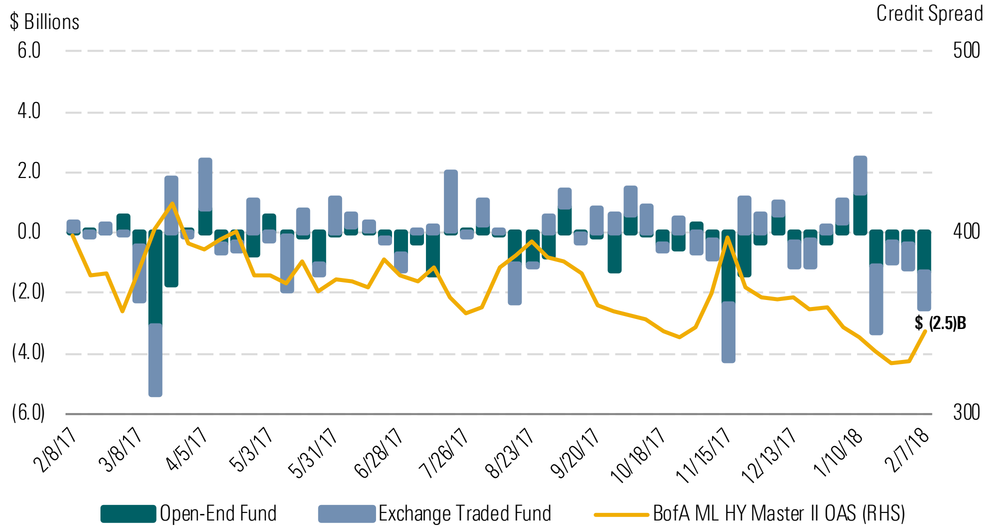
Since their most recent low in mid-2016, inflation expectations have been on an upward trend. For example, the 5-year, 5-year forward inflation expectation rate has risen to 2.30%, its highest level since fall 2014. The 5-year, 5-year forward inflation expectation rate is the market-derived expectation for the average inflation rate for 5 years, beginning 5 years in the future.

Following the sell-off last week, investors are re-evaluating their expectations for further interest rate hikes. According to CME Group's FedWatch Tool, the market-derived probability that the Federal Reserve will raise the federal-funds rate at its March meeting declined to 72% from 78% the prior week. The probability of further rate hikes through the rest of the year has also declined. For example, by the end of last week, the probability that the federal-funds rate at the end of 2018 will be greater than 1.75% had declined to 81% from 88%, and the probability that the federal-funds rate will be 2% or higher declined to 48% from 59%.

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

For Fourth Consecutive Week, Investors Pull Assets Out of High-Yield Funds
For the fourth consecutive week this year, investors pulled assets out of the high-yield market. For the week ended Feb. 7, high-yield open-end funds and exchange-traded funds experienced a net outflow of $2.5 billion. This consisted of $1.3 billion of withdrawals from open-end funds and $1.2 billion of unit redemptions from ETFs. Over the past four weeks, outflows total $8.0 billion. Since June 2009 (when we first began measuring high-yield fund flows), there have been only six instances in which fund outflows have been $8.0 billion or more. The most recent instance was at the end of 2015; the other instances occurred in mid-2014 and mid-2013.

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. 9, 2018

(000,000s $ unless otherwise noted)

Issuer			Issue				
Name	Ticker	Morningstar Corporate Rating(1)	Size	Coupon	Description	Maturity	Approx Spread to US Treasuries
Celgene	CELG	A-	$500	2.875%	Senior Unsecured	2021	+60
Celgene	CELG	A-	$1,000	3.25%	Senior Unsecured	2023	+75
Celgene	CELG	A-	$1,500	3.90%	Senior Unsecured	2028	+110
Celgene	CELG	A-	$1,500	4.55%	Senior Unsecured	2048	+145
Citigroup	C	A-	$700	L+35	Senior Unsecured	2021	NA
Citigroup	C	A-	$1,300	2.85%	Senior Unsecured	2021	+55
Darden Restaurants	DRI	BBB-	$300	4.55%	Senior Unsecured	2048	+145
JPMorgan Chase	JPM	A	$1,750	L+25	Senior Unsecured	2020	NA
McKesson	MCK	A-	€ 250	Euribor+15	Senior Unsecured	2020	NA
McKesson	MCK	A-	€ 500	1.625%	Senior Unsecured	2026	+109(2)
McKesson	MCK	A-	$600	3.95%	Senior Unsecured	2028	+113
Novartis Finance	NVS	AA(1)	€ 750	0.50%	Senior Unsecured	2023	+2(2)
Novartis Finance	NVS	AA(1)	€ 750	1.38%	Senior Unsecured	2030	+10(2)
Novartis Finance	NVS	AA(1)	€ 750	1.70%	Senior Unsecured	2038	+20(2)

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.

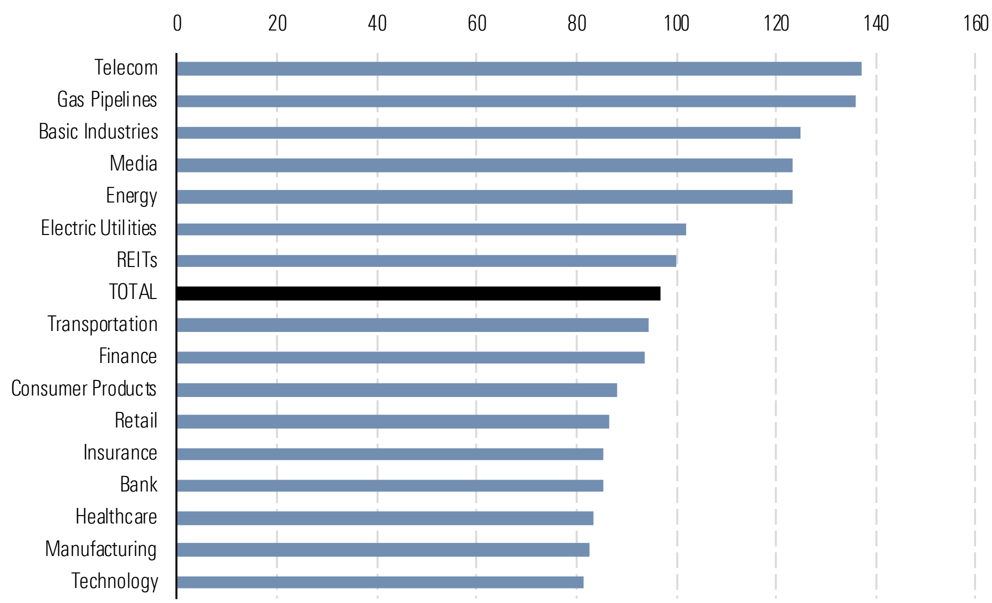
Exhibit 2 Morningstar, Inc. Corporate Bond Index Sector Summary

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**	**97**	**7**	**1**	**(1.43)**	**(2.35)**
FINANCIAL	**A-**	**1,502**	**5.4**	**87**	**7**	**4**	**(0.94)**	**(1.92)**
Bank	A-	921	4.9	85	8	4	(0.86)	(1.69)
Finance	A	271	5.6	94	7	6	(1.08)	(2.39)
Insurance	A	216	7.7	85	3	(1)	(1.27)	(2.71)
REITs	BBB+	85	6.0	100	5	(4)	(0.76)	(1.68)
INDUSTRIAL	**A-**	**2,889**	**7.5**	**100**	**7**	**(1)**	**(1.66)**	**(2.57)**
Basic Industries	BBB	241	7.7	125	13	(4)	(2.10)	(2.44)
Consumer Products	A-	322	7.6	88	8	4	(1.59)	(2.80)
Energy	A-	411	7.3	123	13	1	(2.02)	(2.54)
Healthcare	A-	404	7.7	84	2	(5)	(1.55)	(2.71)
Manufacturing	A-	462	6.1	83	5	2	(1.04)	(2.05)
Media	BBB+	187	8.3	123	7	(6)	(1.89)	(2.67)
Retail	A-	160	7.7	86	7	(1)	(1.62)	(2.70)
Technology	A+	354	7.3	81	7	4	(1.46)	(2.76)
Telecom	BBB+	147	9.1	137	7	(6)	(2.04)	(2.36)
Transportation	BBB+	149	8.8	94	6	(3)	(1.95)	(2.89)
UTILITY	**BBB+**	**564**	**8.6**	**116**	**7**	**(4)**	**(1.84)**	**(2.65)**
Electric Utilities	A-	330	9.1	102	4	(2)	(1.79)	(3.12)
Gas Pipelines	BBB	222	7.7	136	10	(8)	(1.91)	(1.92)
Rating Bucket								
AAA Bucket		115	8.1	49	3	1	(1.53)	(3.04)
AA Bucket		478	5.6	58	5	(1)	(0.87)	(1.90)
A Bucket		1,957	6.8	78	7	4	(1.34)	(2.53)
BBB Bucket		2,443	7.2	125	8	(2)	(1.62)	(2.25)
Term Bucket								
1-4	A-	1,606	2.3	59	5	2	0.03	(0.30)
4-7	A-	1,161	4.6	81	6	2	(0.35)	(1.26)
7-10	A-	932	7.0	110	12	4	(1.45)	(2.81)
10PLUS	A-	1,294	13.7	142	10	(2)	(3.83)	(5.08)

Data as of 02/09/2018

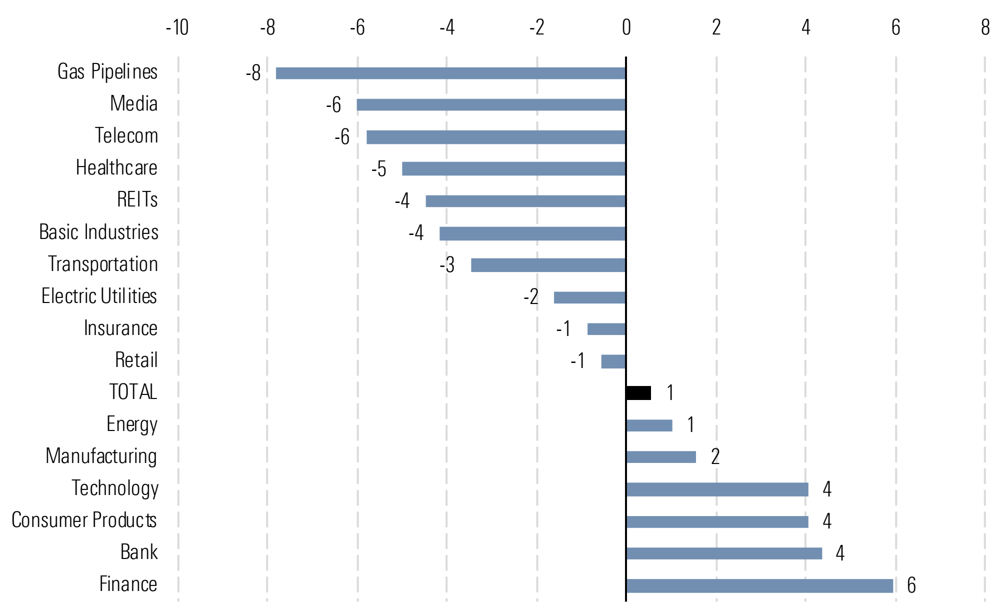
Source: Morningstar, Inc.

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



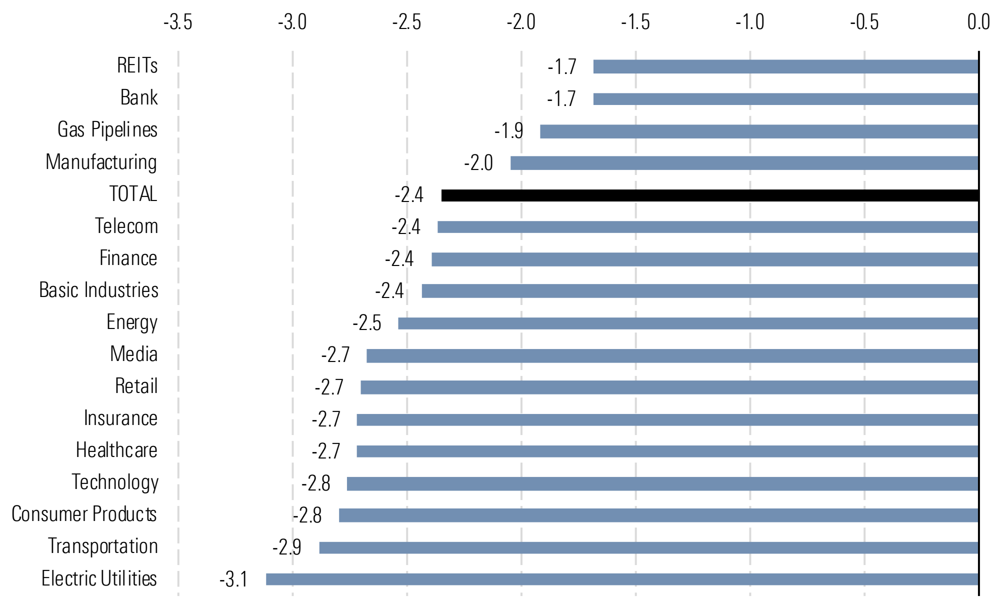
Source: Morningstar, Inc.

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
Zions **ZION**	BBB	BBB-
Freeport-McMoRan **FCX**	BB-	B+
Regions Financial **RF**	BBB+	BBB
Mattel **MAT**	BB	BBB-

Zions' Rating Upgraded to BBB From BBB- on Improved Profits and Asset Quality

Following the adoption of our revised bank methodology, Morningstar Credit Ratings, LLC is upgrading Zions Bancorporation's credit rating to BBB from BBB-. Under the new methodology, the company scores higher on our Solvency Score and Stress Test rating pillars than under the previous criteria in force during our prior review. In combination with a higher Distance to Default score, these improvements outweigh a slight deterioration in the company's Business Risk score and contribute to the higher credit rating. We have also revised our outlook on the company to stable from positive.

Zions' fair Business Risk score benefits from a decent funding mix, the positive effects of which are partially offset by its smaller size, as well as concentrations in certain geographic areas and loan products including commercial real estate and energy loans. Although short-term funding has increased since our prior review to represent about 8.5% of liabilities from 1.5% a year ago, a factor that contributed to a lower pillar score, most of Zions' funding comes from sources that we consider stable. Deposits represented about 90% of liabilities as of December 2017, while long-term debt represented about 1%. Management's decision to exit lower-rated structured securities in 2015 and its ability to execute on plans to increase operating efficiencies and profitability during the ensuing two-year period contribute to an average management score. However, Morningstar's Equity Research Group does not believe that Zions possesses an economic moat, given higher operating costs and profits that have trailed its estimated weighted average cost of capital, a factor that negatively influences the company's Business Risk score. Zions is primarily a commercial lender. At year-end, approximately 51% of loans outstanding were considered commercial and industrial, 24.8% commercial real estate, and 24% consumer loans. Although we maintain a constructive outlook on energy prices, our pillar score is constrained by Zions' comparatively large exposure to energy-related loans (4.4% at year-end) and commercial real estate in energy-producing areas, which could contribute to higher credit costs if energy prices decrease during our forecast horizon. Zions' revenue sources are narrowly focused on interest income, which represented about 79% of 2017 revenue and further limits the Business Risk score.

Under our new methodology, Zions generates a higher Solvency Score, which contributes to a higher credit rating. Relative to peers, we now consider the company's score on the pillar to be modestly above average versus slightly below average previously. Higher profits during the year, which include a return on average assets of 0.92% and a return on average common equity of 8.5% after adjusting for higher tax costs associated with the recently enacted Tax Act, contribute positively to the higher pillar score. Higher levels of loan-loss reserves and capital relative to problem loans than existed a year ago also contribute positively to the higher pillar score. Although somewhat lower than a year ago, Zions continues to score modestly above average in terms of capital buffers and deposit funding.

Similar to regional banking peers, Zions generates a good score on our Stress Test pillar. Although the company's loan portfolio maintains an above-average exposure to commercial and industrial loans, including energy-related loans and commercial real estate loans to which we assign high risk weights, results on the Stress Test reflect Zions' decent initial capital position and adequate levels of loan-loss reserves, combined with our expectation that preprovision profits will continue improving over our forecast horizon. Altogether, forecast capital levels are maintained at decent levels under our stress-case assumptions.

Our rating on Zions also considers its modestly below-average Distance to Default score. This market-based pillar compares the company's equity market value, including the volatility of its equity value, with the book value of its assets. The pillar score considers the 1.48 times multiple of the company's stock price relative to its book value, which ranks above 61% of banks in our peer set. However, a higher equity volatility measure during our measurement period detracts from the pillar score.

Our stable outlook implies that we are unlikely to change Zions' credit rating within the next couple of years. However, factors that could individually or collectively lead to a higher credit rating include higher pretax profits or higher capital levels that could contribute to higher Solvency and Stress Test scores. Lower levels of short-term funding could contribute to a higher Business Risk score and a higher credit rating. Higher credit costs resulting from deteriorating energy prices or commercial real estate values could contribute to lower profits and potentially lower capital levels, which could lead to a lower credit rating. Our rating may also be negatively affected by lower reserves relative to nonperforming and delinquent assets to the extent that they lead to a lower Solvency Score. We expect the range of positive or negative outcomes to be limited to plus or minus one notch.

Freeport-McMoRan's Rating Upgraded to BB- from B+; Outlook Positive

Morningstar Credit Ratings, LLC is upgrading the corporate credit rating of Freeport-McMoRan Inc. to BB- from B+ and maintaining the outlook at positive.

The upgrade results from further debt reduction that Freeport-McMoRan made in 2017. Balance sheet debt was reduced to approximately $13.1 billion at Dec. 31, from $16 billion at the end of 2016. The ratings reflect the company's large asset base of global mines coupled with a still modestly leveraged balance sheet in a lower copper price environment. The rating also reflects uncertainty regarding the company's ultimate ownership position in its Grasberg mine in Indonesia. Freeport-McMoRan is the second largest copper producer in the world after state-run Codelco with seven North American copper mines, two majority-owned copper mines in South America, and an approximate 90% interest (PTFI) in the Grasberg mine, which produces a significant amount of gold as well as copper. Although the company has attractive mines and properties, it participates in the volatile and competitive commodities industry and does not possess an economic moat as assigned by Morningstar's Equity Research Group. The current rating incorporates the company's high Business Risk, its higher-than-average Cash Flow

Cushion and Distance to Default risk and its moderate Solvency Score risk. Its Business Risk is affected by product concentration, industry cyclicality, and lack of an economic moat, while its Cash Flow Cushion reflects good operating cash flow offset by heavy debt maturities over the next few years.

At the end of 2017, debt was $13.1 billion ($8.7 billion net), down from $16 billion ($11.8 billion net) at year-end 2016. Coupled with strong copper prices last year, adjusted latest 12-month EBITDA by our estimate was approximately $5.4 billion, resulting in debt/adjusted LTM EBITDA of about 2.4 times, down from the 3.6 times recorded for 2016. Freeport-McMoRan has a high degree of operating leverage, and its EBITDA price sensitivity to copper is approximately $360 million for every $0.10 move in the price of copper. We forecast the company to produce free cash flow over the next few years at copper prices ranging from approximately $3.00 per pound to $2.30 per pound and gold prices ranging from approximately $1,360 per ounce to $1,150 per ounce. As of Dec. 31, cash on hand was $4.4 billion. For external liquidity, the company has an undrawn, unsecured $3.5 billion revolving credit facility expiring in May 2019. We estimate that nearer-term maturities over the next few years are approximately $1.4 billion in 2018, $1.0 billion in 2020, $1.4 billion in 2021, $2.8 billion in 2022, and $2.8 billion in 2023.

In terms of further rating action, additional debt reduction that is significant could improve the company's Solvency Score such that we could consider an upgrade to the rating. Also, sustained levels of robust copper and gold prices above our expectations could result in a better Cash Flow Cushion, which could result in an upgrade. For an upgrade, we would also look to a satisfactory resolution of the company's negotiations with the Indonesian government regarding a new mining license (IUPK) to extend its operating permit for its Grasberg operation until 2041. Alternatively, a substantial and prolonged weakening in copper and gold prices could pressure the company's Cash Flow Cushion such that it may cause us to consider lowering the rating.

Regions Financial's Rating Upgraded to BBB+ From BBB on Improved Profits and Asset Quality

Following the adoption of our revised bank methodology, Morningstar Credit Ratings, LLC is upgrading Regions Financial's credit rating to BBB+ from BBB. Under the new methodology, which compares a large group of systemically important banks from developed countries, Regions scores higher on our Solvency Score and Stress Test rating pillars than under our previous criteria. Higher scores on the pillars are supported by reasonably diverse revenue sources and solid profitability measures as well as stable asset quality and reserve buffers. We now consider Regions' credit profile, which when compared with recent years includes higher profits, improving asset quality, and decent capital levels, to be comparable to those of other large regional banks including KeyCorp, Huntington Bancshares, and SunTrust Banks, which we rate BBB+. Our outlook on the company remains stable.

Regions' good Business Risk score benefits from the company's reasonably diverse operations and good funding mix. The company operates around 1,500 branches across the Southeastern and Midwestern United States. Operations are focused primarily on traditional consumer banking, which generated 58% of revenue in the first three quarters of the year, and corporate banking, which generated about 33%. Wealth management and other corporate operations generated the remaining revenue during the period. Revenue sources are reasonably diverse and split between net interest income, which represented about 63% of revenue during 2017, and fee-based sources, which contributed 37%. Regions' loan portfolio emphasizes commercial exposure, which modestly exceeds peers' and represented about 61% of loans at year-end including 15% in commercial real estate. Limiting Regions' Business Risk score is Morningstar's Equity Research Group's no-moat assessment, which results from higher operating costs and lack of a funding cost advantages. However, Regions Financial benefits from a solid funding mix with over 100% of funding--when judged relative to assets less cash--coming from sources that we would consider stable, including equity, long-term debt, and deposits.

Under our new methodology, Regions generates a higher Solvency Score, which positively contributes to a higher credit rating. Relative to peers, we now consider the company's score on the pillar to be approximately average compared with modestly below average previously. The company's capital score within the pillar improved to modestly above-average levels relative to peers when combining the rankings of Regions' common equity Tier 1/risk-weighted asset ratio with its Tier 1 capital/adjusted total asset ratio. Although these decreased slightly compared with year-end 2016, their relative ranking is higher than under our previous methodology, where we only considered tangible capital levels within a U.S. bank peer set. Regions' liquidity, as measured by a deposits/loan ratio of 123% as of December, scores higher than 73% of global peers. We believe this metric is a more efficient measure of deposit funding for global banks than our prior approach, which simply considered deposits relative to total liabilities. Under this measure, Regions Financial scored approximately average. We continue to consider Regions' reserves for loan losses to be below average and thereby detract from the pillar score.

Similar to regional banking peers, Regions Financial generates a good score on our Stress Test pillar. The company's score on the pillar benefits from a reasonably diverse loan portfolio spread across the U.S. Southeast and Midwest. The portfolio emphasizes commercial loans, including commercial and industrial loans, at 45% of total loans, and commercial real estate, at about 15%, a level we consider approximately average for a large regional bank. We consider the company's energy loans (3%) and investor-owned commercial real estate (7%) to be higher risk and detract from the pillar score. Consumer loans represent the remaining 39% of loans outstanding at year-end, focused mainly on residential mortgages (18%), and home equity loans (13%), and represent average risk, in our opinion. Most of Regions' investment portfolio is composed of government agency guaranteed securities, which contribute positively to the company's score on the pillar. Results on the Stress Test reflect Regions' initial capital position and adequate levels of loan-loss reserves and our expectation that preprovision profits will continue to improve over our forecast horizon. Taken together, forecast capital levels are maintained at decent levels under our stress-case assumptions.

Regions Financial's rating also considers its average Distance to Default score. This market-based pillar compares the company's equity market value, including the volatility of its equity value, with the book value of its assets. The pillar score considers the 1.37 times multiple of the company's stock price relative to its book value as well as a measure of equity volatility during our measurement period. Both measures rank near average in our peer set.

Our stable outlook implies that we are unlikely to change Regions Financial's credit rating within the next couple of years. However, factors individually or collectively that could lead to a higher credit rating include higher pretax profits or higher capital levels, which could contribute to higher Solvency and Stress Test scores. Capital levels that persist below peer averages could lead to a lower credit rating. Our rating may also be negatively affected by lower reserves relative to nonperforming and delinquent assets to the extent that they lead to a lower Solvency Score. A riskier loan portfolio or lower underwriting standards could contribute to a lower Stress Test score and a lower credit rating.

Mattel's Rating Downgraded to BB With Negative Outlook on Deteriorating Operating Results
Morningstar Credit Ratings, LLC is downgrading Mattel Inc.'s rating two notches to BB and maintaining a negative outlook. The downgrade reflects ongoing revenue and cash flow declines, weaker credit protection measures, and heightened uncertainty regarding future operating performance. The negative outlook reflects the potential for a lower rating if Mattel is unable to stabilize revenue and improve margins and debt protection metrics.

During the past several years, Mattel's revenue has declined. The company had to address the loss of a key license agreement, intensified competition due to shorter product lifecycles, the increasing use of technology in toys, the growth of online retailers, heightened competition from its largest retail customers that promote their own private-label toys, and the bankruptcy filing of Toys 'R' Us.

Mattel installed a new management team in 2017, which has outlined actions designed to stabilize revenue and improve profitability. The company expanded prior initiatives to reduce its cost structure with a plan to eliminate at least $650 million in net costs over the next two years. Mattel expects that one third of these net savings will be achieved through process simplification and the optimization of advertising, selling, general, and administrative expense, and cost of goods sold. Management expects larger, more structural changes to manufacturing along with technology investments that will generate the balance of the savings in year two.

In 2017, Mattel's Solvency Score deteriorated due to lower returns, weaker interest coverage, and higher leverage. Over the past two quarters, Mattel has taken aggressive actions to reduce and manage obsolete inventory. As such, Mattel's recent fourth-quarter results posted a substantial decline in gross margin to 31% from 47% in the prior year. Morningstar forecasts that margins will begin to recover in 2018, as indicated by the growth of key brands at the consumer level, including single-digit point-of-sale growth at the store level for its Barbie and Hot Wheels brands over the past several quarters.

Mattel's actions to reduce obsolete inventory severely depressed gross margins and EBITDA in the fourth quarter of 2017, resulting in double-digit debt leverage at year-end. As Mattel normalizes operations, we forecast leverage will decline to an adjusted net debt/EBITDAR ratio of 5.2 times by year-end 2018. Adjusted debt at Dec. 31, 2017, was $4.2 billion, with $3.1 billion of senior unsecured notes and $1.1 billion of commitments related to operating leases and underfunded pensions and postretirement obligations. Recently, Mattel replaced its unsecured revolving credit facility with a $1.6 billion asset-based lending facility, which is secured by accounts receivable and inventory and expires in June 2020.

Also, in December 2017, Mattel issued $1.0 billion 6.75% senior unsecured notes due 2025 in a private offering, with proceeds to retire its $250 million March 2018 bond maturity and bolster its liquidity position. Year-end cash balances totaled $1.1 billion, and Mattel is committed to the maintenance of at least $800 million in year-end cash to fund its seasonal working-capital needs. Mattel's maturity schedule is well laddered, with less than half of its senior unsecured notes maturing in five years. Morningstar forecasts cash balances, its asset-based lending facility, and free cash flow will support repayment of upcoming debt maturities, including $500 million in 2019, $250 million in 2020, and $350 million in 2021. In addition to its cost-reduction plan, management suspended the dividend, which was over $500 million in previous years, and reduced capital spending by one third to about $200 million annually. Mattel has stated its commitment to a strong credit profile and has historically targeted a year-end debt/capital ratio of 35%.

Mattel's rating and solid Business Risk score reflect its strong competitive position and brand strength in the fragmented toy market. The company's leading market share positions in the industry, along with licensing and entertainment relationships, provide substantial barriers to entry. Still, competition is intensifying with shorter product cycles and an increasing use of high technology in electronics and video games. Mattel's largest customers, including Walmart and Target, are increasingly selling their own private-label toys. Meanwhile, online retailers such as Amazon.com offer a growing and wide variety of toys at low prices. Morningstar's Equity Research Group has assigned Mattel a narrow economic moat.

The negative outlook reflects the potential for a lower rating if Mattel is unable to sustain its competitive position, stabilize revenue, and improve margins and debt protection metrics, which could result in a weakened Business Risk and Cash Flow Cushion. The rating outlook could be stabilized if Mattel is able to return to industry growth rates, normalize operating margins, and reduce debt leverage to historical levels, which would support improvement in the Solvency Score.

Recent Notes Published by Credit Analysts

Rogers Files to Sell U.S.-Dollar-Denominated 30-Year Senior Notes to Term Out Short-Term Debt

Market Data

On Feb. 5, Rogers Communications Inc. (BBB-, positive) filed to issue $500 million of new U.S.-dollar-denominated 30-year senior notes. According to the filing, management indicated it may apply a portion of the proceeds from the proposed notes to repay some of its outstanding commercial paper and other short-term borrowings, which totaled nearly CAD 1.6 billion at year-end.

We believe the two closest comparable peers are U.S. wireless carriers Verizon Communications (BBB, stable) and AT&T Inc. (BBB-, stable). According to pricing from Interactive Data as of Feb. 2, long-maturity senior notes of Rogers' and its U.S. peers are indicated as follows:

Rogers' existing 5.00% notes due 2044 at +125 basis points.
Verizon's 4.52% notes due 2048 at +159 basis points.
AT&T 4.50% notes due 2048 at +179 basis points.

According to data from Morningstar, Inc., the BBB category of the Morningstar Corporate Bond Index was +114 basis points as of Feb. 2.

MCR Credit Risk Assessment

Morningstar Credit Ratings, LLC affirmed its BBB- corporate credit rating for Rogers on Jan. 12 and raised its outlook to positive from stable. The outlook considers that recent improvement in EBITDA and free cash flow have contributed to modest improvement in leverage metrics, with a path to further improvement if Rogers monetizes certain noncore assets, which management recently said that it is considering.

Rogers is the largest wireless and cable network operator in Canada by revenue share. However, its Business Risk Score remains a notch weaker than its U.S. counterparts, AT&T and Verizon, due to smaller overall size ranking and a high capital market dependence. Morningstar's Equity Research Group continues to assign the company a narrow economic moat rating, in line with the U.S. carriers, supported by efficient scale in both wireless and fixed-line businesses as well as sustainable cost advantages over rivals.

Upward migration in Rogers' rating remains constrained by a Cash Flow Cushion pressured by near-term maturities and a Solvency Score held back by high leverage and lower returns on invested capital stemming from CAD 5.6 billion of strategic acquisitions. Recently, we note that Rogers' investment in wireless spectrum and fixed-line network improvements have been supportive for customer growth and pricing, allowing the carrier to remain competitive against aggressive rivals.

At the end of the December quarter, Rogers reported CAD 15.0 billion of debt, net of a CAD 1 billion derivative offset for currency hedging. This equates to leverage at 2.8 times trailing EBITDA down from 3.1 times a year ago but still meaningfully above the 2.4 times level it reported at year-end 2013. For comparison, Verizon reported its net debt at 2.6 times EBITDA at Dec. 31, while AT&T reported net debt at 2.4 times. However, if AT&T's pending acquisition of Time Warner Inc. (not rated) eventually closes, we expect its net debt to increase to 2.8 times pro forma combined EBITDA.

Rogers reported no cash and equivalents as of the end of the quarter as it continues to manage its operations to zero net cash flow after dividends and debt repayments. In lieu of cash on hand, the carrier relies on commercial paper backed by its CAD 3.2 billion revolving credit facility due March 2022.

Rogers' trailing 12-month free cash flow was CAD 1.5 billion at year-end 2017, down 6% from 2016. Operating cash flow was flat year-over-year while capital spending increased 4% to CAD $2.4 billion for the year, in-line with management's guidance. Though spending appears on track to decline over the next year or two, we continue to expect both fixed line and wireless to remain capital-intensive over the long term. Dividends remained the primary use of cash flow in 2017, with a payout rising to 66% from 62% a year ago. We expect dividend payout to remain around 60% of free cash flow, assuming annual dividend growth in line with revenue.

Apple Announces Intention to Reduce Excess Cash to Zero; Outlook Negative

MCR Credit Risk Assessment

Apple Inc. (AA-, negative) released its fiscal first-quarter operating results Feb. 1, featuring seasonally strong operating performance across all geographic regions, driven by iPhone sales and wearable products. Management also announced its plan to radically alter its capital policy in light of changes in taxation of foreign earnings, with intentions of reducing its net cash position to zero over time through share repurchases and dividend growth. This, combined with Apple's declining growth and the high concentration of revenue contributed by the iPhone, supports our negative rating outlook.

In its fiscal first quarter ended Dec. 31, Apple's total revenue increased 13% from a year ago, while gross margin stayed flat at 38.4%. Meanwhile, operating expenses increased 12% year over year. Growth was due primarily to a mix shift toward higher-priced iPhone models (8 and X), as well as healthy volume in tablets and wearable products. However, phone and iMac volume was down from a year ago. IPhone results continue to dominate Apple's overall performance, contributing 70% of revenue in the first quarter.

For the fiscal second quarter ending March 31, management is guiding to midpoint revenue growth of 15% year over year. Management is also guiding to gross margin down slightly to 38% and operating expenses up around 18% year over year. From this guidance, we estimate EBITDA growth between 15% and 16% to just under $19 billion at the midpoint.

Management is also guiding to a decline in its income tax rate to 15% from 26% in the second quarter, incorporating impacts from the Tax Cuts and Jobs Act of 2017, which also resulted in a $38 billion charge in the quarter to reflect a tax on overseas cash, as well as adjustments to deferred tax accounts to reflect the lower future tax rate. In light of tax reform, management now plans to repatriate a significant amount of overseas cash, targeting a net cash balance after subtracting debt of near zero over time. This marks a radical departure from Apple's historical net cash positions of 2 times EBITDA or greater, though the policy would position Apple's net cash level in line with same-rated peers Texas Instruments, Inc (AA-, stable), at net cash of 0.1 times EBITDA, and Intel Corp (AA-, stable), with net debt at 0.4 times EBITDA, both as of Dec. 31.

Apple reported total debt of $122.4 billion for the December quarter, moving its gross leverage ratio slightly higher from last quarter to 1.65 times trailing 12-month EBITDA. Debt included $11.4 billion of commercial paper outstanding at quarter-end. While this may portend another senior debt issue in the near-term, Apple may choose to repatriate cash instead. Meanwhile, global cash and investments ended the fiscal year at $285.1 billion, up $16.2 billion from last quarter, with net cash ending the quarter at 2.1 times EBITDA. Domestic cash reserves remained at 6% of the global total, down $207 million from a year ago, while global cash and investments expanded by $38.8 billion. Growth in global cash was the net result of trailing 12-month free cash flow of $52.9 billion and $7 billion of net new debt issuance, offset by $3.7 billion of dividends and net share repurchases. Total payout was 84% over the period, down 200 basis points from a year ago. Apple reported $34 billion of remaining capacity on its $210 billion share-repurchase authorization. Although management deferred more detailed guidance on its future capital policy to its earnings release next quarter, we expect to see a significant increase in share-repurchase volume and dividend growth in the year ahead.

Market Data
According to pricing from Interactive Data as of Feb. 2, Apple Inc.'s 3.00% senior notes due in 2027 are indicated at a spread of +60 basis points over the nearest Treasury, 12 basis points tighter from their issuance on Nov 13. Among comparable issuers, Texas Instruments Inc's 2.90% notes due in 2027 are indicated at +54 basis points, 4 basis points tighter from their issuance on Nov. 3. Intel Corp's 3.15% notes due in 2027 are indicated at +55 basis points, 10 basis points tighter from Nov. 3. Over the same period, the Morningstar Industrial Corporate AA index tightened 8 basis points and is now quoted at +52 basis points.

Credit Impact of Wells Fargo's Consent Order Manageable
MCR Credit Risk Assessment
On Feb. 2, Wells Fargo (A, stable) entered into a consent order with the Federal Reserve relating to company governance oversight, compliance and risk management relating to prior issues including sales practices announced Sept. 8, 2016. The agreement with the Federal Reserve included the unusual step of limiting Wells Fargo's asset size to Dec. 31, 2017, levels. The constraint will be effective in the second quarter following the approval by the Federal Reserve of a company plan to further enhance the board's oversight capacity and improve the company's operational and risk management program. On a call with investors, CEO Timothy Sloan said the company had already started many of the changes cited by the Federal Reserve. Sloan also said the company possesses considerable financial flexibility to adjust its operations and comply with the asset cap restriction by limiting nonoperating deposits growth and the size of certain asset portfolios the bank considers less efficient. The company estimates that these restrictions will shave $300 million-$400 million (about 1.9% of 2017 net income) from 2018 net income, which we consider manageable.

We do not currently anticipate any changes to Wells Fargo's credit rating or outlook, although we believe that this consent order and actions the bank will take may negatively pressure Wells' position within its rating category. We think they may result in a lower management grade, which would reduce Wells' score in our Business Risk pillar. In addition, we believe that the limit on asset growth may reduce Wells' near-term profitability, which could reduce the company's performance in our Solvency and Stress Test pillars. This negative impact could be offset by an improvement in other areas, such as stronger capital levels. Finally, we note the recent fall in Wells' share price, which may pressure the bank's performance in our market-driven Distance to Default pillar. We have considered the likely magnitude of these factors both collectively and severally, and we do not anticipate a change to our A rating.

Market Data

Given its business model, Wells Fargo can be compared with large regional banks like U.S. Bancorp as well as global banks. Wells Fargo's 3.584% notes due 2028 are indicated by pricing service Interactive Data at +76 basis points over the nearest Treasury. Spreads on JPMorgan's (A, stable) 3.782% notes due 2028 are indicated at a similar spread of +75 basis points. By contrast, U.S. Bancorp's (AA-, stable) 2.375% notes due 2026 are indicated at +55 basis points while lower-rated Citigroup's (A-, stable) 3.887% notes due 2028 are indicated at +89 basis points. Meanwhile, 10-year notes of Bank of America Corp (BBB+, stable) are indicated at +72 basis points.

Hess' Cash Provides Backstop to Increasing Guyana Spending; Forecast Negative 2018 Net Cash Flow

MCR Credit Risk Assessment

On Feb. 5, Hess Corp. (BBB-, stable) reported fourth-quarter 2017 revenue of $1.3 billion, a $90 million (6%) decline relative to $1.4 billion in fourth-quarter 2016. However, net cash provided by operating activities for the quarter was $343 million, a $17 million increase from $326 million generated in the year-ago quarter (after adding back impairments and deferred tax benefits equal to $1.8 billion and $3.2 billion, respectively). After capital expenditures, dividends and asset sales, we estimate fourth-quarter 2017 net cash flow was about $2.2 billion. Proceeds from asset sales in the fourth quarter were $2.5 billion, which includes the sale of interests in Equatorial Guinea and Norway, announced in October. We view Hess' liquidity as very good, ending December with about $4.5 billion in cash and equivalents and total liquidity of $8.6 billion, including unused revolver and committed lines (pro forma for a $350 million bond redemption scheduled for February).

Actual companywide fourth-quarter production was 25.7 million barrels of oil equivalent (excluding Libya), sequentially 6% lower, reflecting asset sales and an unplanned disruption at the third-party-operated Enchilada platform in the Gulf of Mexico. The first-quarter 2018 production guidance midpoint is 20.3 million boe, 21% lower sequentially, which incorporates recent divestments and an extended shutdown of the Enchilada platform. Hess forecasts total 2018 production of 89.4 million-93.1 million boe, or a 3% increase at the midpoint relative to pro forma 2017 net production, which we think is readily achievable. Production growth in 2018 will center on the core Bakken Shale (North Dakota) operations and the reinstatement of negatively affected and new developments in the deep-water Gulf of Mexico.

For 2018, company guidance is for exploration and production unit operating costs (including depreciation, depletion, and amortization) of $31-$33/boe. Based on pro forma 2017 unit costs of $36.71/boe (removing the impact from asset sales), we think the company's 2018 cost guidance is achievable, with most of the reduction from lower DD&A. Company guidance for 2018 capital expenditures is $2.1 billion (excludes midstream), nearly unchanged from 2017. About two thirds of the 2018 capital budget is allocated to continuing exploration and development activities in the Stabroek Block (Hess has a 30% interest) offshore Guyana, where massive recent oil discoveries have been made. After capital expenditures, dividends, share repurchases, and asset sales, we estimate net cash flow to be below break-even for 2018. Redemption of $350 million long-term notes is scheduled for Feb. 15. The next debt maturities include $300 million due in 2024 and $1.0 billion in 2027.

At the end of December, Hess' consolidated debt was $6.6 billion and net debt $2.1 billion (pro forma for $350 million redemption scheduled for February). Hess' ratio of total debt/trailing adjusted EBITDAX is 3.1 times and net leverage 1.0 time, the ratios having declined by 2.4 and 2.3 turns, respectively, since the end of 2016. As of December, we estimate trailing 12-month adjusted EBITDAX is $2.1 billion. Improved leverage metrics for Hess are largely the result of rebounding cash flow.

Market Data

Hess can be compared with Apache (BBB-, positive), a large, diversified exploration and production peer. According to pricing service Interactive Data, the 3.5% notes due July 15, 2024, from Hess recently traded at +110 basis points over the nearest Treasury. By comparison, Apache's 2.63% notes due in 2023 recently traded at +91 basis points. Additionally, the 3.45% notes due July 15, 2024, from Anadarko Petroleum (BB+, positive) recently traded at +111 basis points over the nearest Treasury. For index comparison, we look to the BBB- Morningstar Corporate Bond Index, which is currently at a spread of +134 basis points.

Liberty Property Trust Has Solid 2017; Strong Demand Bodes Well For 2018

MCR Credit Risk Assessment

Liberty Property Trust (BBB, stable) topped full-year guidance for funds from operations with strong rent and occupancy performance. The company's portfolio benefits from locations in the strongest warehouse markets in which ever-building e-commerce activity and a strengthening economy are producing some of the strongest demand for industrial space on record. In addition, Liberty's management team is constantly honing the portfolio by recycling noncore assets into modern and efficient facilities while working to create further balance sheet strength and flexibility, driving higher scores for Business Risk and Cash Flow Cushion.

For the year, FFO was up 9.4%, driven by a 14.9% increase in industrial rents and same-store net operating income growth of 3.1%. Occupancy was relatively high at 96.9% in the in-service portfolio, which compares well with 96.0% at year-end 2016 and a five-year average of 93.6%. Liberty delivered $870 million of completed developments and made $271 million of acquisitions, partially funded by asset sales of $319 million. We expect the company to continue funding investments with noncore property sales, especially suburban office properties, reducing the need to source new capital.

In its 2018 guidance, management indicated that it expects same-store NOI to grow 4.5% at the midpoint, again fueled by industrial rent growth in the midteens percentage range. Liberty also anticipates midrange development starts of $550 million and acquisitions of $500 million, funded in part by dispositions of $700 million. We project revenue growth of about 3.0% and total NOI growth close to 4.0%, with leverage remaining flat at close to 5.5 times and some modest deterioration in interest coverage as a result of increasing interest rates.

Market Data
Liberty Property Trust's industrial real estate investment trust peers are Prologis, Inc. (A-, stable), Duke Realty Corporation (BBB+, stable) and DCT Industrial Trust Inc. (BBB, stable). The following pricing data is from Interactive Data as of Feb. 5.

In the 10-year area, spreads of the nearest Treasury from these issuers are:
Liberty's $400 million 3.25% bonds due 2026 at +102 basis points.
Prologis' $750 million 3.75% bonds due 2025 at +67 basis points.
Duke Realty's $375 million 3.375% bonds due 2027 at +87 basis points.
DCT's $275 million 4.50% bonds due 2023 at +132 basis points.

The BBB Morningstar Corporate Bond Index is currently priced at +117 basis points.

LabCorp Deleveraging After Chiltern Acquisition and Projecting Benefit From New Tax Law
MCR Credit Risk Assessment
On Feb. 6, Laboratory Corp of America Holdings (BBB+, negative) reported fourth-quarter operating results that included higher free cash flow than expected, while management released strong guidance for 2018, with new tax law benefits outweighing Protecting Access to Medicare Act-related Medicare reimbursement headwinds. Our current negative rating outlook relates to LabCorp's delayed deleveraging after the Covance (2015) acquisition, which was exacerbated by the Chiltern acquisition in 2017. However, we were pleased to see some deleveraging in the fourth quarter through active debt repayment, along with management's commitment to continue deleveraging. While ongoing acquisition-related risks are reflected in our negative outlook currently, LabCorp's credit trajectory could eventually stabilize if it continues to deleverage.

In the fourth quarter, sales grew 13.2% (2.6% on an organic basis in constant currency) and met consensus of $2.7 billion, while adjusted earnings per share grew 14% year over year to $2.45, above consensus of $2.38. The core diagnostic business grew about 9% year over year during the period to $1.8 billion on 6.6% volume growth (2.9% organic and the balance from acquisitions) and 1.8% growth in revenue per requisition. These results exceeded those of its key peer in the diagnostic lab business, Quest Diagnostics Inc (BBB+, stable), which recently reported 4% growth that was evenly split between volume (most of that was acquired) and revenue per requisition. LabCorp's contract research operations, Covance, grew 24% to $0.7 billion in the quarter, including significant benefits from the Chiltern acquisition that closed in late August and some organic growth. This segment's book/bill ratio continued to improve slightly in the fourth quarter, rising to 1.35 times from 1.33 times at the end of September and 1.23 times at the end of June, which suggests the segment's organic growth should continue. Overall, both of LabCorp's segments experienced positive operating trends. We were also impressed with the firm's free cash flow generation during 2017 of $1.1 billion, which exceeded its latest guidance of $970 million-$1.0 billion.

Management provided guidance for 2018 that suggested these positive operating trends will continue despite the new Medicare reimbursement rate schedule. Specifically, LabCorp anticipates revenue growth of 9.5%-11.5%. That expected growth reflects 3%-5% of diagnostic segment growth, including a roughly 100-basis-point headwind from the new Medicare reimbursement rules. In its Covance drug development segment, the company aims for 20%-24% top-line growth, including benefits from the Chiltern acquisition and mid- to high-single-digit organic growth. Considering this top-line growth and tax-related benefits (the firm's effective tax rate is expected to decline to about 25% in 2018 from 33% in 2017) from new tax rules in the U.S., adjusted earnings per share should grow 18%-22% to $11.30-$11.70. The company also expects $1.1 billion-$1.2 billion in free cash flow in 2018.

From a credit perspective, the company also appears committed to deleveraging to between 2.5 and 3.0 times in the near future. During the fourth quarter, the company repaid $443 million of debt, causing gross leverage to decline to about 3.2 times from 3.5 times at the end of September, pro forma for the Chiltern acquisition. On the fourth-quarter call, management noted that deleveraging remains a top priority, so we think it could deleverage into the high 2s by the end of 2018. However, our negative outlook reflects the potential for LabCorp to continue pursuing debt-financed acquisitions or shareholder returns that further delay its deleveraging. Notably, creditors should be aware that LabCorp's roll-up strategy could accelerate, as smaller labs face even more onerous headwinds related to the new PAMA-related reimbursement schedule, given their higher cost structures and higher Medicare concentration relative to LabCorp. In a scenario where LabCorp significantly increases leverage to make more acquisitions, our rating could fall.

Market Data

LabCorp's closest comparable from a business and credit perspective is Quest, and their bonds recently traded at similar spreads when adjusted for maturity. 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:
LabCorp's 3.60% notes due in 2027 at +114 basis points.
Quest's 3.45% notes due in 2026 at +110 basis points.

For comparison to the roughly 10-year maturities, the Morningstar Corporate Bond Index recently was at +111 basis points at BBB+ and +117 basis points at BBB.

In the approximate 30-year maturity bucket, bonds from these two issuers recently traded over the nearest Treasury as follows:
LabCorp's 4.70% notes due in 2045 at +149 basis points.
Quest's 4.70%% notes due in 2045 at +155 basis points.

Becton, Dickinson Closes Leverage-Increasing Bard Acquisition in 1Q
MCR Credit Risk Assessment
On Feb. 6, Becton, Dickinson and Co (BBB, stable) reported fiscal first-quarter results and updated its fiscal 2018 guidance above consensus expectations. With the recently completed C.R. Bard acquisition, management revealed its updated pro forma leverage as of December and reiterated its long-term leverage target. Our BBB rating and stable outlook on BD already reflect the Bard combination.

In its last quarter before the Bard acquisition, BD turned in $3.1 billion in sales (roughly in line with consensus) and adjusted earnings per share of $2.48 (above consensus of $2.41), which both represented 4% growth in constant currency. During the quarter, BD's medical segment grew 2% on an organic constant-currency basis to $2.0 billion, which included a 170-basis-point headwind on a recent change in how BD recognizes revenue in its U.S. dispensing business. This change, which resulted in recording revenue ratably over the contract term versus recognizing the entire contract value up front with a hardware placement, was implemented three quarters ago, so it will be a growth headwind for another quarter. BD's life sciences segment grew 7% on a constant-currency basis to $1.0 billion, including low-double-digit growth in diagnostic systems and mid-single-digit growth in preanalytical systems and biosciences in constant currency. The company also increased adjusted earnings per share at a similar pace as sales growth in the quarter, which saw some operating margin contraction offset by a lower tax rate.

The acquisition of Bard closed in late December, and BD updated its fiscal 2018 guidance and leverage levels for that transaction on the call. Underlying sales growth in constant currency is expected to rise 5%-6% in fiscal 2018. The company also expects $10.85-$11.00 of adjusted earnings per share, representing 12% constant-currency growth. This earnings per share guidance was above consensus of $10.82. Also, while the firm does not share full balance sheet information with its quarterly releases, management revealed that pro forma gross leverage had risen as expected to 4.7 times at the end of December from the low 3s before the acquisition. Our current rating and stable outlook for BD reflect that elevated leverage along with the company's plan to deleverage to below 3 times within three years of the Bard acquisition.

Market Data
From a credit perspective, BD's closest comparables are similar-rated firms in the medical technology sector, including Boston Scientific Corp (BBB, positive) and Zimmer Biomet Holdings Inc (BBB, stable). In the 10-year maturity bucket, BD's bonds recently traded roughly in line with the BBB category of the Morningstar Corporate Bond Index. All of the following bond 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:
Becton, Dickinson's 2.89% notes due 2022 at +91 basis points.
Boston Scientific's 3.38% notes due 2022 at +83 basis points.
Zimmer Biomet's 3.15% notes due 2022 at +92 basis points.

In the approximate 10-year maturity bucket, bonds from these issuers recently traded over the nearest Treasury as follows:
Becton, Dickinson's 3.70%% notes due 2027 at +123 basis points.
Boston Scientific's 3.85% notes due 2025 at +95 basis points.
Zimmer Biomet's 3.55% notes due 2025 at +118 basis points.

For comparison with the approximate 10-year maturities, the Morningstar Corporate Bond Index is at +111 basis points in the BBB+ category and +117 basis points in the BBB category.

In the approximate 30-year maturity bucket, bonds from these issuers recently traded over the nearest Treasury as follows:
Becton, Dickinson's 4.67%% notes due 2027 at +143 basis points.
Zimmer Biomet's 4.45% notes due 2045 at +176 basis points.

Allergan Sees Revenue Growth in 2017 Despite Patent Expirations; Heavy Debt Load Unwinding
MCR Credit Risk Assessment
On Feb. 6 Allergan PLC (BBB-, positive) detailed solid operational performance in 2017 capped by a sales increase of 9.4% even as the firm battled key drug patent losses throughout the year. We expect Allergan to manage through its patent cliff in the long term but expect the most pronounced erosion in 2018 concomitant with generic competition to eye care medicine Restasis. Our positive outlook on Allergan's rating reflects that we would consider upgrading our credit rating if the firm substantially mitigates its patent exposure and advances closer to its goal of gross debt/EBITDA of 3.0-3.5 times.

Allergan's strong revenue growth for the year was driven by its first-half acquisitions of Zeltiq Aesthetics and LifeCell that added about $781 million of new sales. Excluding this revenue, total sales increased by 4%, despite generic competition to gastrointestinal disorder drug Asacol HD, contraceptive Minastrin 24 Fe, Alzheimer's disease therapy Namenda XR, women's health pharmaceutical Estrace, and acne medicine Aczone. Despite the number, these pharmaceuticals collectively represented only 8% of sales in 2017. In light of potential generic entrants to dry-eye treatment Restasis (about 9% of total sales) in April to July 2018, management expects revenue between $15 billion and $15.3 billion in 2018 (a decrease of 5% at the midpoint of the range). The firm also plans to reach non-GAAP net income per share in 2018 of $15.25-$16.00, down from $16.35 in 2017. On the back of its new drug and medical device products launched over the past few years, we expect Allergan to work through its patent cliff to drive sales growth in the midsingle digits over the next five years compounded annually.

Allergan carries a heavy debt burden nearly three years after the Allergan-Actavis mega-merger with $30.1 billion of debt at the end of 2017. Positively from a creditor's perspective, the firm plans to decrease total debt by $4.2 billion during 2018, including repayment of $3.75 billion of debt obligations coming due in the first quarter. This is on top of debt reduction of $2.9 billion that Allergan achieved in 2017. As a result, Allergan's total and net debt leverage (considering cash and marketable securities of $6.4 billion) was 4.2 times and 3.3 times at the end of 2017. Expected debt reduction in 2018 along with sustained operational improvement could decrease gross leverage to Allergan's target of 3.0-3.5 times by the end of 2018, in our estimation. This deleveraging reinforces our positive outlook on the firm's current BBB- rating. We anticipate that Allergan has the financial flexibility to repay the coming debt maturities with its sizable cash balance and solid free cash flow generation of $6 billion on average over the next five years, by our estimates. We recognize the firm's history of aggressive asset purchasing, but we think that it may rest on the sidelines as it repairs its balance sheet in 2018. Allergan may still greatly reward shareholders via share repurchasing and rising dividend payments, which may hinder debt reduction efforts if the firm significantly steps up these activities over this year.

Market Data
For closest comparisons to Allergan's notes, we look to similar-rated companies, Shire PLC (BBB-, positive) and Mylan NV (BBB-, negative). Within this comparable group and adjusted for bond maturities, Allergan's 10-year bonds trade closest to those at Shire and tighter than the bonds at Mylan and tighter than the BBB and BBB- Morningstar Corporate Bond Indexes. All of the following bond 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:
Allergan's 3.25% notes due in 2022 at +88 basis points.
Shire's 2.88% notes due 2023 at +91 basis points.
Mylan's 4.20% notes due in 2023 at +113 basis points.

In the approximate 10-year maturity bucket, bonds from these issuers recently traded over the nearest Treasury as follows:
Allergan's 3.80% notes due in 2025 at +111 basis points.
Shire's 3.20% notes due 2026 at +114 basis points.
Mylan's 3.95% notes due in 2026 at +140 basis points.

For comparison to the approximate 10-year maturities, the Morningstar Corporate Bond Index is at +117 basis points in the BBB category and at +138 basis points in the BBB- category.

In the approximate 30-year maturity bucket, bonds from these issuers recently traded over the nearest Treasury as follows:
Allergan's 4.75% notes due in 2045 at +145 basis points.
Shire's (Baxalta) 5.25% notes due 2045 at +135 basis points.
Mylan's 5.25% notes due in 2046 at +182 basis points.

AmerisourceBergen Completes H.D. Smith Acquisition and Benefits From U.S. Tax Reform

MCR Credit Risk Assessment

On Feb. 6, AmerisourceBergen Corp. (A, stable) turned in fiscal first-quarter operating results that beat consensus on the top and bottom lines. Including tax reform benefits, the company even raised its guidance for fiscal 2018. However, that boost was tempered by a manufacturing problem in its PharMEDium sterile compounding business. Also, the company just completed an acquisition that has increased gross and net leverage slightly. Overall, these offsetting factors contribute to our stable view of AmerisourceBergen's credit profile.

In the fiscal first quarter, revenue grew 6% to $40.5 billion (above consensus of $40.4 billion), and adjusted earnings per share grew 14% to $1.55 (above consensus of $1.34), reflecting solid operations and recently implemented tax benefits. The company noted that most of its operations were stronger in the first quarter than initially expected at the beginning of the fiscal year. However, its PharMEDium operations were suffering from poor results at a recent U.S. Food and Drug Administration inspection that caused the company to voluntarily shut down production at its Memphis, Tennessee, facility, which accounts for about half of the production capacity of that business. Management anticipates that its remediation efforts could be completed this quarter, but these problems have cut into the company's operating expectations for 2018 somewhat. Fortunately, benefits from recent changes in the U.S. tax law should more than offset those concerns from a bottom-line and free cash flow perspective.

In fiscal 2018, management expects revenue growth of 8%-11% (up from 7%-9% on the recent H.D. Smith acquisition). The company's branded drug inflation (6%-7%) and generic drug deflation (7%-9%) remain unchanged. Adjusted earnings per share are expected to grow 10%-13% year over year (up from 0%-5% expected previously) to $6.45-$6.65. These projections reflect the expected benefit from tax reform, as the firm's effective tax rate should decline to 23%-24% in fiscal 2018 from 32%-33% expected previously. This benefit should also positively influence free cash flow generation, which management expects to reach $1.35 billion-$1.60 billion in fiscal 2018, up from $1.25 billion-$1.50 billion expected previously.

Positively from a credit perspective, AmerisourceBergen maintains a conservative balance sheet relative to its key distribution peers, Cardinal Health Inc (A-, stable) and McKesson Corp (A-, stable), supporting AmerisourceBergen's one-notch-higher rating even when considering its January acquisition of H.D. Smith. Pro forma for that acquisition, we estimate AmerisourceBergen's lease-adjusted leverage stands just under 2 times, gross leverage stands in the high 1s, and net leverage stands around 1 times. By our estimates, the company's acquisition-inflated leverage still compares favorably to McKesson (lease-adjusted leverage around 2.5 times, gross leverage of 1.9 times, and net leverage of 1.3 times) and Cardinal (lease-adjusted leverage around 2.8 times, gross leverage around 2.7 times, and net leverage just over 2 times) on a pro forma basis. These leverage metrics reinforce our one-notch-higher credit rating on AmerisourceBergen, and our outlook on its rating remains stable.

Market Data

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

In the approximate 10-year maturity bucket, bonds recently traded as follows over the nearest Treasury:
AmerisourceBergen's 3.45% notes due in 2027 at +109 basis points.
Cardinal's 3.25% notes due in 2027 at +117 basis points.

For comparison to the 10-year maturity bucket, the Morningstar Corporate Bond Index is at +72 basis points in the A category and +80 basis points in the A- category.

In the approximate 30-year maturity bucket, bonds recently traded as follows over the nearest Treasury:
AmerisourceBergen's 4.30% notes due in 2047 at +145 basis points.
Cardinal's 4.34% notes due in 2047 at +151 basis points.
McKesson's 4.88% notes due in 2044 at +150 basis points.

Better Pricing and Ramp-Up of Several New Projects Drive Sharp Rebound in BP's 4Q Results

MCR Credit Risk Assessment

BP PLC (A-, stable) reported fourth-quarter total revenue of $70.0 billion, $17.9 billion (34%) more than the $52.1 billion of revenue in the fourth quarter of 2016. Commensurate with this, net cash provided by operating activities for the fourth quarter was $6.2 billion, a sizable $1.7 billion (38%) more than the $4.5 billion for the year-ago quarter (after adding back posttax payments related to the 2010 Gulf of Mexico oil spill of $284 million and $2.0 billion, respectively). After capital expenditures, noncore asset sales, dividends, and oil-spill-related payments, we estimate fourth-quarter net cash flow was $2.3 billion. Regarding BP's 19.8% equity interest in the Russian integrated oil company Rosneft (not rated), on a preliminary basis, BP recognized $321 million of net income in the fourth quarter compared with $135 million a year ago.

Similar to other integrated oil and gas companies, BP's fourth quarter was characterized by an especially sharp rebound from the upstream segment versus the year-ago period, driven by 18% higher total production--including the impact from seven project startups, such as Juniper gas, offshore Trinidad and Tobago (BP 100%) and Khazzan gas in Oman (BP 60% and operator)--and much higher liquids and modestly higher gas price realizations. Excellent (96.1%) refining availability and much better refining margins resulted in a downstream contribution for the fourth quarter nearly double that of a year ago. Included in the downstream segment, the petrochemical contribution was 19% higher versus the year-ago period, benefiting from an improved price environment and efficiencies.
BP expects first-quarter upstream oil and gas production to be broadly flat with the fourth quarter; for downstream, it expects lower industry refining margins. The company looks for lower planned turnaround activity in refining to be offset by higher turnarounds in petrochemicals.

As of Dec. 31, BP's liquidity remains good, with $25.6 billion in cash and equivalents and an estimated $7.4 billion available on its aggregate committed bank facilities. For 2018, BP's guidance for organic capital expenditures is $15 billion-$16 billion, about 6% less than the $16.5 billion spent in 2017. The company estimates 2018 cash payments related to Gulf of Mexico oil-spill-related liabilities to be just over $3 billion, declining to around $2 billion in 2019 and $1 billion per year thereafter. After adjusting for capital expenditures, dividends, noncore asset sales, and oil-spill-related payments, we estimate positive 2018 net cash flow to be more than $3 billion. Our assumption for 2018 noncore asset sales is $2.5 billion, the midpoint of company guidance. Upcoming maturities of long-term borrowings include $7.4 billion due in 2018, $7.0 billion in 2019, and $6.6 billion in 2020.

At the end of December, total debt was $63.2 billion and net debt $37.6 billion. We estimate the ratio of total debt/trailing 12-month EBITDAX to be 2.2 times and net leverage 1.3 times, much less than 4.2 times and 2.5 times at year-end 2016, respectively. Improved leverage metrics reflect rebounding cash flow, more than offsetting a modest increase in debt from a year ago. Our estimate for trailing 12-month EBITDAX for 2017 is $28.1 billion.

Market Data

BP can be compared with Royal Dutch Shell PLC (A, stable), another U.K. integrated oil and gas company. According to pricing service Interactive Data, the 2.88% notes due May 10, 2026, from Shell recently traded at +49 basis points over the nearest Treasury. By comparison, BP's 3.12% notes due in 2026 recently traded at +64 basis points. For Exxon Mobil (AA+, stable), a larger, U.S.-based integrated peer, the 3.04% notes due March 1, 2026, recently traded at +45 basis points over the nearest Treasury.

Gilead's Top-Line Decline Continues in 2017; Gross Leverage Jumps While Cash Rises

MCR Credit Risk Assessment

On Feb. 6, Gilead Sciences Inc. (A, stable) announced sustained pressure on its hepatitis C (HCV) franchises had pushed total revenue down 14.1% in 2017. Despite the continued operational decline, we see potential for a reversal of sales and earnings declines in the next few years, stemming in part to recently acquired Yescarta (non-Hodgkin lymphoma) that gained Food and Drug Administration approval in October 2017. This expectation of improving performance along with the firm's focus on deleveraging after the Kite Pharma acquisition helps inform our stable outlook on Gilead's credit rating.

Gilead's top-line decline in 2017 was again driven by the firm's HCV medicines--Harvoni, Solvaldi, and Epclusa--that collectively fell 40% due to decreasing patient starts and increasing competition in the treatment area. Despite this, the firm reached its sales guidance in 2017, having achieved $25.6 billion of total product revenue compared with a goal of $24.5 billion-$25.5 billion. The firm sees signs of a stabilizing HCV market, which may offer more predictable sales forecasting. As such, Gilead expects net product sales of $20 billion-$21 billion in 2018, which includes potential generic entrants to Letairis (pulmonary arterial hypertension) after the patent expires in July. Longer term, Gilead's HIV portfolio may encounter generic competition as patents lapse for treatment cornerstones Viread, Truvada, and Complera in 2018-22. Despite the benefit over time from Kite's therapies including Yescarta, we still expect revenue to decrease in the midsingle digits compounded annually through 2021 and EBITDA to decline at a faster rate as Gilead dedicates additional resources to its internal research engine.

Gilead's debt load jumped to $38.1 billion at the end of 2017 after the firm financed the vast majority of the $11.9 billion purchase price for Kite with $9 billion of new debt, composed of $3 billion of new short-dated notes and $6 billion of term loan borrowings. In the fourth quarter, the firm reduced its term loans by $1.5 billion, and as a result, gross debt leverage was 2.4 times at the end of 2017. Gilead's modest use of its substantial cash holdings for the Kite purchase kept the firm near a net cash position with $37.0 billion of cash and marketable securities as of Dec. 31, 2017. Strong financial flexibility stemming from free cash flow averaging more than $9 billion annually through 2021, in our estimation, could manage around $13.9 billion of maturing debt through 2021. These cash flows are front-loaded in the next two years, given sustained pressure on operations from falling HCV revenue, which increases the likelihood that the new short-term notes may be repaid upon maturity. Our expectation of improving debt leverage helps inform our stable outlook. On a cautious note, we think Gilead may still prioritize capital deployment to reward shareholders through rising dividends and aggressive share repurchases even as it continues to fill gaps in its research and product portfolios and tries to work down its high debt load.

Market Data

For closest comparisons to Gilead's notes we look to similar-rated peers in the biotechnology industry, Amgen Inc (A, stable) and Biogen Inc (A, stable). We also look to lower-rated Celgene Corp (A-, stable) to better frame the comparison. Within this comparable group and adjusted for bond maturities, Gilead's 10-year bonds recently traded tighter than those bonds at the entire comparable group. Also, Gilead's 10-year bonds traded slightly tighter than the level of the Morningstar Corporate Bond Index at A. All of the following bond 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:
Gilead's 1.95% notes due 2022 at +50 basis points.
Amgen's 3.63% notes due 2022 at +57 basis points.
Biogen's 3.63% notes due 2022 at +56 basis points.
Celgene's 3.25% notes due 2022 at +68 basis points.

In the approximate 10-year maturity bucket, bonds from these issuers recently traded over the nearest Treasury as follows:
Gilead's 2.95% notes due 2027 at +67 basis points.
Amgen's 2.60% notes due 2026 at +76 basis points.
Biogen's 4.05% notes due 2025 at +86 basis points.
Celgene's 3.88% notes due 2025 at +94 basis points.

For comparison to the approximate 10-year maturities, the Morningstar Corporate Bond Index is at +72 basis points in the A category and at +80 basis points in the A- category.

In the approximate 30-year maturity bucket, bonds from these issuers recently traded over the nearest Treasury as follows:
Gilead's 4.75% notes due 2046 at +111 basis points.
Amgen's 4.56% notes due 2048 at +121 basis points.
Biogen's 5.20% notes due 2045 at +133 basis points.
Celgene's 5.00% notes due 2045 at +147 basis points.

McKesson Issuing New 10-Year Notes to Help Redeem Existing Debt
Market Data
McKesson Corp (A-, stable) is in the market issuing about $500 million of new 10-year bonds. Along with proceeds from new euro-denominated issues, proceeds from this new offering will be used to help redeem up to $1.1 billion of existing debt. Specifically, the company plans to tender for the following notes in this redemption priority: 6.00% notes due 2041, 7.65% debentures due 2027, 4.88% notes due 2044, 4.75% notes due 2021, and 7.50% notes due 2019. The tender offer is set to expire March 7.

McKesson's drug distribution peers AmerisourceBergen Corp (A, stable) and Cardinal Health Inc (A-, stable) are its key credit comparables. McKesson does not have a bond outstanding in the 10-year maturity bucket, so we have included its 30-year bonds to show how its longer-dated bonds recently traded at similar spreads as its key 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:
AmerisourceBergen's 3.45% notes due 2027 at +109 basis points.
Cardinal Health's 3.41% notes due 2027 at +117 basis points.

For comparison with the 10-year maturity bucket, the Morningstar Corporate Bond Index is at +72 basis points in the A category and +80 basis points in the A- category.

In the approximate 30-year maturity bucket, bonds from these issuers recently traded over the nearest Treasury as follows:
McKesson's 4.88% notes due 2044 at +150 basis points.
AmerisourceBergen's 3.45% notes due 2047 at +145 basis points.
Cardinal Health's 4.37% notes due 2047 at +151 basis points.

MCR Credit Risk Assessment
McKesson's A- credit rating recognizes its top-tier position in pharmaceutical distribution and easily manageable leverage. In our methodology, McKesson scores best on the Business Risk pillar, which recognizes its advantaged position in the pharmaceutical supply chain, substantial size, and reasonable certainty around cash flow, offset by some concentration risks, including about 20% of sales from CVS Health. McKesson, AmerisourceBergen, and Cardinal Health cumulatively control nearly all of the U.S. drug distribution industry and enjoy scale advantages in this key sector of the pharmaceutical supply chain. Accordingly, Morningstar's Equity Research Group asserts that McKesson operates with a wide

moat. Negatively, one of its key clients, Rite Aid (not rated), has agreed to sell a significant chunk of its stores to Walgreens Boots Alliance Inc (BBB, stable), which operates with a close relationship with AmerisourceBergen. However, we estimate these stores only represent about 1% of McKesson's earnings power, which is insufficient to move the needle on our view of McKesson.

Relative to the Business Risk pillar, McKesson scores slightly weaker but still moderately in the other pillars of our methodology--the Cash Flow Cushion, Solvency Score, and Distance to Default--given its manageable leverage position. At the end of December, gross debt stood at $8.8 billion, or pro forma lease-adjusted leverage around 2.5 times, gross leverage just under 2 times, and net leverage in the low 1s by our estimates. For comparison, we estimate AmerisourceBergen's lease-adjusted leverage stands just under 2 times, gross leverage stands in the high 1s, and net leverage stands around 1 times, while Cardinal's lease-adjusted leverage stands around 2.8 times, gross leverage around 2.7 times, and net leverage just over 2 times on a pro forma basis. Currently, we see few catalysts that could contribute to a rating change on McKesson in the near term, which is reflected in our stable outlook.

Media Weakness and High Share Repurchases Overshadow Disney's 1Q Performance

MCR Credit Risk Assessment

Walt Disney Co. (A+, stable) announced its fiscal first quarter operating results Feb. 6. Performance in the quarter featured ongoing decline in ESPN subscribers and weak ad spending in media while theme parks and resorts metrics were stronger year over year with contributions from park attendance and per capita spend, hotel rates, and occupancy. Meanwhile, leverage once again crept higher as Disney continued its recent trend of spending more cash on share repurchases than it earns after dividends. Our outlook on Disney's credit rating remains stable as regulators begin to review the pending merger with Twenty-First Century Fox (not rated). On a pro forma basis, we expect Disney's Business Risk and Solvency Score to remain strong and expect only modest deterioration in the Cash Flow Cushion, driven by higher debt maturities and partially offset by higher expected free cash flow.

Revenue grew 3.8% while operating margin slipped 100 basis points from a year ago. Media networks revenue was flat, held up by strong growth in affiliate fees but offset by weak ad spending and another 3% decline in ESPN's subscriber base. Disney remains on track to launch its ESPN streaming service in the spring, with base pricing at $4.99 per month. Softness in ad spending was attributed to the timing of college football bowl games, some of which occurred in the second quarter as well as difficult ad spending comps compared with the 2016 election year. Management expects ad spending to remain weak in the early part of the fiscal second quarter as the Super Bowl and Winter Olympics crowd out other spending. Film revenue declined 1% year over year with weaker trends in home entertainment offsetting strong box office results. The contraction in operating margin was driven by a 300-basis-point contraction in media margins, which more than offset a 200-basis-point increase in the parks and resorts margin. Contributing to media margin weakness was an operating loss at BAMTech resulting from technology spending.

Disney's debt ended the quarter at $26 billion, a net increase of $5.6 billion from a year ago, reflecting approximately $4.0 billion of net new issuance. We expect the new debt to fund a $1.6 billion incremental purchase of a 42% stake in BAMTech, which will be reflected in the March quarter, as well as share repurchases in excess of post-dividend cash flow. Cash and equivalents ended the first quarter at $4.7 billion, $941 million higher from a year ago. Net debt edged higher to just under 1.3 times trailing EBITDA from 1.0 time a year ago. Free cash flow for the most recent 12 months increased 10% to $9.8 billion, including a 26% decline in capital spending. Meanwhile, dividends and net share repurchases totaled 117% of free cash flow, with payout up about 500 basis points from last year.

Over the next 12 months, Disney faces $6.0 billion of debt maturities, including $3.2 billion of commercial paper. Given its recent pace of share repurchases, we expect Disney to look to refinance these maturities later this year, rather than reducing debt. The company reported 179 million shares ($19 billion at the $102.17 Feb. 6 share price) remaining under its current 400 million share-repurchase authorization, which has no expiration.

Market Data

According to pricing data provided by Interactive Data as of Feb. 6, A+ rated Disney's 2.95% notes due 2027 are indicated at a spread to Treasuries of 48 basis points, 15 basis points tighter from their level on Sept. 30, before merger speculation around Fox surfaced in the market. For comparison, Comcast Corp.'s (A-, stable) 3.15% notes due 2028 are indicated at +81 basis points, unchanged from the end of September, while Apple Inc.'s (AA-, negative) 2.90% notes due 2027 are indicated at 63 basis points, 6 basis points wider from Sept. 30. Over the same period, the A category subindex of the Morningstar Corporate Bond Index is 10 basis points tighter, now quoted at 72 basis points.

Intercontinental Exchange's Results Improve Year Over Year, Aided by Margin Expansion and Tax Reform

MCR Credit Risk Assessment

Intercontinental Exchange (A, stable) rounded out the year with a fourth-quarter earnings boost from a nonrecurring tax adjustment, reporting roughly $2.5 billion in 2017 net earnings, a 77% increase over 2016. Excluding the revaluation of deferred tax liabilities, we estimate that growth in earnings would still have been strong at 23%. Operating results also improved, as 2017 EBITDA grew to $3.2 billion, a 15% increase over 2016. ICE's operating margin expanded 3.2 percentage points to 51.4% at year-end 2017 from 48.2% at year-end 2016, and we project margins to increase another 2-4 percentage points in 2018.

Financial leverage decreased to 1.9 times debt/EBITDA at year-end 2017 from 2.0 times at September end. The company's leverage places it in between peers CME Group (A+, stable) and Nasdaq (BBB+, stable), which reported year-end 2017 debt/EBITDA at 0.8 times and 3.5 times, respectively. While we view ICE's declining leverage favorably, we remain wary of the company's willingness to materially leverage up, such as when leverage skyrocketed to 7.1 times at year-end 2013 from 1.2 times at year-end 2012 after its purchase of NYSE Euronext. A relatively smaller cash reserve also places the company's net debt/EBITDA at 1.7 times in comparison with higher-rated peer CME Group, which reported 0.1 times net debt/EBITDA at year-end 2017.

ICE completed the sale of Trayport Holdings to TMX Group in December and closed the acquisition of Virtu BondPoint at the beginning of January. The sale of Trayport likely contributed to the 7.5% decrease in net transaction and clearing revenue (before transaction-based expenses) as well as a modest reduction in balance sheet size. While BondPoint represents a relatively small portion of ICE's total revenue, management did note in its commentary that the new addition is off to a strong start, reporting 30% year over year volume gains in January, and that attractive growth potential remains going forward. Based on management commentary we expect that ICE will continue to monitor the market environment for smaller, strategic bolt-on mergers and acquisitions.

ICE gained board authorization to repurchase $1.2 billion of shares in 2018. In 2017, the company returned roughly $1.4 billion of capital to shareholders through dividends and buybacks, accounting for 68.3% of operating cash flows. Going forward, the company plans to return most of its free cash flow to shareholders, barring cash needed for M&A or growth opportunities. To the extent that ICE exceeds this target, our assessment of the company's Cash Flow Cushion pillar could deteriorate.

We look to exchange sector peers CME Group and Nasdaq as comparables to ICE. CME Group ended the year with a bang as a downward revaluation of deferred tax liabilities increased fourth-quarter net earnings by $2.6 billion, contributing to a 165% jump in net income to $4.1 billion for full-year 2017. Nasdaq also reported material improvement in 2017 results, with net income increasing fivefold to $734 million from $108 million in 2016, helped largely by the absence of asset impairment charges and revaluation of certain deferred tax liabilities.

Market Data
The following spreads over the nearest Treasury are provided by Interactive Data as of Feb. 6:
Intercontinental Exchange 3.75% notes due in 2025 are indicated at +60 basis points.
CME Group 3.00% notes due in 2025 are indicated at +44 basis points.
Nasdaq 3.85% notes due in 2026 are indicated at +109 basis points.

For comparison with the approximate 10-year maturities, the Morningstar Corporate Bond Index is at +62 basis points in the A+ category, +71 basis points in the A category, and +82 basis points in the A- rating category.

Steady 4Q, Good 2017 Rent Growth Keep UDR on Track
MCR Credit Risk Assessment
UDR Inc. (BBB, stable) reported solid fourth-quarter and full-year operating results Feb. 6, featuring a respectable fourth-quarter same-store NOI year-over-year increase of 3.1% and FFO growth of 2.1%. Despite some headwinds coming from the supply side, we believe the company will remain a solid investment-grade credit in the apartment REIT sector given its moderate to high-quality portfolio in a variety of markets.

By market, the NOI growth leaders were Los Angeles at 17.8% (with an unusually large drop in expenses), Richmond, Virginia, at 9.1% (also expense driven), and the Monterey Peninsula, California, at

8.7%. The growth laggards were New York City at negative 2.0%, Austin at negative 0.6%, and Baltimore at negative 0.1%. Hurricane activity did not have a material impact on fourth-quarter or full-year results. For 2018, management is guiding 2018 FFO growth to 5.5% at the mid-range, compared with growth of 1.7% in 2017. Given its greater diversity of markets, UDR is less exposed to the prospect of increased competition from new apartment supply in comparison with some of its peers, such as Equity Residential (A-, stable) and AvalonBay Communities (A-, stable).

For the same-store portfolio in full-year 2017, the companywide increase was 3.7% for revenue and 3.8% for NOI, while occupancy of 96.8% was unchanged at year-end 2017. Effective rents were 3.1% higher at year-end 2017.

For 2018, we expect that several of UDR's markets will continue to experience relatively high levels of new supply that will put pressure on rents. However, we believe that generally favorable economic conditions, particularly with respect to employment (likely bolstered by the new tax regime) and wages, should support demand and mitigate the effects of supply pressure. Based on this outlook, we project rent growth of 1.8% for 2018. Management guidance for 2018 indicates expectations for same-store revenue growth of 2.5%-3.5% and NOI growth of 2.5%-3.5%. The rate of supply growth is expected to slow after 2018.

The company estimates the delivery of 833 new units in 2018, including 533 units in 50%-owned joint ventures, with a pipeline projected at $810 million over the next two years. Management expects the pipeline to shrink after 2018, as developable land is becoming more expensive and difficult to obtain. Debt maturities total $1.9 billion through 2022, well laddered with the highest amount at $498 million in 2020. The company also has a credit facility with a capacity of $1.1 billion with no outstanding balance at year-end 2017. During 2017, $600 million of new 10-year unsecured debt was used to retire $575 million of higher-cost debt. The company's $6.3 billion operating portfolio is 83% unencumbered, providing plenty of potential liquidity.

Market Data

UDR Inc.'s apartment REIT peers are Camden Property Trust (A-, stable), Essex Property Trust (BBB+, stable), and Mid-America Apartment Communities (BBB, stable). The following pricing data is from Interactive Data as of Feb. 6.

In the 10-year area, spreads over the nearest Treasury from these issuers are:
UDR's $750 million 3.50% bonds due 2027 at +105 basis points.
Camden's $250 million 3.50% bonds due 2024 at +91 basis points.
Essex's $350 million 3.625% bonds due 2027 at +105 basis points.
Mid-America's $600 million 3.6% bonds due 2027 at +108 basis points.
The Morningstar BBB Corporate Bond Index is currently priced at +119 basis points.

Celgene Issuing Senior Unsecured Debt to Partially Fund Juno Acquisition

Market Data

Celgene Corp. (A-, stable) is in the market with a proposed offering of 3-, 5-, 10- and 30-year fixed-coupon senior unsecured notes. According to a preliminary prospectus filed Feb. 8, net proceeds will be used to partly fund the acquisition of cellular immunotherapy developer Juno Therapeutics for $9 billion and related fees associated with the transaction.

For nearest comparison with Celgene's notes, we look at higher-rated biotechnology peers Biogen Inc (A, stable), Gilead Sciences Inc (A, stable), and Amgen Inc (A, stable). All bond data is sourced from Interactive Data as of Feb. 7.

In the approximate 5-year maturity bucket, bonds from these issuers recently traded over the nearest Treasury as follows:
Celgene's 3.25% notes due 2022 at +71 basis points.
Amgen's 3.63% notes due 2022 at +62 basis points.
Biogen's 3.63% notes due 2022 at +52 basis points.
Gilead's 1.95% notes due 2022 at +46 basis points.

In the approximate 10-year maturity bucket, bonds from these issuers recently traded over the nearest Treasury as follows:
Celgene's 3.88% notes due 2025 at +89 basis points.
Amgen's 3.20% notes due 2027 at +78 basis points.
Biogen's 4.05% notes due 2025 at +81 basis points.
Gilead's 2.95% notes due 2027 at +64 basis points.

For comparison with the approximate 10-year maturities, the Morningstar Corporate Bond Index is at +73 basis points in the A category and at +82 basis points in the A- category.

In the approximate 30-year maturity bucket, bonds from these issuers recently traded over the nearest Treasury as follows:
Celgene's 5.00% notes due 2045 at +137 basis points.
Amgen's 4.56% notes due 2048 at +112 basis points.
Biogen's 5.20% notes due 2045 at +128 basis points.
Gilead's 4.75% notes due 2046 at +106 basis points.

MCR Credit Risk Assessment

Celgene's A- credit rating and stable outlook reflect its intention to reduce heavy reliance on top-selling medicine Revlimid through external means balanced against elevated debt leverage resulting from purchasing these diversifying assets. While we view the purchases of Juno Therapeutics for $9 billion and biotechnology firm Impact Biomedicines for an up-front payment of $1.1 billion as strategically sound, new debt utilized for the deals may leave debt leverage historically high. However, the recently announced acquisitions should help alleviate Celgene's dependence on its bestseller cancer medicine

Revlimid, which represents about 62% of total sales and significantly weighs on our Business Risk pillar. Strong uptake of Revlimid backstops our expectation for sustained double-digit EBITDA compound annual growth through 2021, which is the sole driver of leverage improvement to historical levels over the next few years. Easing sales and earnings concentration on Revlimid, possibly from successful commercialization of Juno's leading drug project JCAR-017 in diffuse large B-cell lymphoma, could benefit our Business Risk pillar. Celgene has time to diversify its portfolio via its internal research engine and external opportunities as direct generic competition to Revlimid is expected on a limited basis in March 2022 and fully in January 2026 per a patent settlement with Teva. We still see Revlimid accounting for a majority of revenue in 2021 despite rising contributions from autoimmune medicine Otezla and the potential of the firm's research pipeline, which contains several promising therapeutics, most notably potential blockbuster ozanimod for treating ulcerative colitis and multiple sclerosis.

We anticipate Celgene's balance sheet to remain stretched after the recent acquisitions, given this new debt issuance to help fund the Juno purchase. At the end of 2017, the firm owed $15.8 billion in senior notes, or gross debt leverage of 2.8 times. Considering $12.0 billion in cash and investments, net debt leverage was 0.6 times for the same period. These metrics compare with gross and net leverage of 2.4 times and net cash, respectively, in 2014 before heavy share repurchases and the Receptos acquisition pressured the balance sheet. We see the firm having the financial flexibility to lighten its debt load with over $7 billion in annual free cash flow on average during the next five years compared with debt maturities of around $4.4 billion through 2021. Following incremental funding for the Juno and Impact transactions, we expect that subsequent improvement in debt leverage may stem from solid operational performance since the firm may continue its plan to diversify its research and commercial portfolio with tuck-in asset purchases. Given the lag for drug candidates to reach commercialization and contribute meaningfully to earnings, we see Celgene staying active in business development to supplement its research program over the next few years. We still think share buybacks may stay a high priority. Celgene is an active purchaser of its shares, having bought $3.8 billion of equity in 2017, $2 billion in 2016, and around $3 billion annually during 2015 and 2014. Additional leveraging transactions, such as a transformational acquisition or heavy share repurchasing in the near to intermediate term that significantly pushes up net leverage for the long run, could prompt a rating downgrade.

Cardinal Health Boosts Fiscal 2018 Guidance on New Tax Law; Rating Outlook Remains Stable

MCR Credit Risk Assessment

Cardinal Health Inc (A-, stable) reported fiscal second-quarter operating results Feb. 8 that exceeded consensus expectations on the top and bottom lines, and the company raised its outlook for fiscal 2018 because of the new U.S. tax law. From a credit perspective, the company repaid some debt. However, the credit story did not change much, reinforcing our stable outlook on its credit rating.

Cardinal's operating results in its fiscal second quarter beat top- and bottom-line consensus expectations. Revenue grew 6% to $35.2 billion, or above consensus of $34.7 billion, and adjusted earnings per share increased 13% to $1.51 (or $1.31 without tax-related benefits and above consensus of $1.15). By business segment, the pharmaceutical segment was stronger than management anticipated, despite ongoing investments in its IT systems and the recent Prime Therapeutics contract expiration. The company noted that growth in its specialty business and the cost side of its Red Oak generic drug sourcing partnership with CVS Health Corp (BBB+/UR-) positively influenced the pharmaceutical distribution segment's results in the quarter. In the medical segment, the company recorded its first full quarter of contribution from the recent acquisition of Medtronic's patient care, deep vein thrombosis, and nutritional insufficiency businesses. This acquisition is boosting the segment's top-line growth and margins. On the margin front, management noted that its segment profit margin should rise to about 6% from 5.4% in the second quarter and 4.7% in the prior year quarter, as it continues to integrate the Medtronic operations. Without these benefits from the acquisition though, the medical segment's trends weren't as strong as expected because of weakness in its Cordis operations and a supply disruption in exam gloves.

Considering these offsetting underlying trends, Cardinal's adjusted earnings per share guidance for fiscal 2018 prior to tax reform benefits still stands at $4.85-$5.10, which is unchanged from the previous outlook. Positively, tax-related benefits should boost fiscal 2018 earnings by about $0.40 to $5.25-$5.50 given Cardinal's effective rate may decline to 29% to 31% in fiscal 2018 versus about 33% in fiscal 2017. The effective tax rate should decline even further in fiscal 2019 to the mid-20s as the firm enjoys this tax-related benefit for a full fiscal year.

From a credit perspective, Cardinal reduced its debt obligations slightly during the quarter. As of December, debt stood at $9.8 billion, down from $10.0 billion in September. However, on a pro forma basis, leverage does not appear to have changed much, with lease-adjusted and gross leverage still in the high 2s and net leverage around 2 times when accounting for the recent China distribution divestiture, which closed Feb. 1, yielding net proceeds of roughly $800 million. With these proceeds and recent tax reform benefits, the board increased Cardinal's repurchase authorization by $1 billion to total availability of $1.3 billion through December 2020. With the firm only targeting gross leverage of 2.0 times by the end of fiscal 2020 (mid-calendar 2020), we would not be surprised to see significant returns to shareholders and tuck-in acquisitions between now and then. For comparison, we estimate similarly rated McKesson Corp's (A-, stable) pro forma lease-adjusted leverage at around 2.5 times, gross leverage at just under 2 times, and net leverage in the low 1s. Higher-rated AmerisourceBergen Corp's (A, stable) lease-adjusted leverage stands just under 2 times, gross leverage stands in the high 1s, and net leverage stands around 1 times. Cardinal's leverage metrics currently appear weak for its A- rating, but our outlook remains stable as we anticipate the firm will deleverage as previously projected, which would put it more in line with McKesson's metrics.

Market Data

We use Cardinal's distribution peers as its credit comparables, given their similar credit profiles and exposure to industry trends. Cardinal's bonds recently traded at similar to wider spreads than its key peers. Also, in the 10-year maturity bucket, all of these issuers traded wider than the Morningstar Corporate Bond Index in their respective ratings. The following bond data is sourced from Interactive Data.

Bonds in the approximate 5-year maturity bucket for the drug distribution sector recently traded over the nearest Treasury as follows:
Cardinal Health Inc's 2.62% notes due in 2022 at +78 basis points.
AmerisourceBergen Corp's 3.50% notes due in 2021 at +75 basis points.
McKesson Corp's 2.70% notes due in 2022 at +66 basis points.

Bonds in the approximate 10-year maturity bucket for the drug distribution sector recently traded over the nearest Treasury as follows:
Cardinal Health's 3.41% notes due in 2027 at +111 basis points.
AmerisourceBergen's 3.45% notes due in 2027 at +105 basis points.
McKesson's 3.95% notes due in 2028 at +113 basis points.

For comparison, the Morningstar Corporate Bond Index is at +73 basis points in the A category and +81 basis points in the A- category.

Bonds in the approximate 30-year maturity bucket for the drug distribution sector recently traded over the nearest Treasury as follows:
Cardinal Health's 4.37% notes due in 2047 at +149 basis points.
AmerisourceBergen's 4.30% notes due in 2047 at +137 basis points.
McKesson's 4.88% notes due in 2044 at +132 basis points.

Highwoods Properties Beats Guidance and Should Benefit From Healthy Southeast Markets
MCR Credit Risk Assessment
Highwoods Properties, Inc. (BBB, stable) reported 2017 earnings after the market close Feb. 6 that were meaningfully improved over 2016 and above the top of management's guidance range. We view Highwoods' Business Risk as being supported by its leadership position in the Southeastern U.S. and an experienced management team with a relatively conservative approach to managing capital and investments.

For 2017, funds from operations increased 7.6% over 2016, lifted by a revenue increase of 5.6% and a cash same-store increase in net operating income of 4.1%. On the earnings call, the Highwoods management team highlighted the steady performance of its Better Business District markets, with growing economies and increasing employment, in contrast to the recent volatility exhibited in particular by the financial markets. To wit, four (Atlanta, Nashville, Pittsburgh, and Raleigh) of Highwoods' markets made Amazon's short list of 20 potential locations for its second headquarters. Notably, its BBD occupancies are 350 basis points above the national average. As well, the development pipeline has been mostly derisked at 70% preleased.

While occupancy is expected to tick down in 2018 as a result of some expected move-outs, we anticipate this will be offset by a favorable leasing environment and by the completion and stabilization of new developments. We project revenue and total NOI growth of about 4.0% for 2018. As well, we project modest improvements in leverage, with debt at 4.8 times EBITDA and 34.1% of gross assets. The company's coverage should also improve, though somewhat more in magnitude, to EBITDA of 5.7 times interest expense from 5.1 despite rising interest rates, as the relatively high-rate $200 million 7.50% April 2018 bonds mature.

Market Data
Highwoods' office REIT peers are Boston Properties, Inc. (A-, stable) and Kilroy Realty Corporation (BBB, stable). The following pricing data is from Interactive Data as of Feb. 7.

In the 10-year area, spreads of the nearest Treasury from these issuers are:
Highwoods' $300 million 3.875% bonds due 2027 at +140 basis points.
Boston Properties' $1.0 billion 2.75% bonds due 2026 at +95 basis points.
Kilroy's $400 million 4.25% bonds due 2029 at +134 basis points.
The BBB Morningstar Corporate Bond Index is currently priced at +117 basis points.

CVS' Rating Still UR-, Despite Tax Benefits
That Could Enable Quicker Deleveraging After Aetna Deal
MCR Credit Risk Assessment
On Feb. 8, CVS Health Corp (BBB+/UR-) reported fourth-quarter results that beat consensus expectations on the top and bottom lines. The company also revealed tax-related benefits that it will use to reduce leverage a little quicker than initially anticipated when it announced the planned Aetna Inc (not rated) merger in December. However, the company kept its long-term leverage target the same, or higher than its previous target, and our credit rating for CVS remains under review with negative implications.

In the fourth quarter, the company's net revenue grew 5.3% to $48.4 billion (above consensus of $47.5 billion), and adjusted earnings per share grew 12.0% to $1.92 (above consensus of $1.89). These consolidated results reflect continued strength in the pharmacy benefit management business, which generated 9.3% revenue growth on 7.8% adjusted claims growth year over year. The retail/long-term care segment grew only 0.3% year over year, but that growth was better than expected related to strong same-store sales growth on both prescription volume and front-of-store operations. Adjusted earnings grew faster than sales on a lower-than-expected tax rate and recent share repurchase activities.

From a credit perspective, the most substantial news revealed on the earnings call related to the projected use of tax-related benefits. Specifically, because of the new U.S. tax law, CVS expects to generate about $1.2 billion in cash benefits in 2018. Management plans to use at least half of that to deleverage after the pending Aetna merger. Therefore, the initial deleveraging could be a bit quicker than anticipated. However, management still anticipates that gross leverage will only decline to the mid-3s within two years of the Aetna deal's initial closure and the low 3s in the long run. That long-term leverage target appears higher than the firm's previous long-term goal (lease-adjusted leverage of 2.7 times), and the company's willingness to boost and keep leverage above its previous target continues to reinforce our under review negative status on CVS.

Of course, those leverage targets all remain pending for the Aetna merger's closure. Notably, the merging entities received a second request for information from U.S. antitrust regulators on the merger, which extended the deadline for a decision on the deal. Management noted on the call that nothing surprising had been asked in the inquiries so far, and the team still anticipates the Aetna deal will close in the second half of the year. Shareholder voting on the deal is still scheduled for March 20 at both firms, and CVS continues to evaluate its debt issuance options, primarily in terms of tenor and timing.

Market Data

We compare CVS' bonds with key pharmaceutical supply chain peers Express Scripts Holding Co (A-, negative) and Walgreens Boots Alliance Inc (BBB, stable). CVS' roughly 10-year bonds recently traded roughly in line with the Morningstar Corporate Bond Index at BBB+, and in the following maturity buckets, its bonds traded roughly in line with its key peers' bonds. All of the following bond data is sourced from Interactive Data.

In the approximate 5-year maturity bucket, recent trades over the nearest Treasury were as follows:
CVS Health Corp's 2.13% notes due 2021 at +69 basis points.
Express Scripts Holding Co's 3.30% notes due 2021 at +71 basis points.
Walgreens Boots Alliance Inc's 3.30% notes due 2021 at +62 basis points.

In the approximate 10-year maturity bucket, spreads over the nearest Treasury from recent trades can be seen as follows:
CVS' 2.88% notes due 2026 at +112 basis points.
Express Scripts' 3.40% notes due 2027 at +109 basis points.
Walgreens' 3.45% notes due 2026 at +115 basis points.
For comparison to the roughly 10-year maturities, the Morningstar Corporate Bond Index is at +81 basis points at A-, +111 basis points at BBB+, and +117 basis points at BBB.

In the approximate 30-year maturity bucket, recent trades over the nearest Treasury were as follows:
CVS' 5.13% notes due 2045 at +150 basis points.
Express Scripts' 4.80% notes due 2046 at +146 basis points.
Walgreens' 4.65% due 2046 at +149 basis points.

T-Mobile 4Q Reports In-Line Results for 4Q, Begins Share Repurchases

MCR Credit Risk Assessment

T-Mobile US (BB, stable) reported its fourth-quarter and full-year 2017 financial results Feb. 8, featuring continued growth in wireless subscribers and an expansion of both margin and cash flow. Leverage remained steady and the carrier repurchased a modest amount of common stock during the fourth quarter, indicating a subtle shift in its capital allocation policy. Operating performance remains supportive of a stable outlook as growth and profit expansion trends are balanced by the capital intensity of the wireless business and the highly competitive price environment in which T-Mobile must compete. With the recent collapse of merger talks with Sprint Corp. (B, negative) late last year, we believe T-Mobile is likely to remain firmly in third place among the carriers. We are assuming T-Mobile will remain aggressive on pricing, with ARPU trending lower over time, as the carrier continues to focus on expanding its subscriber base at the expense of the other wireless operators.

Revenue increased 8.3% for the full year, while operating costs increased 7.3%, driving a 9% increase in EBITDA. T-Mobile added 891,000 net new postpaid phone subscribers, bringing the total to 2.8 million for the year while total branded postpaid subs increased 3.6 million for the full year, in line with the top end of revised guidance issued in the third quarter. However, adjusted billed revenue per subscriber levels declined 5.1% year over year in the fourth quarter and 3.6% for the full year. The decline is partially attributable to disruption from hurricanes last summer as well as dilution from promotional activity. Trailing 12-month revenue growth slowed to 9% from 16.2% for the trailing period ending in fourth quarter 2016, suggesting a subtle slowing in the carrier's growth trend. This view is supported by conservative guidance for 2018, which includes a conservative postpaid net add guidance of 2 million subscribers and EBITDA growth of $1 billion. However, given the company's record of underpromising and subsequently overdelivering, we believe there could be upside to these initial estimates.

As T-Mobile's growth in consumer wireless begins to mature, management indicated it is seeking to build its share in enterprise wireless, where it currently holds only 2%-3%. T-Mobile is also looking to extend its Un-carrier disruptive business model to mobile video through its pending acquisition of Layer3, entering a market already crowded with streaming video platforms. However, unlike phone service, where it could simply compete on price and network quality, we believe a competitive mobile video platform will likely require substantial investment in proprietary content. Alternatively, T-Mobile will have to gain reliable access to third-party content over which it will have little control and which is already in high demand from established video platforms.

Supported by higher profitability, T-Mobile's free cash flow grew 90% in 2017 to $2.7 billion. The primary use of cash during the year was the acquisition of new wireless spectrum in the second quarter for $5.8 billion. After hinting at the possibility of future share repurchases on prior investor calls, T-Mobile also made modest net share repurchases of $406 million late in the fourth quarter, with an additional $356 million disclosed subsequent to quarter-end. However, management stated that it sees "significant opportunity" for additional share repurchases as free cash flow generation increases. The carrier reports $717 million remaining under its current authorization, which expires December 2018.

Meanwhile, total debt ended the year at $30.9 billion, including tower obligations, up $502 million from a year ago, while cash and equivalents ended at $1.2 billion, a decline of $5.5 billion during the year due to the midyear spectrum purchase. Net debt increased a half-turn from year-end 2016, ending 2017 at 2.8 times trailing EBITDA. On its investor call, management pointed to an investment-grade rating as a midterm goal, though it does not plan to alter its net leverage target of 3.0-4.0 times EBITDA.

Market Data

According to indicative pricing from Interactive Data as of Feb. 8, T-Mobile's 5.38% notes due 2027 are indicated at a yield of 4.75% to the 2025 call (+199 basis points over the nearest Treasury), 14 basis points tighter on a spread basis since Oct. 30, the day that the collapse of talks with Sprint was first reported. For comparison, Netflix's (BB-, stable) 4.38% notes due 2026 yield 4.82% to maturity (+202 basis points), 5 basis points tighter from Oct. 30. Finally, the BofA Merrill Lynch High Yield BB Rated Index is quoted at a yield to worst of 4.69% (+209 basis points).

Hologic's Leverage Stagnant, Despite International Strength and Cynosure Improvement
MCR Credit Risk Assessment
On Feb. 8, Hologic Inc (BB+, stable) reported fiscal first-quarter results that exceeded consensus expectations on the top and bottom lines with strength from its international operations and improvement in its Cynosure division. However, from a credit perspective, the company's net leverage remains stagnant. So while we continue to view Hologic as strongly positioned in its BB+ rating, our outlook is stable, and we do not expect significant, sustained improvement in its credit metrics in the near future.

In the quarter, Hologic generated $791 million in revenue (slightly above consensus of $786 million), or 7% growth in constant currency and 3% growth excluding the effects of recent portfolio changes. The firm turned in adjusted earnings per share of $0.55, or 6% growth and above consensus of $0.50. Highlights from the quarter included strong growth from the international division (12% on an organic, constant-currency basis) relative to a slight decline in U.S. operations year over year on an organic basis. By operating segment, the breast health and diagnostics divisions excluding the blood screening divestiture grew 4% and 3% in constant currency, respectively, year over year. The breast health segment growth accelerated slightly on a sequential basis, and new mammography system launches (the first since 2011) may help that segment's growth accelerate further in future periods. Notably, the medical aesthetic business grew 12% from the fiscal fourth quarter. Management expressed confidence in the new managers of this business, which include the former leader of the international division, which is now leading growth from a geographic perspective. Also in medical aesthetics, Hologic in January launched TempSure Envi, a new radiofrequency device for fine lines and wrinkles, skin tightening, and cellulite appearance. The sales team will focus on launching this new product in its core cosmetic and dermatology audience, and it could help this business accelerate even further going forward.

With those solid trends, management maintained its top-line guidance for fiscal 2018 and increased its adjusted earnings per share outlook to reflect benefits associated with the new U.S. tax law. For fiscal 2018, management still expects 4%-7% constant-currency growth to $3.2 billion-$3.3 billion in revenue. However, it increased its adjusted EPS guidance to 9%-12% growth to $2.22-$2.27 versus its previous outlook of 3%-6% growth to EPS of $2.10-$2.15. Management now expects its effective tax rate for fiscal 2018 to decline to 23% versus its previous expectation of 31%. The company does not expect all of that benefit to fall to the bottom line. Hologic plans to reinvest in its business through marketing campaigns, particularly in its medical aesthetic and currently weak GYN surgical division (down 7% in constant currency this quarter), and accelerate some of its research and development initiatives.

From a credit perspective, Hologic continues to restructure its balance sheet, but its net leverage appears stagnant. For example, in March, the firm anticipates redeeming the rest of its outstanding convertible notes. In January, it issued $1.0 billion of debt--$600 million of 4.38% notes due 2025 and $400 million of 4.63% notes due 2028--to redeem its 5.25% notes due 2022 ($1.0 billion outstanding). Even with these moves after the end of the quarter, we expect Hologic's net leverage to remain in the mid-2s with management citing 2.6 times as of December. So while we think the company stands at the strong end of its BB+ rating, our outlook remains stable since management appears satisfied operating with metrics that keep the firm's rating below investment grade.

Market Data
Hologic does not have perfect credit comparables in the healthcare industry. We think the best comparables are recently upgraded Fresenius Medical Care AG & Co. KGaA (BBB-, stable) and DaVita Inc (BB+, negative). All of the following bond data is sourced from Interactive Data.

Hologic's 4.38% notes due 2025 were recently indicated at 97.94, a yield to maturity of 4.70%, and a spread to maturity of +195 basis points.
Fresenius' 4.75% notes due 2024 were recently indicated at 106.28, a yield to maturity of 3.65%, and a spread to maturity of +97 basis points.
DaVita's 5.00% notes due 2025 were recently indicated at 97.67, a yield to maturity of 5.39%, and a spread to maturity of +265 basis points.

For comparison, the Morningstar Corporate Bond Index in the BBB- category is at +138 basis points while the BofA Merrill Lynch BB Index is at a yield of 4.81% and spread of +220 basis points.

Essex Property's Strong Year Supported by High-Barrier Markets and Healthy Tech Environment

MCR Credit Risk Assessment
Essex Property Trust (BBB+, stable) reported strong earnings and generally healthy overall fundamentals for 2017. The apartment REIT especially benefits from high-barrier markets and a highly experienced management team, which support a solid Business Risk rank. As well, Essex maintains a large unencumbered portfolio that boosts its relatively favorable Cash Flow Cushion.

For 2017, Essex earned FFO that was 7.6% above 2016 which was driven by respectable same-store revenue and NOI growth of 3.7% and 4.2%, respectively. Occupancy in the same-store portfolio remained flat albeit at a high level, 96.8%, compared with 96.6% at year-end 2016. The Essex management team highlighted on the earnings call that after a somewhat weaker third quarter of 2017, job growth rebounded stronger during the fourth quarter at 1.6% on a trailing three-month basis. This improvement was helped in large part by investment and hiring by the significant presence of technology firms in the company's West Coast markets. Finally, we anticipate leverage to remain steady within our expectations for Essex's rating the low 6 times debt/EBITDA range.

We project 2018 growth in revenue and NOI similar to 2017, with increases of around 4.0% percent each, lifted by the strong tech employment environment--to be compounded by a lower tax regime--which will be more than enough to absorb expected new supply deliveries. Essex's markets remain among the most undersupplied in the nation, which should also support solid growth rents and steady occupancies. While momentum is picking up in favor of rent control in California, around 80% of the portfolio, we believe it will take years (if ever) before any impact registers in Essex's results.

Market Data
Essex's apartment REIT peers are Camden Property Trust (A-, stable), UDR Inc. (BBB, stable), and Mid-America Apartment Communities (BBB, stable). The following pricing data is from Interactive Data as of Feb. 7.

In the 10-year area, spreads over the nearest Treasury from these issuers are:
Essex's $350 million 3.625% bonds due 2027 at +112 basis points.
UDR's $300 million 3.50% bonds due 2028 at +115 basis points.
Camden's $250 million 3.50% bonds due 2024 at +94 basis points.
Mid-America's $600 million 3.60% bonds due 2027 at +115 basis points.
The BBB Morningstar Corporate Bond Index is currently at spread of +120 basis points.

Regency Centers Reports Solid 2017 Results Despite Challenging Retail Environment
MCR Credit Risk Assessment
Regency Centers Corporation (BBB+, stable) reported 2017 earnings that were significantly improved over the prior year as a result of the Equity One merger and robust performance across its grocery-anchored portfolio despite the challenging retail environment. The quality of Regency's centers is a key driver of its solid Business Risk position, which also benefits from increased market penetration provided by the Equity One acquisition and places Regency near the top in terms of size among shopping center REIT peers.

Regency posted an increase in funds from operations of 78.4%, as a direct result of the addition of Equity One, though same-store NOI growth was also impressive, coming in at 3.6%. As well, same-store occupancy came in at a relatively high 96.3%, a slight increase over 2016. The firm's management team discussed asset pricing on the earnings call, stating that top-quality centers in which they typically have interest are seeing significant demand from property buyers, with very little new supply available, so pricing is expensive. Given that Regency's equity has been trading at a discount to net asset value in the 20% to 25% range, management indicated that it is considering share repurchases, effectively buying its own centers for $0.75-$0.80 on the dollar, which has been approved via a board-approved program. We think this makes sense, and we expect any such activity will be funded with disposition proceeds and conducted on leverage-neutral basis.

We see Regency continuing benefit from its well-positioned and well-managed portfolio over the coming quarters while redeveloping and re-leasing the minimal number of stores they are forced to take back from bankrupt retailers. We project Regency to generate total net operating income growth of 2.0%-3.0% over the next 12-24 months, while maintaining debt at around than 5.0 times EBITDA or less and between 25% to 30% of gross assets. We also project EBITDA coverage to range between 4.5 and 5.0 times interest expense.

Market Data

Regency's shopping center REIT peers are Federal Realty Investment Trust (A-, stable), Kimco Realty Corporation (BBB+, stable) and Weingarten Realty Investors (BBB, stable). The following pricing data is from Interactive Data as of Feb. 8.

In the 10-year area, spreads over the nearest Treasury from these issuers are:
Regency's $350 million 3.60% bonds due 2027 at +125 basis points.
Federal Realty's $475 million 3.25% bonds due 2027 at +99 basis points.
Kimco's $400 million 3.80% bonds due 2027 at +124 basis points.
Weingarten's $250 million 3.25% bonds due 2026 at +147 basis points.
The BBB Morningstar Corporate Bond Index is currently at a spread of +120 basis points.

Viacom Reports Mixed 1Q Results, Though Management Guides to Improvement in 2H

MCR Credit Risk Assessment

Viacom Inc. (BBB, stable) reported its fiscal first-quarter results Feb. 8. Despite reporting a net decline in revenue, the company's free cash flow and leverage improved, which supports our stable outlook. However, event risk remains elevated amid a recent renewal of discussions with CBS Corp. (BBB, stable) over a potential re-merger of the two companies. The boards of both companies have appointed committees to review transaction proposals. We would view the credit impact of a merger as more beneficial for Viacom than for CBS, though much will depend on the financing mix being considered.

Viacom's fiscal first-quarter organic revenue declined 4.7%, year over year, driven by a 6% decline in domestic operations. Domestic performance was marked by lower affiliate fees related to ongoing subscriber declines as well as recent carriage disputes with distributors. Ad spending was also weak, declining 2.2% year over year on an organic basis. With disputes resolved and positive early ratings results from the recently launched Paramount Network, management is guiding to stronger ad revenue in the back half of fiscal 2018 and an improved trajectory on affiliate revenue from previous guidance. Meanwhile, international revenue grew 7% year over year on an organic basis. Core growth was supplemented by 7 percentage points of growth from integration of Argentinian broadcast company Telefe during the past year, and 5 percentage points of benefit from currency fluctuations. Organic growth was even distributed between advertising (up 7%) and affiliate revenues (up 9%). In film, revenue declined 28% on lower home entertainment and licensing fees as well as fewer theatrical releases this quarter relative to a year ago.

Meanwhile, Viacom's adjusted operating income declined 4%, on prelaunch expenses for Paramount Network. However, operating margin increased by 77 basis points. The media segment's operating margin slipped 100 basis points to 47% from a year ago, while the film segment reported a $130 million operating loss, which was $50 million narrower relative to a year ago.

Though operating income was down in the latest quarter, it is up 2.7% on a trailing 12-month basis. Together with a 14% decline in capital expenditures, this contributed to 7.2% growth in free cash flow over the past 12 months. Meanwhile, use of cash for dividends declined 42% year over year, with the total shareholder payout ratio now running at just 11% compared with 37% a year ago. For 2018 and beyond, management expects a $200 million annual cash flow benefit from lower tax rates.

Total debt ended the December quarter at $10.2 billion, down $2.1 billion from a year ago, while cash ended the year down just $49 million to $374 million. The decline in debt reflects the tender offer for certain of Viacom's senior notes, which was completed last June. Net senior leverage was 2.9 times trailing EBITDA at Dec. 31 compared with 4.1 times a year ago. Meanwhile, all-in net leverage, including the $1.3 billion of hybrid subordinated note, ended the quarter at 3.3 times, down from 4.1 times from a year ago.

Market Data

According to pricing data from Interactive Data as of Feb. 8, Viacom's 3.45% notes due 2026 are indicated at +134 basis points over the nearest Treasury, 33 basis points tighter from Oct. 31. Much of this tightening has coincided with the return of market speculation around a potential re-merger transaction with same-rated CBS Corp. For comparison, CBS 4.00% notes due 2026 are indicated at +122 basis points, unchanged over the past three months. Meanwhile, Discovery Communications' (BBB, stable) 4.90% notes due 2026 are indicated at +148 basis points, only 5 basis points tighter over the same period. Finally, we note that the BBB Morningstar Corporate Bond Index is currently quoted at +110 basis points, 17 basis points tighter since Oct. 31.

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