Morningstar Corporate Credit Research Highlights
Corporate bond market suffers bout of indigestion.

Morningstar Credit Research
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Contents

Credit Market Insights

- Market Data and Insights
- Energy Companies' Credit Quality Expected to Continue to Improve; 2018 Oil Forecast $55-$60
- High-Yield Fund Flows

Credit Rating Actions

- Rating changes

Issuer/Ticker	Current Issuer Credit Rating	Previous Issuer Credit Rating
Regency Centers **REG**	BBB+	NA
Federal Realty Investment Trust **FRT**	A-	NA

- Rating affirmations

Issuer/Ticker	Current Issuer Credit Rating	Previous Issuer Credit Rating
Interpublic Group **IPG**	BBB	BBB
Omnicom **OMC**	BBB+	BBB+
Deere **DE**	A	A
Cummins **CMI**	A	A
Caterpillar **CAT**	A-	A-
Agco **AGCO**	BBB-	BBB-

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- Another Quarter, Another **Apple** Debt Issuance
- **CVS**' Balance Sheet Stays Stagnant in 3Q While Event Risk Rises
- Pressure on Best-Seller EpiPen Weighs on **Mylan**'s 3Q Performance; Debt Load Lightened
- **Cardinal Health** Starts Deleveraging in Fiscal 1Q After Recent Acquisition
- With **T-Mobile** Merger off the Table, **Sprint** Faces Considerable Investment Challenges
- **Oracle** Announces Multitranche Issue of Senior Notes
- **Tenet**'s Leverage Remained Elevated in 3Q After USPI Investment and Weak Operating Results
- **Kellogg** Issuing New 10-Year Senior Notes to Refinance Commercial Paper
- Specialty Generics Business Damps **Mallinckrodt**'s Operating Results in 3Q; Total Debt Eases
- **Valeant** Adjusts Sales Outlook for Divestments; Total Debt Reduced by $2.4 Billion in 2017
- **DaVita**'s DMG Segment Continues to Struggle; Share-Repurchase Authorization Increased
- **Johnson & Johnson** Issuing Multitranche Debt for Commercial Paper Repayment
- **Hologic**'s Cynosure Division Continues to Stumble in Fiscal 4Q; Net Leverage Remains in Mid-2s
- **United Parcel Service** Issuing New Notes to Retire Debt and Make Pension Contributions
- More

Credit Market Insights

Corporate Bond Market Suffers Bout of Indigestion

The corporate bond market suffered a bout of indigestion last week. Between absorbing a healthy amount of new issues and profit-taking from early year-end window-dressing, corporate credit spreads widened, albeit from levels that are still near multiyear lows. The average spread of the Morningstar Corporate Bond Index (our proxy for the investment-grade bond market) widened 5 basis points to +104. In the high-yield market, the BofA Merrill Lynch High Yield Master Index widened 24 basis points to end the week at +376.

Corporate Bond Credit Spreads

Source: Morningstar,Inc., BofA Merrill Lynch Global Indexes. Data as of 11/10/2017.

A healthy amount of new issues came to market as issuers looked to take advantage of the small window between third-quarter earnings reports and the beginning of the holiday season next week. The new issues priced at the beginning of last week were sold without offering a new-issue concession to where the existing bonds were trading, but by the end of the week, new-issue concessions widened to 20 basis points in some cases to develop investor demand. For example, Apple (AA-, negative) started the week with its fifth issue of U.S. dollar-denominated senior notes this year. Before this offering, Apple had sold $23 billion of dollar-denominated notes and $9.5 billion of foreign-currency-denominated notes since January. In this most recent offering, Apple sold another $7 billion of notes with maturities ranging from 2 to 30 years. Immediately following the Apple offering, Oracle (AA-, stable) brought a $10 billion transaction to market. As the market was still digesting Apple's AA- rated technology offering, Oracle had to sell its offering at a discount to where its existing bonds were trading in the secondary market. Finally, among the multi-billion-dollar deals last week, United Parcel Service (A+, stable) sold a total of $6.6 billion of notes denominated in U.S. dollars and euros toward the end of the week. UPS also had to sell its offering at a wide concession to where its existing bonds were trading.

Further pressuring the corporate bond market, interest rates rose across the U.S. Treasury bond market yield curve. The yield on the 2-year Treasury bond rose another 4 basis points to 1.65%, continuing its march higher and hitting its highest level since October 2008. The yields on 5-, 10-, and 30-year Treasury bonds rose 6-7 basis points, ending the week at 2.05%, 2.40%, and 2.88%, respectively. The yield on the 2-year bond has been trending steadily higher for several years and has outpaced the increase of longer-term bonds. As such, the yield curve has been flattening and the spread between the 2-year and the 10-year has tightened.

Historically, a flattening yield curve has been a leading indicator of a potentially weakening economy. This time around, however, this signal may be distorted by global central bank actions. The short end of the curve is being directly influenced by the Federal Reserve, which is hiking short-term rates, whereas the long end of the curve may be influenced by the ongoing quantitative easing programs of the European Central Bank and Bank of Japan. Even though the 10-year U.S. Treasury is yielding only 2.40%, that is attractive to global bond investors as the yield on Germany's 10-year bond is only 0.41%, and the yield on Japan's 10-year bond is barely positive at 0.04%. From an economic perspective, growth in the short term appears to be healthy. GDP was reported to be a relatively strong 3.0% in the third quarter, and the GDPNow model forecast produced by the Federal Reserve Bank of Atlanta for real GDP growth in the fourth quarter is 3.3%.

This flattening trend may continue to be influenced by global central bank monetary policy. While the Federal Open Market Committee held off on raising short-term interest rates at its November meeting, the futures market for the federal funds rate has priced in an interest rate hike following the December meeting as fait accompli. According to the CME FedWatch Tool, the market is pricing in a 100% probability of a rate hike in December. The European Central Bank announced that it would not begin to taper its asset-purchase program until next year. Even then, the ECB will continue to continue to purchase EUR 30 billion per month until September 2018 and noted that purchases could be extended if warranted. While this places the ECB on the path toward a more normalized monetary policy late next year, these purchases will still infuse the eurozone with EUR 270 billion of new money that will need to find a home somewhere, and the ECB's main financing rate remains at 0%.

Energy Companies' Credit Quality Expected to Continue to Improve; 2018 Oil Forecast $55-$60

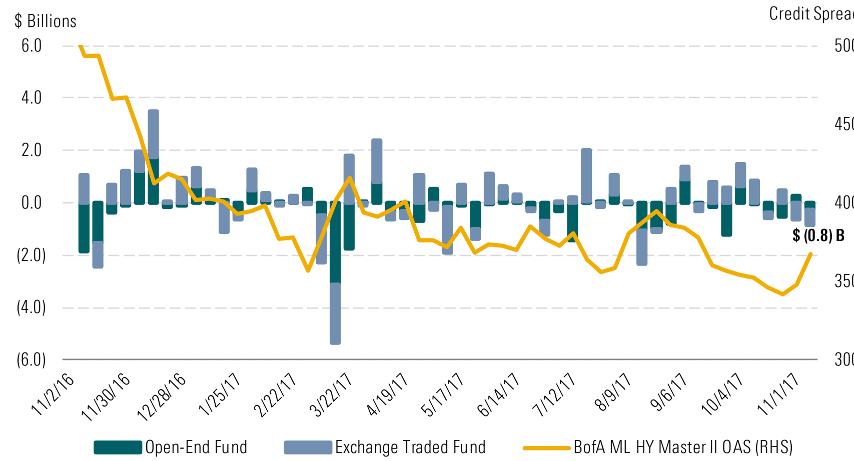
A confluence of global events recently drove the crude oil futures price curve into backwardation, a condition in which a commodity's market price today (or spot price) is higher than the price for further-out month contracts. As of this writing, the spot price for West Texas Intermediate crude is $56.90/barrel and the December 2018 contract is priced at $55.70/barrel. Typically, the oil market trades in contango, which is the opposite of backwardation. In contango, a commodity's spot price is below the price for further-out month contracts.

Backwardation primarily occurs when there is a shortage of a commodity in the spot market. Because it is infrequent and typically does not last long, the condition has often signaled a price top in the past. However, the exact timing for a price reversal is speculative at best. The factors aligning to create more bullish sentiment in the marketplace and cause the crude oil price to squib higher since mid-October include (1)) a focus on a modest draw-down of global crude inventories since the beginning of 2017, evidence that supply/demand fundamentals are gradually tightening, (2) a near-certain market view that OPEC will extend the production cut agreement when the cartel meets Nov. 30, (3) fears of more significant Venezuelan and Iraqi oil production outages caused by worsening political and economic crises, and (4) political uncertainty created by a sweeping purge of royals, officials, and businessmen in Saudi Arabia last week. Although we think the likelihood of a near-term price correction is building, we maintain a constructive long-term view, with no change to our price forecast for WTI oil of $55-$60/barrel in 2018. Our long-term view is underpinned by sharp cuts in global exploration and production expenditures during the past three years, which is helping to bring about a more balanced crude oil supply/demand balance. Commensurate with our price forecast and a strict industry focus on costs, we think the overall credit quality of companies in the energy sector will continue to improve next year. *(Contributed by Andy O'Conor, assistant vice president, energy sector)*

High-Yield Fund Flows

For the fourth consecutive week, open-end high-yield mutual funds and high-yield exchange-traded funds registered an outflow. The net amount of outflows was $0.8 billion, consisting of redemptions of $0.3 billion in open-end funds and $0.5 billion in ETFs. Over the past month, total outflows are $1.8 billion, equally split between open-end high-yield mutual funds and high-yield ETFs. The amount of outflows over the past month represents one fourth of the total outflows the high-yield asset class has registered this year. Year to date, the high-yield asset class has suffered total redemptions of $7.4 billion, consisting of $11.3 billion of redemptions in open-end mutual funds offset by $3.9 billion of new unit creation in ETFs. Typically, ETFs are considered a proxy for institutional investor demand, which is often more correlated to changes in the corporate credit spread, whereas open-end funds are considered a proxy for individual investors and correlated to changes in the absolute yield.

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 Nov. 10, 2017

(000,000s $ unless otherwise noted)

Issuer			Issue				
Name	Ticker	Morningstar Corporate Rating	Size	Coupon	Description	Maturity	Approx Spread to US Treasuries
Apple	AAPL	AA-	$1,000	1.80%	Senior Unsecured	2019	+20
Apple	AAPL	AA-	$1,000	2.00%	Senior Unsecured	2020	+30
Apple	AAPL	AA-	$750	2.40%	Senior Unsecured	2023	+42
Apple	AAPL	AA-	$1,500	2.75%	Senior Unsecured	2025	+60
Apple	AAPL	AA-	$1,500	3.00%	Senior Unsecured	2027	+72
Apple	AAPL	AA-	$1,250	3.75%	Senior Unsecured	2047	+100
AutoNation	AN	BBB-	$450	3.50%	Senior Unsecured	2024	+135
AutoNation	AN	BBB-	$300	3.80%	Senior Unsecured	2027	+150
AvalonBay Communities	AVB	A-	$300	L+43	Senior Unsecured	2021	NA
AvalonBay Communities	AVB	A-	$450	3.20%	Senior Unsecured	2028	+92
Johnson & Johnson	JNJ	AAA	$500	1.95%	Senior Unsecured	2020	+23
Johnson & Johnson	JNJ	AAA	$750	2.625%	Senior Unsecured	2025	+43
Johnson & Johnson	JNJ	AAA	$1,500	2.90%	Senior Unsecured	2028	+58
Johnson & Johnson	JNJ	AAA	$1,000	3.40%	Senior Unsecured	2038	+63
Johnson & Johnson	JNJ	AAA	$750	3.50%	Senior Unsecured	2048	+73
Kellogg	K	BBB	$600	3.40%	Senior Unsecured	2027	+112.5
Mosaic	MOS	BBB	$550	3.25%	Senior Unsecured	2022	+125
Mosaic	MOS	BBB	$700	4.05%	Senior Unsecured	2027	+175
Oracle	ORCL	AA-	$1,250	2.625%	Senior Unsecured	2023	+65
Oracle	ORCL	AA-	$2,000	2.95%	Senior Unsecured	2024	+80
Oracle	ORCL	AA-	$2,750	3.25%	Senior Unsecured	2027	+95
Oracle	ORCL	AA-	$1,750	3.80%	Senior Unsecured	2037	+105
Oracle	ORCL	AA-	$2,250	4.00%	Senior Unsecured	2047	+125
SunTrust Banks	STI	BBB+(1)	$500	VAR	Junior Subordinated	Perpetual	NA
United Parcel Service	UPS	A+	$700	2.05%	Senior Unsecured	2021	+35
United Parcel Service	UPS	A+	$350	L+15	Senior Unsecured	2021	NA
United Parcel Service	UPS	A+	$500	L+45	Senior Unsecured	2023	NA
United Parcel Service	UPS	A+	$1,000	2.50%	Senior Unsecured	2023	+55
United Parcel Service	UPS	A+	€ 700	0.375%	Senior Unsecured	2023	+12(2)
United Parcel Service	UPS	A+	$500	2.80%	Senior Unsecured	2024	+65
United Parcel Service	UPS	A+	$1,000	3.05%	Senior Unsecured	2027	+75
United Parcel Service	UPS	A+	€ 500	1.500%	Senior Unsecured	2032	+30(2)
United Parcel Service	UPS	A+	$1,150	3.75%	Senior Unsecured	2047	+95

Source: Bloomberg, company Securities and Exchange Commission filings.

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

(2) Spread over midswaps.

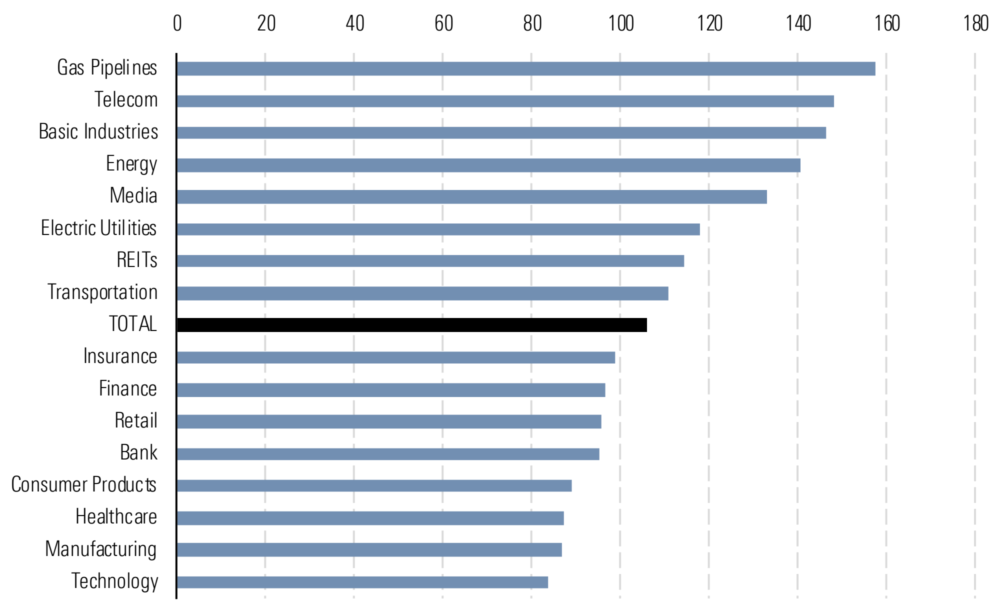
Exhibit 2 Morningstar, Inc. Corporate Bond Index Sector Summary

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-**	**4,938**	**6.9**	**104**	**6**	**(24)**	**(0.53)**	**5.07**
FINANCIAL	**A-**	**1,468**	**5.4**	**90**	**4**	**(33)**	**(0.37)**	**4.58**
Bank	A-	902	5.0	88	4	(34)	(0.37)	4.45
Finance	A	261	5.8	92	5	(28)	(0.41)	4.19
Insurance	A	215	7.8	93	3	(29)	(0.39)	5.92
REITs	BBB+	81	5.9	107	3	(28)	(0.23)	5.19
INDUSTRIAL	**A-**	**2,884**	**7.6**	**110**	**8**	**(20)**	**(0.64)**	**5.19**
Basic Industries	BBB	237	7.8	133	6	(47)	(0.41)	8.82
Consumer Products	A-	326	7.6	92	6	(15)	(0.58)	4.44
Energy	A-	411	7.3	128	4	(27)	(0.26)	6.48
Healthcare	A-	406	7.8	100	11	(16)	(0.90)	4.91
Manufacturing	A-	453	6.3	86	3	(23)	(0.36)	4.27
Media	BBB+	201	8.5	142	9	(16)	(0.94)	5.21
Retail	A-	166	8.1	97	4	(11)	(0.59)	4.10
Technology	A+	336	7.2	90	13	(16)	(1.10)	4.30
Telecom	BBB+	155	8.8	157	13	(1)	(0.66)	4.73
Transportation	BBB+	142	9.0	103	4	(30)	(0.42)	6.33
UTILITY	**BBB+**	**548**	**8.6**	**124**	**4**	**(28)**	**(0.42)**	**6.59**
Electric Utilities	A-	322	9.2	108	3	(28)	(0.34)	6.54
Gas Pipelines	BBB	214	7.7	147	5	(30)	(0.54)	6.67
Rating Bucket								
AAA Bucket		111	8.1	57	6	(9)	(0.78)	4.10
AA Bucket		492	6.0	64	4	(20)	(0.42)	3.57
A Bucket		1,899	6.8	81	5	(25)	(0.50)	4.58
BBB Bucket		2,436	7.2	135	8	(30)	(0.57)	5.93
Term Bucket								
1-4	A-	1,563	2.3	60	4	(33)	(0.15)	2.33
4-7	A-	1,173	4.6	87	6	(28)	(0.37)	4.24
7-10	A-	924	7.0	117	9	(20)	(0.63)	5.35
10PLUS	A-	1,278	13.8	157	8	(18)	(1.02)	8.78

Data as of 11/10/2017

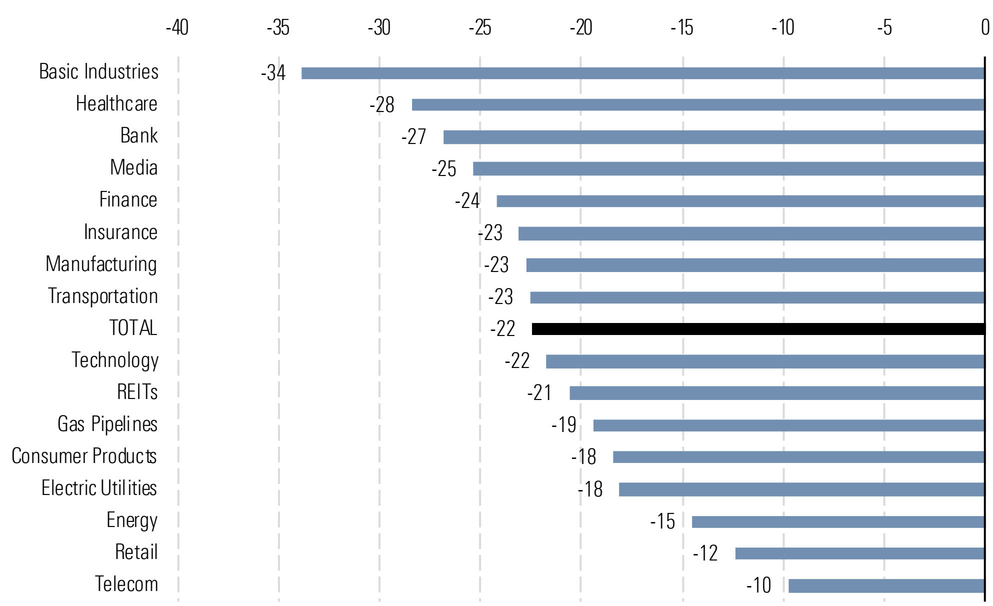
Source: Morningstar, Inc.

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



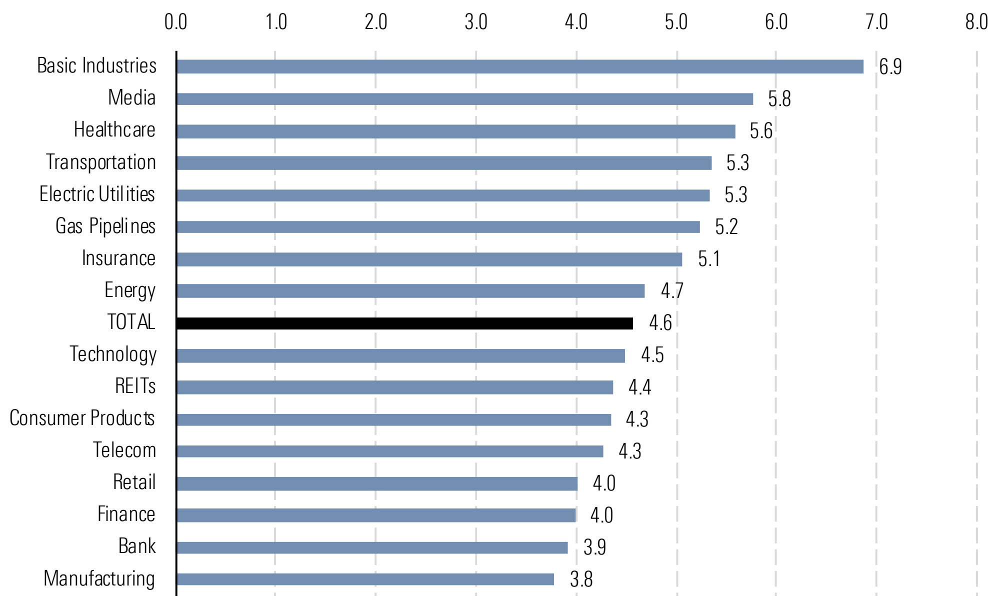
Source: Morningstar, Inc.

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
Regency Centers **REG**	BBB+	NA
Federal Realty Investment Trust **FRT**	A-	NA

► Rating affirmations

Issuer/Ticker	Current Issuer Credit Rating	Previous Issuer Credit Rating
Interpublic Group **IPG**	BBB	BBB
Omnicom **OMC**	BBB+	BBB+
Deere **DE**	A	A
Cummins **CMI**	A	A
Caterpillar **CAT**	A-	A-
Agco **AGCO**	BBB-	BBB-

Regency Centers Initiated With BBB+ Rating, Stable Outlook

Morningstar Credit Ratings, LLC is assigning Regency Centers Corporation a corporate credit rating of BBB+. The outlook is stable. Regency's rating is reinforced by the real estate investment trust's very good record owning and operating one of the best shopping center portfolios in the industry while maintaining arguably the most conservative balance sheet of its peers. Its dominant position was significantly strengthened by the acquisition of peer Equity One in the first quarter of 2017. Regency's Business Risk benefits from its centers, which are primarily anchored by the most successful grocers in the most desirable locations. The Cash Flow Cushion benefits from these centers being largely unencumbered. As with most REITs, however, competition in the commercial real estate markets, including among landlords of retail shopping centers, limits opportunities to establish sustainable competitive advantages whereby Regency would be able to generate returns meaningfully in excess of its cost of capital over the long term.

We anticipate that Regency will maintain metrics similar to if not more conservative than what it has in the past. We forecast debt at around 5.0 times or below EBITDA and at approximately 30% of total assets (or 28% of gross assets). We project interest coverage to range between 4.5 and 5.0 times EBITDA. Business Risk for immediately benefits from the addition of the Equity One portfolio, which provides more depth and removes a key competitor in Regency's markets. Regency is now challenging for the top spot in terms of asset size and total EBITDA among its shopping center REIT peers.

Regency had $3.5 billion of debt outstanding on its balance sheet as of the end of the third quarter. The bulk of this was $2.9 billion in unsecured notes and term loans, with the remaining $618 million in primarily fixed-rate mortgage loans from banks and insurance companies. Regency had been steadily lowering secured debt levels since the recession; with the acquisition of Equity One completed this year, secured debt will drop below 5% of gross assets, down from over 10% in 2012; this increases balance sheet flexibility. Maturities coming due over the next five years are not a concern, with an average of $200 million per year and a maximum of $513 million in 2020. As well, Regency maintains a $1.0 billion unsecured revolving credit facility, which was nearly undrawn at Sept. 30. The facility matures in May

2019 and has two six-month extension options. Finally, Regency has ample cushion in all of its unsecured debt covenants.

We could upgrade Regency's rating if the REIT is able to grow to near $1.0 billion of annual EBITDA while maintaining its conservative balance sheet and focus on grocery-anchored centers, all of which would strengthen the Business Risk profile. We could lower Regency's rating should the firm engage in acquisitions, especially leveraged, that entail significant exposure to at-risk tenants, or expand its development pipeline or secured debt closer to 20% of total assets.

Federal Realty Investment Trust Initiated With A- Rating, Stable Outlook
Morningstar Credit Ratings, LLC is assigning Federal Realty Investment Trust a corporate credit rating of A-. The outlook is stable. Federal Realty's rating is reinforced by its superior portfolio of shopping centers and mixed-use projects combined with an experienced and conservative management team that drive Business Risk to rank better than its shopping center peers as well as most other real estate investment trusts. The rating is supported by a solid Cash Flow Cushion, which benefits from an unencumbered portfolio of top-quality assets though somewhat offset by a modestly weaker Solvency Score. Still, while Federal Realty owns several shopping center assets that do command outsize demand from tenants, Morningstar's Equity Research Group believes Federal Realty's overall portfolio will not maintain lasting, structural competitive advantages to a level that warrants a moat.

Despite the relatively low number of locations represented in Federal Realty's portfolio compared with more geographically diversified peers, these affluent and densely populated metro markets represent between one third and two fifths of all retail spending in the in United States. Portfolio performance pursuant to the last recession demonstrates the validity of this Federal Realty's strategy, as declines in property cash flows were the lowest in duration and magnitude in the shopping center REIT sector, underlining a best-in-class Business Risk profile. We estimate high leverage at year-end 2017 with debt at 5.7 times (5.5 times net of cash) EBITDA; however, this is in part a result of the spending on the REIT's mixed-use projects, Assembly Row and Pike & Rose, and leverage will decline as associated projects are completed and property cash flows increase. We anticipate this metric to decline close to 5.5 times by year-end 2018 and continue to decline thereafter.

As of Sept. 30, the balance sheet had $2.7 billion of unsecured debt and $565 million of secured debt, including nearly $2.4 billion of long-term senior notes and $42 million due on the revolving credit facility, which has a capacity of $800 million and expires in April 2020 with options to extend for an additional year. Over the past five years Federal Realty has reduced secured debt levels from 9.4% to less than 6.2% of gross assets, increasing balance sheet flexibility and a credit plus. Current maturities are more than manageable and average $172 million over the next five years with a maximum of $292 million in 2018 ($275 million of which is subject to a one-year extension option).

We do not expect improvement in Federal Realty's rating for the foreseeable future, as it would require significant increases in size and diversity to achieve meaningful improvement in what is already among the highest scores in Business Risk. The rating assumes improvements in capital structure and interest coverage, components of Federal Realty's Solvency Score; barring these improvements, which would probably result from challenges in the completion of the REIT's high-profile mixed-use developments and which would also have implications for Business Risk, we would be likely to downgrade the rating.

Interpublic's BBB Rating Affirmed, Outlook Stable

Morningstar Credit Ratings, LLC is affirming its BBB corporate credit rating on The Interpublic Group of Companies Inc. and maintaining a stable outlook. Our rating reflects Interpublic Group's margin expansion and disciplined use of debt. Business Risk is supported by moderate uncertainty, competitive strength, and diversity, partially offset by high cyclicality of operating performance and Interpublic's smaller market share relative to its peers. The rating is also supported by moderate Cash Flow Cushion and Solvency Score pillars.

As the fourth-largest global advertising firm, Interpublic's broad portfolio of services allows the company flexibility in serving its customers. Morningstar's Equity Research Group assigns the company a narrow moat rating, supported by high customer switching costs and a substantial base of creative talent and intangible assets. Interpublic's revenue growth slowed in recent quarters driven by tough comparisons with 2016's U.S. election-year spending and Summer Olympics-related spending, along with soft client spending in Brazil due to macroeconomic uncertainty. However, we believe the pressure will prove temporary, with ad spending likely to remain in line with economic growth over the long term. Despite softness in revenue growth, Interpublic's cost controls continue to support a gradual expansion of operating margins. Though we believe competition from digital advertising is likely to remain an ongoing risk to the firm, we think Interpublic's diversified and integration portfolio of services mitigates competitive threats in any one product area.

We calculate that Interpublic's net debt ended the September quarter at 1.3 times EBITDA, or 2.9 times EBITDAR including operating leases. Total debt ended the September quarter at $2.1 billion, up from a year ago. In addition to $705 million of cash on hand, short-term liquidity is supported by an undrawn $1 billion revolving credit facility due October 2020. The credit facility also supports Interpublic's $1.5 billion commercial paper program, against which it reported $359.3 million outstanding at Sept. 30.

Short-term debt has increased over the past year to fund excess cash payouts to shareholders. During the most recent 12 months, the company's payout for acquisitions and dividends and share repurchases to shareholders exceeded free cash flow by $470 million. Over the next year, we expect management to maintain its current capital-allocation policy, allocating 100% or more of free cash flow to a mixture of acquisitions and share repurchases. We view its maturity schedule as manageable, with $300 million due in November 2017 and no additional maturities ahead of the credit facility in 2020.

Our stable outlook reflects our expectation for steady revenue growth after 2017 and further improvement in operating margins. We may consider an upgrade of the rating if leverage and operating performance improve meaningfully from current levels. We may consider a downgrade of the rating in the event of a downturn in operating performance or reversal in debt trends.

Omnicom's BBB+ Rating Affirmed, Outlook Stable

Morningstar Credit Ratings, LLC is affirming the BBB+ corporate credit rating on Omnicom Group Inc. and maintaining a stable outlook. The rating is supported by Omnicom's scale, stable operating performance, and generally low financial risk, offset by cyclicality and an aggressive shareholder payout policy. The firm continues to exhibit moderately low Business Risk with solid Cash Flow Cushion and Solvency pillars, with the latter well supported by high returns on invested capital.

Morningstar's Equity Research Group assigns Omnicom a narrow moat, supported by the firm's massive scale advantage as well as high switching costs arising from the integrated nature of the working relationship between its agencies and clients. Although digital advertising remains a long-term threat, we believe Omnicom's investment in a highly diversified and integrated portfolio of services should mitigate the impact of competitive pressures in any one area. While Omnicom's revenue is prone to cyclical variance and the periodic impact of acquisitions and divestitures, we continue to expect organic revenue growth to remain in line with trends in global ad spending and GDP growth. Growth through the September quarter was under pressure from a slowdown in customer spending on public relations and customer relationship management as well as from recent divestitures. However, effective cost management has allowed the trend in operating margin to remain positive.

We believe Omnicom remains in good financial health with financial leverage consistent with the rating category. However, the company has spent more than its free cash flow over the past year to fund share repurchases and dividends, which may eventually push debt higher. Cash and equivalents declined $118 million in the September quarter from a year ago, ending at $1.9 billion. We calculate net debt at 1.3 times EBITDA and lease-adjusted net leverage of 2.2 times EBITDAR, both unchanged from the prior year. Our outlook assumes management will continue to adhere to a disciplined capital-allocation policy over the next a few years, dividing free cash flows between acquisitions and shareholder payouts without a material increase in leverage.

Our rating assumes that organic revenue growth averages between 3% and 4% per year over the next five years and that operating margin remains stable. We may consider an upgrade of the rating if the company moves to sustainably decrease debt levels or expand free cash flow. Conversely, we may consider a downgrade of the rating if management becomes more aggressive with leverage or shareholder payout, particularly in the context of weaker margins.

Deere's A Rating Affirmed, Outlook Lifted to Stable

Morningstar Credit Ratings, LLC is affirming our A corporate credit rating on Deere & Co. Our rating on Deere focuses on the company's manufacturing operations, along with a qualitative assessment of risk added by the finance subsidiary, John Deere Capital. Deere's credit profile benefits from its strong competitive position and solid financial ratios. The Wirtgen acquisition will result in additional debt, but Deere has minimized the incremental borrowing. Moreover, with the farming economy showing signs of life, we think that Deere's profitability should improve such that it will stave off a possible ratings downgrade in the next year or so. As a result, we are lifting our outlook to stable from negative.

Deere has amassed dominant market share in the North American agricultural equipment market related to its strong brand name and immense dealership network. These factors have helped the firm earn a wide economic moat from Morningstar's Equity Research Group that bolsters its Business Risk pillar. We view the firm's historic focus on farming and its corresponding volatility as slight detractors, although its Wirtgen acquisition improves our cyclicality assessment. Deere has translated its competitive position into impressive high-double-digit returns on invested capital and solid interest coverage ratios, while its high cash balance produces a healthy quick ratio. Deere's Cash Flow Cushion score benefits from its strong operating cash flow generation and limited reinvestment needs. The firm's maturity schedule is light during the next five years, with $842 million in debt due in 2019 and negligible payments over in remaining years. However, Deere's average Cash Flow Cushion score reflects the cash requirements for its $5.2 billion acquisition of Wirtgen Group and its targeted 25%-35% dividend payout ratio. Deere still aims to use its return excess cash flow to repurchase shares, but we expect diminished disbursements over the next few years.

With forecasts for improving end-markets, we expect that Deere will be able to repair its credit profile over the coming years. So far in fiscal 2017, revenue is up 8% with EBITDA up 31%, resulting in nearly half a turn of deleveraging. Moreover, we no longer see a substantial risk of the firm's credit profile weakening in the near future and have raised our outlook to stable, as we believe that projected growth and margin expansion should help its Solvency Score and Cash Flow Cushion going forward. Should the environment improve more than expected, we could foresee a lift in both the Solvency Score and Cash Flow Cushion pillars that causes an upgrade, assuming no change in Deere's leverage profile. Conversely, should the prospects sour or the harvest from the Wirtgen deal prove rotten, then a downgrade is possible, as lower profitability and cash flow could cause those pillars to wilt.

Cummins' A Rating Affirmed With Stable Outlook

Morningstar Credit Ratings, LLC, is affirming our A corporate credit rating on Cummins Inc. Our rating reflects Cummins' position as the leading global engine manufacturer and strong credit profile offset by the risks associated with its cyclical end-markets. Cummins' fortunes have improved meaningfully during 2017, with global economic growth boosting its end markets. The stronger-than-expected results have further strengthened its credit profile. Moreover, Cummins financial conservatism supports its balance sheet during the downturns in this cyclical industry, so its credit metrics will look more impressive during an upswing. As such, we think a stable outlook is warranted.

Cummins has amassed a low-cost position that has helped it earn a narrow economic moat from Morningstar's Equity Research Group that supports its Business Risk pillar. However, the firm's customer concentration (its largest customer Paccar represented 16% of 2016 while its four largest represented 33%) and the industry's cyclicality constrain that pillar to moderate levels. Cummins has capitalized on its cost position and technology prowess by producing mid-teens returns on invested capital, despite a nearly double-digit decline in 2016 revenue. Cummins also operates with minimal financial leverage (0.9 times gross), which helps its total-liability-to-total-asset ratio, while its meaningful cash balance helps it produce a strong quick ratio. As a result, it manufactures an impressive Solvency Score. Cummins finances its business almost extensively with long-term debt. It has a weighted-average maturity of approximately 23 years and thus faces de minimums debt maturities over the next five years. It operates with a generally creditor-friendly capital allocation policy that targets to return roughly 50% of its free cash flow back to shareholders via a growing dividend and periodic share repurchases. Combined, these factors support its strong Cash Flow Cushion score.

While we expect our corporate credit rating to remain at A given our current projections, we note that our credit rating could move upward should the heavy-duty truck market exhibit a faster-than-expected rebound. In this situation, we suspect that the stronger prospects could improve the Solvency Score and Cash Flow Cushion even further. Moreover, should international emission standards enable Cummins to again sustain market-share gains, we foresee a potential reassessment of the firm's competitive position, which could boost its Business Risk pillar. Alternatively, our rating could fall if Cummins were to decide to increase leverage to pursue an acquisition. Management in the past has mentioned taking leverage up to 1.5-2.0 times for the right target. A meaningfully debt-financed deal could result in a rating downgrade.

Caterpillar's A- Rating Affirmed, Outlook Elevated to Stable on Stronger Prospects

Morningstar Credit Ratings, LLC is affirming our A- corporate credit rating on Caterpillar Inc. Our issuer rating on Caterpillar focuses on its manufacturing operations, along with a qualitative assessment of the risk added by its finance subsidiary, Caterpillar Financial Services. Caterpillar's end markets and fortunes have improved drastically since our previous update when we assigned it a negative outlook. Since then, the firm has meaningfully increased its 2017 revenue guidance, and its cost reductions have paid off. As a result, we believe that a ratings downgrade is unlikely, and we are moving our outlook to stable.

Caterpillar's strong brand name and global dealer network have enabled the company to enjoy a 19% market share of the construction market, nearly double the size of its nearest competitor. This strong advantage has resulted in a wide economic moat assessment from Morningstar's Equity Research Group. Combined, these factors help its Business Risk pillar, although they are counteracted slightly by the firm's end-market cyclicality and limited industry focus. Despite a tumultuous four-year stretch that lopped off more than 40% of top-line revenue from 2012 through 2016, Caterpillar still managed to monetize its competitive position into double-digit returns on invested capital and solid interest coverage ratios. During this span, the firm eradicated inefficiencies and cut costs, so we expect the industry's rebound will further help elevate these metrics. We forecast that Caterpillar will generate average annual operating cash flow of $4.9 billion over our forecast year and reinvest $1.4 billion per year back into the business. However, the firm faces three meaningful debt maturities totaling $2.8 billion over the next five years and is committed to growing its $1.8 billion dividend with earnings; factors that constrain its Cash Flow Cushion score.

End markets have vastly improved in 2017, and the restructuring actions have helped adjusted EBITDA margins expand 520 basis points to 19.7%, while free cash flow has nearly quadrupled versus the same period last year to $3.6 billion in the past three quarters. We now see the firm on much sounder footing and think it's unlikely that Caterpillar's credit profile will deteriorate further. As such, we have moved our outlook to stable. Should restructuring prove even more fruitful than our estimates, we could see upward movement in the Solvency Score and Cash Flow Cushion that lead to a ratings upgrade. Although we suspect that Caterpillar's aggressive capital-allocation polices of yesteryear are unlikely to reappear, we could envision a ratings downgrade should the firm become more aggressive on that front. A debt-funded deal could unwind the improvements in the Solvency Score and put further pressure on the Cash Flow Cushion.

Agco's BBB- Rating Affirmed With Stable Outlook

Morningstar Credit Ratings, LLC is affirming our BBB- credit rating on Agco Corp. The farming economy has improved nicely during the past 12 months with Agco's South America volumes increasing approximately 20% versus low-double-digit declines in 2016. This has helped lift Agco's fortunes enough to stave off a further deterioration in its credit profile. We forecast EBITDA growth should continue throughout our forecast period thus assigned the firm a stable outlook.

Agco benefits from its large size as the dominant tractor manufacturer in Brazil, with around 50% market share. However, we believe the firm has been unable to translate this position into a sustainable competitive advantage because its multiple-brand strategy makes it difficult to focus on a niche market while also effectively managing its dealer network. Moreover, the firm operates with a narrow focus that hurts its customer concentration component that also induces high cyclicality. Combined, these factors contribute to a relatively weak Business Risk score. Agco has also suffered from challenging end-markets. A multiyear drought in farm equipment sales has withered away Agco's profitability, with 2016 EBITDA of $576 million roughly half of 2013's levels. Agco's 2017 harvest will improve, but the reverberations have ravaged its returns on invested capital and reduced its EBITDAR interest coverage ratio to below 8.0 times from 12.0 times in 2014. These negatives counteract modest total-liability/total-asset and quick ratios, resulting in a poor Solvency Score. The resultant meager cash generation, and sizable 2020 and 2021 maturities have hurt its Cash Flow Cushion score.

We have assigned Agco a stable outlook since we view the firm as an investment-grade company. Buttressing our recommendation is management's preference to remain investment-grade. The firm operates with a leverage target of 2.0-to-3.0 times and has ceased share repurchases to focus on deleveraging the balance sheet from its current gross leverage in the low-3s. We expect the recent reversal of industry fortunes to continue, and we project sales to grow near mid-single-digits during our forecast period. Should end markets improve faster, however, then we could foresee a path where stronger EBITDA growth benefits our Solvency Score and Cash Flow Cushion enough to upgrade our corporate credit rating. Alternatively, should the earnings improvement prove temporary and cause leverage to worsen, then we'd expect a further reduction in the firm's Cash Flow Cushion and Solvency Score pillars that could cause a rating downgrade.

Recent Notes Published by Credit Analysts

Another Quarter, Another Apple Debt Issuance

Market Data

Apple Inc. (AA-, negative) has announced its fifth issue of U.S. dollar-denominated senior notes this year, following $23 billion of dollar notes and $9.5 billion of notes in other currencies issued since January. According to a preliminary prospectus filed Nov. 6, Apple's proposed offering includes 2-, 5-, 7-, 10-, and 30-year fixed-coupon maturities. As with prior issues, management expects to use the proceeds from the proposed notes to support its share repurchase and dividend plans. Commercial paper, which Apple relies on throughout the quarter to fund repurchase activity, totaled $12 billion at the end of the September quarter. Apple also reported $6.5 billion debt maturing over the next 12 months.

As references for the proposed notes, we look to higher-rated technology peer Cisco Systems Inc (AA, stable) and same-rated peers Oracle Corp (AA-, stable) and Intel Corp (AA-, stable) as key comparable issuers for Apple. The following market pricing data is sourced from pricing service Interactive Data as of Nov. 3.

In the 10-year area, comparable issues were indicated:
Apple 3.20% notes due 2027 at +69 basis points.
Cisco Systems 2.95% notes due 2026 at +60 basis points.
Oracle 2.65% notes due 2026 at +63 basis points.
Intel 3.15% notes due 2027 at +66 basis points.

MCR Credit Risk Assessment

At the end of September, Apple reported total debt of $115.7 billion. Meanwhile, cash and investments ended the fiscal year at $268.9 billion, up $31.3 billion from last quarter. Growth was primarily the result of $29 billion of net new senior debt issuance during the year, which also helped prop up domestic cash reserves up by $37 billion. Free cash flow was $51.1 billion in fiscal 2017, down 4% from the prior year. Over the same period, Apple spent $1.1 billion on acquisitions and strategic investments, $12.8 billion for dividends and $32 billion in net share repurchases, with shares repurchased representing about 4% of 2016 fiscal year-end shares outstanding.

Apple has relied heavily on the credit markets to maintain its domestic cash reserves to fund its massive $300 billion capital return plan. Over the past 12 months, Apple's payout was 88% of its global free cash flow, compared with 66% for Cisco, 35% for Oracle and 72% for Intel. If U.S. interest rates remain low, we expect Apple to maintain a high payout of cash flow and to fund repurchases with low-cost debt rather than incur repatriation taxes. We expect this to continue to drive debt issuance in the years ahead. Apple reported $44 billion of capacity remaining under its $210 billion share-repurchase plan at the end of September, which the board of directors expanded from $175 billion in May.

Our AA- rating reflects Apple's moderate Business Risk and its strong Solvency and Cash Flow Cushion rankings, which are supported by high returns on invested capital and $252 billion of overseas cash and investments. However, Apple's credit picture remains clouded by slowing growth and profitability and the high revenue contribution of the iPhone.

Apple's Business Risk remains slightly weaker compared with Cisco, Oracle, and Intel, though Apple's high Solvency Score is on par with these issuers. With its substantial balance of cash and investments, Apple's Cash Flow Cushion also remains higher than its peers, but Apple holds just 6% of this cash domestically, compared with 4% for Cisco, 18% for Oracle, and 43% for Intel. The company's net excess global cash over debt at 2.1 times EBITDA remains a bit lower than Cisco's 2.4 times, and favorable compared to 0.5 times net excess cash for Oracle and Intel's pro forma net debt balance of 0.5 times. However, Apple's leverage is up more sharply over the past three years compared with its peers. Through its latest September fiscal year-end, Apple's debt has increased by nearly 6 times its level at the end of fiscal 2013, driving total debt up a full turn to 1.6 times EBITDA. Meanwhile, cash and investments has grown just 83% and trailing 12-month EBITDA has increased by 28%, cumulatively.

Apple's fiscal fourth quarter results once again featured solid revenue growth for Mac and iPad. Total revenue increased 12% from the prior year, though gross margin remained flat at 38% year over year. Despite a pickup in growth in nonphone product revenue, we note that the iPhone revenue still accounted for 62% total revenue over the past year. While the recently released iPhone updates will likely spur sales in the short term, we view Apple's long-term growth and performance as dependent on new product development, an area where Apple has met with only moderate success since the iPhone introduction a decade ago.

CVS' Balance Sheet Stays Stagnant in 3Q While Event Risk Rises

MCR Credit Risk Assessment

On Nov. 6, CVS Health Corp (BBB+, stable) reported third-quarter results that met consensus expectations on the top line and beat on the bottom line. The firm's balance sheet management has remained stagnant through 2017 so far, which influences the stable outlook on our BBB+ rating. However, creditors should know that event risk has risen in recent weeks given CVS' reported interest in acquiring Aetna Inc (non-NRSRO rating: BBB+, stable) and Amazon.com Inc's (A, stable) potential entry into the pharmaceutical supply chain. If leverage looks set to rise or the competitive landscape worsens substantially in the near future, our view of CVS' credit quality could change.

In the third quarter, net revenue grew 3.5% to $46.2 billion (in line with consensus) and adjusted earnings per share declined 8.4% to $1.50 (above consensus of $1.48). These consolidated results reflect a mixed bag from CVS' different segments. The company's pharmacy benefit management (PBM) business beat its expected profit range, and the retail and long-term care segment declined more than expected because of hurricanes during the period while a better-than-expected tax rate helped offset that segment's weakness on the bottom line. For 2017, management has narrowed its outlook ranges slightly. It now expects net revenue growth of 3.25%-3.75% (from 3.0%-4.0% previously) and earnings per share of $5.87-$5.91 (from $5.83-$5.93 previously), or 0.5%-1.25% growth from the $5.84 generated in 2016. And despite generating nearly $7 billion in free cash flow through the first nine months of the year, CVS has not changed its free cash flow outlook of $6.0 billion-$6.4 billion for 2017 due to negative expected cash flows in the fourth quarter after an unusual buildup in payables Medicare Part D and the timing of receipts. Also, for 2017, the company still plans to return more than $7 billion to shareholders through dividends ($2 billion run rate) and repurchases ($5 billion expected, up from $4.4 billion year to date through the end of September). So we expect the firm's gross (2.1 times as of Sept.) and lease-adjusted leverage (3.2 times as of September) to remain relatively stagnant in the near future. Management maintained its 2.7 times lease-adjusted leverage target on the call, but progress to that level could be a multiyear event on profit growth as the main driver of its deleveraging, assuming no major capital-allocation events in the near future. Therefore, we think CVS will remain weakly positioned in its category on a stand-alone basis.

In late October though, *The Wall Street Journal* reported that CVS and managed care organization Aetna were in talks to merge in a deal worth $66 billion (or more than $200 per share) to Aetna shareholders. This deal would make strategic sense, in our opinion, but looks quite pricey relative to the Morningstar Equity Research Group's stand-alone valuation of $94 per share for Aetna. While CVS management remained coy on the call, a recent Reuters report suggested that a deal could be finalized as early as December. Depending on the cash and equity components of the combination, CVS' leverage could rise from its already elevated level. Since we view CVS as operating on the weak end of its BBB+ rating, a large event like that, which significantly increases leverage, could have a negative impact on its rating.

Some sources suggest that the potential Aetna combination could combat the potential entry of Amazon into the pharmaceutical supply chain. Depending on how Amazon plans to enter this marketplace, CVS' retail and PBM operations could be negatively affected. Even without a combination with Aetna, CVS plans to defend its territory in the drug distribution space by introducing more delivery options for patients. Specifically, beginning in 2018, CVS plans to make one-day delivery of prescriptions available on a nationwide basis. In some areas, same-day delivery will be possible, and on Dec. 4, CVS plans to start offering same-day delivery of prescriptions and some front-of-store products in Manhattan. By providing more comprehensive and quick delivery options, CVS hopes to make Amazon's potential entry less of a competitive threat, going forward, which we view as a good start. Overall though, the event risk surrounding CVS has risen substantially in recent weeks, and while our BBB+ and stable outlook remain intact for CVS as a stand-alone entity, our view could change, particularly in a merger scenario.

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' bonds have widened substantially in recent weeks after reports about the potential Aetna merger surfaced, and its 10-year bonds recently traded roughly in line with the Morningstar Corporate Bond Index at BBB+. 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 +78 basis points.
Express Scripts Holding Co's 3.30% notes due 2021 at +69 basis points.
Walgreens Boots Alliance Inc's 3.30% notes due 2021 at +78 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 +126 basis points.
Express Scripts' 3.40% notes due 2027 at +137 basis points.
Walgreen's 3.45% notes due 2026 at +144 basis points.

For comparison to the roughly 10-year maturities, the Morningstar Corporate Bond Index is at +88 basis points at A-, +122 basis points at BBB+, +130 basis points at BBB, and +156 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 +170 basis points.
Express Scripts' 4.80% notes due 2046 at +183 basis points.
Walgreen's 4.65% due 2046 at +176 basis points.

Pressure on Best-Seller EpiPen Weighs on Mylan's 3Q Performance; Debt Load Lightened
MCR Credit Risk Assessment
On Nov. 6, Mylan NV (BBB-, negative) reported declining operational performance in the third quarter in light of competitive inroads and tougher pricing negatively influencing its best-selling product, EpiPen. Despite the headwinds, Mylan generated solid free cash flow, which is important as we look for reduction in the firm's heavy debt burden and improved debt leverage. The current rating depends on the firm easing presently elevated debt leverage, which is reflected in our negative outlook on Mylan's BBB- rating.

In the third quarter, Mylan's revenue fell by 2% year over year given higher-than-expected pricing pressure in the U.S. generic market and damped sales of EpiPen. Total sales were propped up by one extra month of contribution from last year's acquisition of Meda, which added around $164 million of revenue, and if excluded, total sales would have declined by 7.6%. By segment, sales generated by Mylan's Europe division increased 24% (rose 9.8%% organically) and its rest-of-the-world segment rose 8.9% (increased 3.3% organically) due to Meda, while the North America business dropped 22%. With the unexpected launch of its generic version of Teva Pharmaceutical Industries Ltd's (BBB-, negative) Copaxone in October, Mylan raised the bottom ends of its sales and earnings guidance for this year, with revenue now anticipated to be $11.75 billion-$12.5 billion (from $11.5 billion-$12.5 billion) and earnings guidance of $4.45-$4.70 from $4.30-$4.70. Management held its outlook for adjusted EPS in 2018 of at least $5.40. We remain optimistic that revenue and EBITDA may rise in the midsingle digits through 2021 compounded annually, backstopped by an expanding generic segment.

From a credit perspective, Mylan's gross leverage remains stubbornly high, and we see the firm's BBB- rating precariously positioned until this inflated leverage falls, which is reflected in our negative outlook. As of September, Mylan owed $14.79 billion in debt (compared to $15.05 billion on June 30) and had around $615 million of cash yielding gross leverage and net leverage of 4.2 times and 4.1 times, respectively, for the trailing 12 months at the end of the third quarter. While Mylan recently extended its maximum leverage covenant in its revolving credit facility and term loans to 4.25 times through the end of 2018 (from the end of the second quarter of 2017), the firm maintains its commitment to an investment-grade rating. As such, Mylan still targets easing average net debt/adjusted EBITDA to approximately 3 times over the long term. We are concerned that the added headroom may give the firm incentive to aggressively seek new assets and graciously reward shareholders. But, in the absence of these activities, we see this figure as attainable by 2020 through a combination of moderate debt repayment and relatively steady profitability.

Mylan does have the financial flexibility to utilize average free cash flow of $1.9 billion annually through 2021, in our estimation, to pay off most of its long-term debt maturities totaling $7.8 billion through 2021. The firm expects to generate $2.0 billion-$2.4 billion of free cash flow (including capital spending of $300 million-$350 million) in 2017 alone. However, Mylan's weak positioning in the BBB- rating category is influenced by its opportunistic share repurchasing and historically heavy business development activities seeking complementary assets to its branded, generic, and over-the-counter drug portfolios. These activities can occasionally boost gross debt/adjusted EBITDA to more than 4 times on a pro forma basis.

Market Data

For closest comparisons to Mylan's notes, we look to similar-rated companies, Teva, Perrigo Co. PLC (BBB-, stable) and Shire PLC (BBB-, positive). Within this comparable group and adjusted for bond maturities, Mylan's 10-year bonds traded much tighter than those at Teva but wider than those at Shire and Perrigo. Mylan's bonds also traded much wider than Morningstar Inc.'s BBB- 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:
Mylan's 4.20% notes due 2023 at +134 basis points.
Shire's 2.88% notes due 2023 at +107 basis points.
Perrigo's 4.00% notes due 2023 at +124 basis points.
Teva's 2.95% notes due in 2022 at +293 basis points.

In the approximate 10-year maturity bucket, bonds from these issuers recently traded over the nearest Treasury as follows:
Mylan's 3.95% notes due 2026 at +181 basis points.
Shire's 3.20% notes due 2026 at +129 basis points.
Perrigo's 4.38% notes due 2026 at +162 basis points.
Teva's 3.15% notes due in 2026 at +295 basis points.

For comparison to the approximate 10-year maturities, the Morningstar Corporate Bond Index is at +130 basis points in the BBB category and at +156 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:

Mylan's 5.25% notes due 2046 at +232 basis points.
Shire's (Baxalta) 5.25% notes due 2045 at +164 basis points.
Perrigo's 4.90% notes due 2044 at +192 basis points.
Teva's 4.10% notes due in 2046 at +289 basis points.

Cardinal Health Starts Deleveraging in Fiscal 1Q After Recent Acquisition

MCR Credit Risk Assessment

Cardinal Health Inc (A-, stable) reported fiscal first-quarter operating results Nov. 6 that exceeded consensus expectations on the bottom line primarily because of a timing issue while top-line results were below expectations. For creditors, it looks like Cardinal has already started deleveraging after its $6.1 billion acquisition of Medtronic PLC's (A+, stable) patient-care, deep vein thrombosis, and nutritional insufficiency businesses. Overall, we expect Cardinal to continue deleveraging from currently elevated levels, which informs our A- rating and stable outlook.

Cardinal turned in a mixed fiscal first quarter, beating expectations on the bottom line but missing on the top line. Revenue grew 2% to $32.6 billion, or below consensus of $33.5 billion, and adjusted earnings per share decreased 12% to $1.09, or above consensus of $1.00. Profits declined year over year on the company's efforts to invest in its IT systems and tax planning functions in fiscal 2018. However, relative to expectations, recent share repurchases and a timing issue that pushed some expected investments out to the second quarter allowed Cardinal to beat analyst estimates in the first quarter. The company has not changed its guidance for the full year, though. Cardinal still expects mid-single-digit organic growth versus the previous year and adjusted earnings per share of $4.85-$5.10, or a decline of 5% to 10% year over year.

From a credit perspective, we were pleased to see Cardinal reduce its debt obligations slightly during the quarter. As of September, debt stood at $10.0 billion, down from $10.4 billion as of June. Related to that debt redemption, we estimate pro forma gross leverage ticked down to 2.6 times (from our previous estimate of 2.7 times) while pro forma net leverage stood around 2.3 times (from our previous estimate of 2.5 times). Management has previously stated that it expects to repay about $1.5 billion of debt in the three years after the acquisition (or about $500 million annually), and it estimates gross leverage may remain above 2.0 times through June 2020. For comparison, Cardinal's key drug distribution peers recently operated with gross leverage in the mid- to high-1s. However at roughly 2.8 times by our estimates, Cardinal's lease-adjusted leverage is only about a quarter of a turn higher than that of key peer McKesson (A-, stable), currently. Given Cardinal's deleveraging plans, we expect its lease-adjusted leverage will fall slightly below McKesson's once it meets its leverage target. Given their similar lease-adjusted leverage levels, we think McKesson remains Cardinal's best credit comparable, which reinforces our A- rating and stable outlook for Cardinal.

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 wider spreads than its key peers in the roughly 5- and 10-year maturity buckets, but in the 30-year space, all three issuers traded at similar spreads. The following bond data is sourced from Interactive Data.

Spreads in the approximate 5-year maturity bucket for the drug distribution sector can be seen over the nearest Treasury as follows:
Cardinal Health Inc's 2.62% notes due in 2022 at +88 basis points.
AmerisourceBergen Corp's (A, stable) 3.50% notes due in 2021 at +76 basis points.
McKesson Corp's 2.70% notes due in 2022 at +69 basis points.

Spreads in the approximate 10-year maturity bucket for the drug distribution sector can be seen over the nearest Treasury as follows:
Cardinal Health's 3.41% notes due in 2027 at +133 basis points.
AmerisourceBergen's 3.25% notes due in 2025 at +100 basis points.
McKesson's 3.80% notes due in 2024 at +96 basis points.

For comparison, the Morningstar Corporate Bond Index is at +77 basis points in the A category and +88 basis points in the A- category.

Spreads in the approximate 30-year maturity bucket for the drug distribution sector can be seen over the nearest Treasury as follows:
Cardinal Health's 4.37% notes due in 2047 at +164 basis points.
AmerisourceBergen's 4.25% notes due in 2045 at +161 basis points.
McKesson's 4.88% notes due in 2044 at +168 basis points.

With T-Mobile Merger off the Table, Sprint Faces Considerable Investment Challenges
MCR Credit Risk Assessment
On Nov. 4, Sprint Corp.'s (B, negative) majority owner, Softbank Group (not rated), announced it has terminated merger talks with T-Mobile USA (BB, stable) without an agreement. Softbank also announced its intention to increase its ownership stake in Sprint to as high as 85% from the current 82%, which represents an additional commitment of $700 million based on Sprint's Sept. 30 share count and a share price of $5.90. Softbank has indicated it will seek to buy the shares in the open market, so Sprint will not receive monetary proceeds from the additional investment.

The combination with T-Mobile would have created the third-largest wireless operator in the United States. The absence of a merger now puts significant pressure on Sprint as an independent wireless operator in an increasingly competitive and capital-intensive industry, which reinforces our negative rating outlook. Our current rating of B reflects our ongoing concern that Sprint faces a significant investment challenge over the next five years. For the fiscal second quarter ended Sept. 30, its postpaid customer base represented a 12.4% share of total postpaid subscribers among the four largest U.S. wireless operators. While Sprint has attracted 1.1 million net new subscribers over the past two years (growth of 3.7%), its average revenue per subscriber per month has dropped 2% to $69.23, adjusted for handset installment billings. Though free cash flow generation is now tentatively positive ($80 million over the past 12 months), we do not view it as likely to be sufficient to provide relief from funding needs.

Sprint has pursued a parsimonious capital investment strategy in recent years, resulting in a lower capital spending rate than its larger competitors. Sprint's network capital expenditures are running at 9% of its revenue for the trailing 12 months, compared with an average of 12.6% for its three U.S. competitors. With its high proportion of higher-frequency spectrum, Sprint has been forced to increase its antenna density even in urban areas due to the shorter signal propagation compared with the lower-frequency spectrum held by its competitors. Without access to T-Mobile's large trove of lower-frequency spectrum, we believe this challenge is likely to intensify for Sprint as the industry moves toward 5G technology, which involves wider bandwidths but very short-distance signal propagation. This technical limitation is likely to require an even more highly dense network of small cell nodes connected by a cohesive fiber network capable of handling the higher data backhaul volume that 5G is likely to drive.

Sprint announced a mobile virtual network operator agreement with cable operator Altice Group (not rated), which will use Sprint's wireless network to offer a wireless service to its cable television subscribers. While this may offer some operational synergy through access to Altice's fixed-line network and rights-of-way in certain parts of the U.S. (mainly the Northeast corridor), we do not believe it will result in a meaningful uptick in revenue or cash flow.

Sprint reported total debt of $38.4 billion at the end of the September quarter, up 5% from a year ago and now at 3.5 times trailing 12-month EBITDA. Cash and investments ended the period at $6.4 billion compared with $5.7 billion a year ago, with growth primarily due to net new debt issuance. Over the next year, Sprint faces $4.2 billion of debt maturities, including $1.5 billion of senior notes and $1.8 billion of network equipment financing. Over five years, it faces a total of $15.6 billion of scheduled maturities, which exceeds our projected cumulative free cash flow over the period. These maturities do not include the 2021 revolving credit facility, which was undrawn in the latest quarter.

Softbank has indicated it will continue to work with Sprint to provide liquidity and support for network investment. However, we believe this is likely to involve more off-balance-sheet financing and further encumbrances against Sprint's most valuable asset: its wireless spectrum licenses. Sprint has already borrowed $3.5 billion against a $16.4 billion slice of its spectrum holdings, with $3.5 billion of remaining capacity in the facility. Including the spectrum financing notes, secured debt totaled $13.5 billion at Sept. 30, or about a third of total debt. This includes $4 billion drawn on a term loan due 2024, $2.4 billion of loans against factored handset receivables, and $2.5 billion of financing obligations and capital leases to fund network expenditures. We expect Sprint to continue funding senior note maturities with asset-backed debt, taking advantage of the lower cost of these sources. As a result, unencumbered asset coverage available to cover long-dated senior note maturities is likely to continue to decline, supporting the negative outlook on Sprint's B rating.

Market Data

According to pricing from Interactive Data as of Nov. 6, Sprint's 7.63% notes due 2025 are indicated at a yield to maturity of 5.58% (+396 basis points over the nearest maturity). This represents a widening of 98 basis points compared with the note yield on Oct. 26, right before news broke that merger talks had hit an obstacle. For further comparison, Sprint's 2025 notes are still 14 basis points tighter from the indicated yield March 31, which we believe was before merger speculation emerged. CenturyLink Inc's (BB-, negative) 5.63% notes due 2025 are indicated at a yield to maturity of 6.80% (+459 basis points), 38 basis points wider from March 31. Dish Network's (B+, stable) 7.75% notes due 2026 are indicated at a yield of 6.27% to maturity (+405 basis points), 75 basis points wider since March 31.

Oracle Announces Multitranche Issue of Senior Notes

Market Data

Oracle Corp. (AA-, Stable) has announced a new issue of senior notes. According to a preliminary prospectus filed on Nov. 7, the proposed notes will include 5-, 7-, 10-, 20-, and 30-year maturities, all with fixed coupons. The company was not specific about the use of proceeds, though we expect a portion of the proceeds to be applied to upcoming debt maturities. At the end of its August fiscal first quarter, Oracle reported $4.8 billion of senior notes due over the next 12 months. Oracle was featured as a likely debt issuer in Morningstar's Potential New Issue Supply report, published Oct. 20.

As references for the proposed notes, we look to higher-rated technology peer Cisco Systems Inc (AA, stable), same-rated Apple Inc. (AA-, stable) and lower-rated International Business Machines Corp (A+, negative) as key comparable issuers for Oracle. The following market pricing data is sourced from pricing service Interactive Data as of Nov. 6.

In the 10-year area, comparable issues were indicated:
Oracle 2.65% notes due 2026 at +66 basis points.
Cisco Systems 2.95% notes due 2026 at +58 basis points.
Apple 3.00% notes due 2027 issued Nov. 6 at +72 basis points.
IBM 3.30% notes due 2027 at +71 basis points.

MCR Credit Risk Assessment

Oracle remains in solid financial health, but debt-funded acquisitions in 2016 put pressure on its Cash Flow Cushion. Debt peaked at $58 billion in May 2017, but moderated in the company's August quarter to $53 billion as the company repaid $4.8 billion of notes. Total debt ended the quarter at 3.3 times trailing 12-month EBITDA, a slight improvement from 3.5 times a year ago. Meanwhile, cash and short-term investments was $67 billion at Aug. 31, down $1.5 billion over the past 12 months, contracting net cash (in excess of total debt) to 0.85 times EBITDA from 0.90 times a year ago.

Over the last four quarters, Oracle reported free cash flow up 0.7%, year-over-year, to $12.6 billion. The company spent $10 billion on acquisitions during the period, while total shareholder payout of dividends and share repurchases declined to just 18% of free cash flow. This was considerably lower than an average payout of 86% a year ago to compensate for higher acquisition expenditures.

Our AA- rating reflects Oracle's strong market share, cash flow generation, and financial flexibility, which supports solid Business Risk and Solvency Scores. Its Cash Flow Cushion remains under pressure from higher debt levels, though our outlook is stable. Oracle's Business Risk remains on par with Cisco but scores better than Apple and IBM. Cash Flow Cushion is moderate and in line with Cisco, stronger than IBM, but weaker than Apple. Finally, Oracle's Solvency is in line with Cisco and Apple and stronger than IBM. Oracle's total debt is the highest among its comparables at 3.3 times EBITDA, but continues to carry more cash than debt. We view higher debt as offset by its more robust internal cash flow generation. Oracle's free cash flow over the past 12 months was 33% of revenues compared with 27% for Cisco, 22% for Apple and only 15% for IBM.

Our Business Risk Score for Oracle reflects Morningstar's Equity Research Group's wide economic moat, which is derived from the company's dominant market share in enterprise database as well as strong middleware and industry-vertical product solutions. These attributes influence high switching costs for customers and encourage long-term relationships from which Oracle is able to generate a stable stream of high-margin license and support revenue. We expect demand for its high-margin, on-premise data products to continue to decline over time in favor of cloud-based solutions. Over the most recent 12 months, cloud product revenue growth of 59% was eclipsed by a 1.4% decline in legacy on-premise software, which still represents nearly two-thirds of total revenue. As a result, total revenue still declined by 7% year-over-year.

Our rating is based on our forecast for revenue growth of 5%-6% over the next five years, with a moderate decline in gross and operating margins. Our revenue forecast is based on an expectation that demand for on-premise data products will continue its secular decline, which should improve growth over time as the revenue mix shifts to the high-growth cloud products. Oracle's capital spending has increased in recent years as the company ramped its investment in cloud products to compete with emerging competitors. In the context of these assumptions, we expect average free cash flow of around $12 billion per year over the forecast period.

Tenet's Leverage Remained Elevated in 3Q After USPI Investment and Weak Operating Results

MCR Credit Risk Assessment

On Nov. 7, Tenet Healthcare Corp (B-, stable) reported an operating loss in the third quarter and trimmed its guidance for the rest of 2017 related to a challenging operating environment. From a credit perspective, Tenet operates with elevated leverage, and we do not expect that to change in the near term, especially given the company's plan to continue purchasing ambulatory service assets. Therefore, our B- rating and stable outlook remain unchanged.

During the quarter, Tenet produced weak operating results that were hampered by the impact of the Texas and Florida hurricanes along with Medicaid-related changes in those states as well. In the quarter, the firm generated net revenue of $4.6 billion, or on the low-end of management's projected range of $4.6 billion-$4.8 billion previously, and adjusted EBITDA of $507 million, or the low end of its previous projection of $500 million to $550 million. By segment, the firm's hospital and other segment ($3.9 billion of net revenue) was the source of much of this weakness with net revenue declining 4.6%

excluding discontinued health plan operations. This decline reflected a 2.3% decline in patient revenue on a same-hospital basis primarily on weaker admissions (including the hurricane impact), the lack of recognized revenue from the California Provider Fee Program, and the recent divestiture of its Houston-area hospitals and assets. This segment's adjusted EBITDA fell 22% in the quarter to $269 million. Also of note, uncompensated care trends continued to weaken with the ratio of bad debt expense to revenue before bad debt rising to 7.2% in the quarter from 7.0% in the prior year period. Also, total uncompensated care costs (bad debt, charity care write-offs, and uninsured discounts) rose to 22.9% of net revenue before bad debt in the quarter from 21.4% in the year-ago period. Tenet's other major segments fared better. The Ambulatory segment's net revenue grew 4.5% to $468 million in the quarter while its adjusted EBITDA grew 1.3% year over year to $159 million. The Conifer segment's net revenue grew 0.8% to $401 million, and its adjusted EBITDA was flat year over year at $79 million.

With this financial release, Tenet's management also cut its outlook for 2017. The company now expects net revenue of $18.9 billion-$19.1 billion in 2017, down from $19.1 billion-$19.4 billion as of last quarter's call and down from $19.7 billion-$20.1 billion originally. Also, it cut the adjusted EBITDA outlook for 2017 to $2.375 billion-$2.425 billion, down from $2.45 billion-$2.55 billion as of last quarter and down from $2.53 billion-$2.63 billion originally. The company also cut its 2017 adjusted free cash flow guidance to $450 million-$650 million, down from $525 million-$725 million as of last quarter and down from $600 million-$800 million originally. Overall, these trends look weak, and management is undergoing restructuring efforts to cut costs from its operations and boost its profit prospects in future years. Specifically, the company is shooting for $150 million of annualized cost reductions by the end of 2018 through the recent elimination of 1,300 positions (primarily in hospital regional management and corporate functions) and through the renegotiation of contracts with suppliers.

Given Tenet's challenged prospects, we do not expect much improvement of the firm's financial health in the near term, especially since Tenet is pursuing an accelerated purchase of its USPI joint venture that should keep its leverage elevated for the near future. Tenet now owns 80% of the joint venture, up from 56% in June, and plans to increase that ownership interest to 95% by July 2019. Outflows related to these investments are expected to total roughly $275 million-$325 million in both 2018 and 2019. Because of these activities, we expect net leverage, currently around 6.5 times by our estimates, to remain elevated during the next couple of years. For comparison, HCA Healthcare Inc (BB, stable) operated with net leverage around 4 times by our estimates as of September. Tenet management has previously stated that it aims to reduce leverage to below 5 times by 2019 through debt reduction and EBITDA growth. Given that deleveraging plan, our outlook for Tenet's B- rating remains stable, despite its currently elevated leverage position.

Market Data

In our coverage universe, Tenet is rated much lower than its key hospital peer HCA. Therefore, we also include other healthcare companies in the broad B category as key credit comparables, specifically Endo International PLC (B, negative) and Valeant Pharmaceuticals International Inc (B-, negative). Recent bond data from all of these firms is sourced from Interactive Data as follows:

Tenet's 5.13% notes due in 2025 at 96.25, yield to maturity of 5.75%, and spread to maturity of +355 basis points.
HCA's 5.88% notes due 2026 at 104.00, yield to worst (2025 call date) of 5.24%, and spread to worst of +303 basis points.
Endo's 6.00% notes due in 2025 at 76.00, yield to maturity of 10.87%, and spread to worst of +869 basis points.
Valeant's 6.13% notes due in 2025 at 84.00, yield to maturity of 9.43%, and spread to maturity of +723 basis points.

Kellogg Issuing New 10-Year Senior Notes to Refinance Commercial Paper

Market Data

Kellogg Company (BBB, stable) is reportedly in the market with an issuance of new 10-year senior notes. Proceeds from the notes are expected to be used for general corporate purposes including repaying commercial paper. As of Sept. 30, Kellogg had $486 million of commercial paper borrowings. It also issued an additional $610 million of commercial paper to finance the pending acquisition of RXBar. We compare Kellogg with General Mills Inc. (BBB+, stable) and Campbell Soup Company (A-, stable). Bonds from these issuers recently traded over the nearest Treasury as follows, according to Interactive Data:

Kellogg's 3.25% notes due 2026 at +95 basis points.
General Mill's 3.2% notes due 2027 at +85 basis points.
Campbell's 3.3% notes due 2025 at +89 basis points.

MCR Credit Risk Assessment

Our BBB rating on Kellogg's reflects its leadership in the highly profitable ready-to-eat cereal category and its competitive position in snack foods. Kellogg has a narrow economic moat rating as assigned by Morningstar's Equity Research Group, reflecting the strength of its brands and the efficient scale that results from its global distribution network, but despite meaningful returns on invested capital, the company is challenged to obtain pricing sufficient to offset inflation and meaningfully increase the top line. Furthermore, the cereal category continues to shrink as consumption of yogurt, cereal bars, and breakfast sandwiches grows. Diversification efforts in snack foods have been successful, but we believe Kellogg's product mix is slightly overindexed to breakfast consumption. These issues are balanced by our expectations that efficiency improvements and investments in marketing and product innovation will benefit Kellogg over our forecast period.

Our rating outlook for Kellogg is stable, reflecting its ongoing competitive position, successful cost-saving measures and restructuring efforts. Operating margin is expected to continue to improve and was up 280 basis points to 17.6% for the quarter ended Sept. 30. Morningstar anticipates that the discontinuance of the company's direct store delivery system in the United States will free up capital to reinvest in the business. Kellogg had total debt of $8.2 billion and cash of $267 million at Sept. 30. Debt/adjusted EBITDA is high for the rating category at approximately 3.8 times but is expected to decline over the forecast period. In addition to higher leverage, Kellogg exhibits a slightly weaker Business Risk score that its comparables. General Mills is larger and more diversified than Kellogg, and its debt/adjusted EBITDA for the latest 12 months ended Aug. 27 was 3.4 times and its interest coverage ratio was in the low double digits, in line with the rating category. Campbell, which is smaller than both firms, maintains market leadership in the U.S. soup market and had debt/adjusted EBITDA of approximately 2.7 times for the fiscal year ended July 30.

Specialty Generics Business Damps Mallinckrodt's Operating Results in 3Q; Total Debt Eases

MCR Credit Risk Assessment

On Nov. 7, Mallinckrodt PLC (BB-, stable) experienced sustained pressure on its specialty generic drug business and falling volume of its best-selling medicine Acthar Gel, which contributed to a decline in overall sales of 10.5% in the third quarter. As the firm builds capability as a specialty medicine developer through internal and external means that have fueled leverage spikes, we will keep a close eye on its debt levels and leverage. We see the firm having some leeway to advance its late-stage research pipeline after a refinancing of term loans in the first quarter that pushed out significant debt maturities into 2024 and informs our stable outlook.

In the third quarter, both of Mallinckrodt's operating segments reported revenue declines with specialty brands decreasing 6.6% and specialty generics freefalling 21.1%. Each of the firm's best-selling specialty medicines, Acthar Gel (19 different disease states), Inomax (respiratory failure), and Ofirmev (acute pain), saw sales declines of 5.6%, 0.9%, and 0.3%, respectively, and together represented 64% of total sales in the quarter. Sales of Acthar Gel were damped by greater-than-expected prescriptions left unfilled by patients that depressed volumes at the end of the third quarter and helped keep overall revenue ($794 million) below consensus of $807 million. The firm is actively addressing the concern but sees sales hurt by this issue into the fourth quarter. Mallinckrodt is actively building research expertise in core therapeutic areas, including establishing evidence of clinical efficacy via post-marketing studies to bolster growth prospects for its best-seller Acthar Gel representing 39% of total sales alone. Given concentration of Mallinckrodt's late-stage research pipeline on line extensions for marketed drugs that usually have only modest market potential, we expect the firm may accelerate business development over the next few years to expand its specialty drug business to offset a potential Ofirmev patent loss in 2020. These activities include the recent announcement of the purchase of Ocera Therapeutics ($42 million upfront payment), licensing of NeuroproteXeon's investigational xenon gas for inhalation therapy ($10 million upfront) in October, and the completion of the acquisition of InfaCare ($80 million upfront) in September.

As Mallinckrodt executes upon its business strategy of diversifying its commercial portfolio and building strength as an internal drug developer, we keep a cautious eye on the firm's debt leverage. In the third quarter, total debt was $5.84 billion on Sept. 30 (down from $6.15 billion at the end of 2016) or total debt leverage of 4.3 times EBITDA for the trailing 12 months. With $372 million of cash on hand, net debt leverage stood at 4.0 times. After Mallinckrodt extended a debt maturity wall ($1.9 billion) into 2024 earlier this year, we see the firm having little trouble managing a well-laddered long-term debt maturity schedule over the next five years, consisting of $300 million in notes due in 2018 and $700 million of notes due in 2020. The firm has sufficient liquidity to address the maturing debt via steady free cash flow generation, which we expect to average around $900 million annually over the next five years, and its $900 million five-year revolving credit agreement maturing in February 2022. Despite its focus on business development, Mallinckrodt actively repurchases its shares and bought back around $57 million in the third quarter, bringing the total to $438 million for 2017. This amount of repurchases more than consumed free cash flow of $297 million (operating cash flow of $449 million less capital spending of $151 million) generated year to date in 2017. Considering the firm's intentions to bolster its product offering and research pipeline with external assets while graciously rewarding shareholders via share buybacks, we think that any improvement to leverage will likely stem from operational strength rather than a significantly lower debt load. Therefore, we continue to have a stable view of Mallinckrodt's credit profile.

Market Data
We compare Mallinckrodt's bonds with high-yield specialty pharmaceutical peers Endo International PLC (B, negative) and Valeant Pharmaceuticals International Inc. (B-, negative). Mallinckrodt's bonds due 2025 recently traded much tighter than its key peers, including a spread at around 350 basis points tighter than Endo's bonds and 210 basis points tighter than Valeant's bonds. All bond data is sourced from Interactive Data, which can be seen as follows:

Mallinckrodt's 5.50% notes due in 2025 traded at 89.55, yield to maturity of 7.35% and spread to maturity of +515 basis points.
Endo's 6.00% notes due in 2025 traded at 76.00, yield to maturity of 10.87% and spread to maturity of +869 basis points.
Valeant's 6.13% notes due in 2025 traded at 82.63, yield to maturity of 9.43% and spread to maturity of +723 basis points.

Valeant Adjusts Sales Outlook for Divestments; Total Debt Reduced by $2.4 Billion in 2017
MCR Credit Risk Assessment
On Nov. 7, Valeant (B-, negative) reduced it revenue guidance for the year slightly to account for recent and pending divestitures, as the firm repairs its organization from a prior roll-up strategy. We positively view these asset sales as a means to reduce the firm's heavy debt burden that remains after a series of leveraging acquisitions in 2010-15. Our negative outlook reflects our view that the firm may have difficulty rapidly decreasing elevated debt leverage over the next few years.

Valeant's total sales fell 10.5% on a reported basis in the third quarter, consisting of a 0.8% rise in revenue generated by the Bausch & Lomb/international segment that was more than offset by a 17.4% decline in sales from the Branded Rx division and a 29.4% freefall in the U.S. diversified products business. Incorporating continued pressure on the dermatology business and recent divestitures (Dendreon, iNova, its skin-care brands, and the pending sales of Obagi by year's end), the firm slightly lowered its outlook for sales in 2017 to $8.65 billion-$8.80 billion from $8.7 billion-$8.9 billion on its second-quarter teleconference (and from $8.9 billion-$9.1 billion originally). However, Valeant maintained its expectation for adjusted EBITDA in the range of $3.60 billion to $3.75 billion despite these asset sales. We still think Valeant can achieve revenue growth in the low single digits compounded annually through 2021 given its corporate portfolio, including attractive businesses Bausch & Lomb (ophthalmology) and Salix (gastrointestinal medicines). With an eye on bulking up its internal research program and supporting product introductions, including the newly launched Siliq (psoriasis) and potentially IDP-118 (psoriasis) with a U.S. Food and Drug Administration action date of June 18, 2018, we see these added operating costs holding EBITDA generation relatively flat over the next five years.

Since Valeant made its initial statement in August 2016 to reduce debt by $5 billion over the course of 18 months from that time (or February 2018), the firm reduced its total debt load by $3.39 billion, composed of $969 million repaid in the second half of 2016 and $2.42 billion in the first nine months of 2017. Into the fourth quarter, the firm further decreased its debt burden with repayment of $1.05 billion in secured term loans using proceeds from the iNova divestment and cash flows, and refinanced $1 billion of senior notes due in 2020 with secured, private-placement bonds. Considering the added term loan reduction, total debt reduction to the present totals $4.44 billion, nearing Valeant's $5 billion target. Valeant feels that it has already satisfied its debt reduction goal, including debt repayment of $847 million that occurred in the second quarter of 2016, prior to setting its target. The firm's total debt balance stood at $27.43 billion on Sept. 30, 2017, or gross debt leverage (total debt/adjusted EBITDA) of 7.2 times for the trailing 12 months. With Valeant's growing cash and investments of $1.97 billion, net debt leverage was 6.7 times.

While our negative outlook reflects that the firm may have trouble reducing total leverage, we are much less skeptical that Valeant can achieve its original debt-reduction goal. Specifically, we expect the firm to generate $1.3 billion of annual free cash flow on average over the next five years, which could be used to repay debt. Also, incremental proceeds from other assets slated for divestment in the near term—Obagi Medical Products and Sprout Pharmaceuticals—could help Valeant reduce its debt obligations. The firm has plenty of breathing room to repair its businesses given that it has satisfied all of its mandatory term loan amortization and has no significant debt maturities through 2020. In addition, the company no longer is restricted by a maximum secured leverage covenant in its amended term loan agreement, but is bound to maintaining this leverage at or below 3.00 times in its revolving credit facility. Secured leverage stood at 2.5 times for the latest 12 months at the end of the third quarter, by our estimation. The firm also has leeway under a minimum interest coverage covenant of 1.50 times in its revolver given the measure stood at 2.1 times for the trailing 12 months ending Sept. 30, 2017.

Market Data

We compare Valeant's bonds to key peers that are also rated in the general B category in the healthcare industry, which includes specialty pharmaceutical firm Endo International PLC (B, negative) and healthcare provider Tenet Healthcare Corp (B-, stable). In the approximate 10-year maturity bucket, Valeant's bonds are recently trading tighter than Endo's bonds by around 145 basis points and wider than those at Tenet by roughly 370 basis points. All bond data is sourced from Interactive Data, which can be seen as follows:

Valeant's 6.13% notes due in 2025 traded at 82.63, yield to maturity of 9.43% and spread to maturity of +723 basis points.
Endo's 6.00% notes due in 2025 traded at 76.00, yield to maturity of 10.87% and spread to maturity of +869 basis points.
Tenet's 5.13% notes due in 2025 at 96.25, yield to maturity of 5.75%, and spread to maturity of +355 basis points.

DaVita's DMG Segment Continues to Struggle; Share-Repurchase Authorization Increased

MCR Credit Risk Assessment

On Nov. 7, DaVita Inc (BB+, negative) released third-quarter operating results well below consensus estimates on continued weakness in its DaVita Medical Group, or DMG, segment that solid kidney care results could not overcome. The company's leverage remained stagnant during the quarter, albeit near the top end of its long-term target range of 3.0-3.5 times on a net basis. With the firm's weak fundamental trends and new share-repurchase authorization, we would not be surprised to see its leverage remain elevated or even rise above the high end of its target range. This elevated leverage could negatively influence multiple rating pillars (Cash Flow Cushion, Solvency Score, or Distance to Default) enough to cause a downgrade in the near future, which is reflected in our negative outlook.

DaVita's third-quarter results met top-line expectations ($3.9 billion) but significantly underperformed expectations on the bottom line ($0.81 of adjusted earnings per share versus consensus of $0.94) because of weak results in its DMG segment, which are highlighted below. DaVita now expects $1.620 billion-$1.685 billion of adjusted operating income in 2017, down from $1.675 billion-$1.775 billion previously. Notably, DaVita's team made no changes to its operating cash flow guidance of $1.75 billion-$1.95 billion for 2017, down from $1.96 billion in 2016. So far through September, DaVita has generated $1.56 billion of operating cash flow, so we think its 2017 cash flow guidance remains achievable.

The third quarter's results represented a tale of two segments, with the kidney care segment roughly meeting expectations and the DMG segment disappointing. Within the kidney care segment, net revenue grew 2% to $2.8 billion, while adjusted operating profits grew nearly 1% year over year to $404 million. With these solid results, management narrowed the range on its 2017 guidance for the segment's adjusted operating income to $1.570 billion-$1.600 billion from $1.565 billion-$1.625 billion previously. On the other hand, the DMG segment reported disappointing results during the quarter. Specifically, the DMG segment's net revenue declined nearly 2% year over year to $1.2 billion, while the segment reported an operating loss of $588 million on a reported basis, including $601 million in goodwill impairment charges, and a $5 million loss on an adjusted basis. Given these results, management reduced its 2017 adjusted operating income guidance for the segment to $50 million-$85 million from $110 million-$150 million previously. Specifically, management pointed to about $30 million of higher medical costs in the quarter related to patient acuity and a delay in a Medicare-related payment ($13 million in the third quarter of 2016) as the major causes for its cut in guidance. However, management expects this segment's adjusted operating profit to rise in 2018. Specifically, it aims to generate $40 million in annual cost savings through a recent restructuring that cut 350 positions in this segment, to recognize about $30 million in revenue related to the higher medical usage assumptions for its 2018 insurance contracts, and to generate some benefit from new risk assumptions in some of its Medicare Advantage contracts. Management also reiterated its goal of reaching over $200 million in adjusted operating income in this segment in 2019. However, all options appear on the table for the DMG segment, with management highlighting on the call that it was open to strategic alternatives from a full sale of the segment to an equity vehicle for local providers in specific geographies.

Even with the disappointing results from the DMG segment, the company's financial health did not change significantly during the quarter. As of September, its net leverage stood at 3.4 times by our estimates, or in line with its June net leverage. While near the top end of its 3.0-3.5 times target range, we would not be surprised if leverage were to rise further, given the recent increase in its share-repurchase authorization. As of November, the firm was authorized to repurchase $1.2 billion in shares, up from $328 million at the end of September. With the third quarter's disappointing results for shareholders, we think outflows may rise, which could push up net leverage. DaVita already stands at the weak end of its BB+ rating, in our opinion, so the ongoing elevation of net leverage may be enough for us to downgrade in the near future, which is reflected in our negative outlook.

Market Data
In the healthcare services sector, we compare DaVita's bonds with bonds from HCA Healthcare Inc (BB, stable). DaVita's bonds recently traded in line with HCA's bonds. All of the following bond data was sourced from Interactive Data.

DaVita's 5.00% notes due 2025 at 98.50, a yield to maturity of 5.24%, and a spread to maturity of +305 basis points.
HCA's 5.88% notes due 2026 at 104.00, a yield to worst (2025 call date) of 5.24%, and a spread to worst of +303 basis points.

Johnson & Johnson Issuing Multitranche Debt for Commercial Paper Repayment
Market Data
Johnson & Johnson (AAA, negative) is in the market with a proposed bond offering that includes 3-, 7-, 10-, 20-, and 30-year fixed-coupon maturities. According to a preliminary prospectus filed Nov. 8, net proceeds will be used for general corporate purposes, including repayment of outstanding commercial paper. As of Oct. 1, J&J had outstanding commercial paper of approximately $6.7 billion.

For closest comparisons with J&J's notes, we look to lower-rated Eli Lilly and Co (AA, stable) and Merck & Co Inc (AA, stable). All of the following bond data is sourced from Interactive Data.

In the approximate 3-year maturity bucket, bonds from these issuers recently traded over the nearest Treasury as follows:
J&J's 1.65% notes due 2021 at +19 basis points.
Eli Lilly's 1.95% notes due 2019 at +16 basis points.
Merck's 1.85% notes due 2020 at +28 basis points.

In the approximate 7-year maturity bucket, bonds from these issuers recently traded over the nearest Treasury as follows:
J&J's 3.38% notes due 2023 at +18 basis points.
Eli Lilly's 2.75% notes due 2025 at +53 basis points.
Merck's 2.80% notes due 2023 at +37 basis points.

In the approximate 10-year maturity bucket, bonds from these issuers recently traded over the nearest Treasury as follows:
J&J's 2.95% notes due 2027 at +48 basis points.
Eli Lilly's 3.10% notes due 2027 at +65 basis points.
Merck's 2.75% notes due 2025 at +55 basis points.

For comparison to the approximate 10-year maturities, the Morningstar Corporate Bond Index is at +55 basis points in the AAA category and +62 basis points in the AA category.

In the approximate 30-year maturity bucket, bonds from these issuers recently traded over the nearest Treasury as follows:
J&J's 3.75% notes due 2047 at +68 basis points.
Eli Lilly's 3.95% notes due 2047 at +77 basis points.
Merck's 3.7% notes due 2045 at +85 basis points.

MCR Credit Risk Assessment

J&J's AAA credit rating reflects its diversified position across the entire healthcare space that provides exceptional financial flexibility. Our expectation that this flexibility may be compromised over the next few years from aggressive capital deployment while J&J battles key drug patent expirations through 2019 informs our negative outlook. Diverse operations that span pharmaceuticals, medical devices, and over-the-counter medicines (representing roughly 46%, 36%, and 18% of total sales, respectively) buffer J&J from weakness in a particular segment at any given time. Diversification is an important cog in our top-tier Business Risk pillar and gives us confidence that the firm can withstand losses of market exclusivity for multiple blockbuster drugs—Velcade, Invega Sustenna, Zytiga, and Prezista—over the next few years that currently represent around 10% of total revenue. A highly productive drug research program that hopes to launch 10 novel medicines, weighted toward new cancer treatments, over the next five years may help offset the expected patent losses, leading to growth in the low single digits through 2021 compounded annually. J&J's earnings growth prospects fall at the low end of the large pharmaceutical industry, with EBITDA expected to rise in the low single digits through 2021 compounded annually, in our estimation.

J&J maintains a strong balance sheet even after it tapped into its large cash holdings to purchase Actelion in June. As a result, the firm lost its net cash position, and at the end of the third quarter, its debt load stood at $35.17 billion compared with cash and short-term investments of $16.23 billion, leading to net debt leverage of 0.7 times for the trailing 12 months, by our estimates. Nonetheless, we applaud J&J's use of tax-advantaged foreign cash to consummate this transaction, which held gross leverage relatively steady at 1.4 times for the trailing 12 months ending Sept. 30 compared with 1.1 times in 2016. With free cash flow expected to average around $19 billion annually over the next five years, we see the firm easily managing well-laddered debt maturities over the next five years. Capital deployment is traditionally balanced between mergers and acquisitions and returning substantial value to shareholders through dividends and share repurchases. While we see reduced financial flexibility over the next few years as the firm rebuilds its cash balance after the Actelion purchase, we would need to see larger debt-funded repurchases or acquisitions to make a cut in J&J's very strong credit rating.

Hologic's Cynosure Division Continues to Stumble in Fiscal 4Q; Net Leverage Remains in Mid-2s

MCR Credit Risk Assessment

On Nov. 8, Hologic Inc (BB+, positive) reported fiscal fourth-quarter results that exceeded consensus expectations on the top and bottom lines. However, management's sales outlook for 2018 fell below consensus, primarily because of weakness in the recently acquired Cynosure business. Positively from a credit perspective, the firm's pro forma net leverage stayed within shouting distance of its long-term target of 2.5 times, so we think Hologic remains strongly positioned within the BB+ rating.

In the quarter, Hologic generated $803 million in revenue (slightly above consensus of $793 million), or 10% growth in constant currency and 4% growth excluding the effects of recent portfolio changes, representing a sequential uptick from 3% organic growth in constant currency last quarter. The firm turned in adjusted earnings per share of $0.50, a slight decline year over year but still above consensus of $0.49. Highlights from the quarter included the molecular diagnostics division growing 14% in constant currency year over year, driven by strength in its Aptima virology products primarily on the Panther systems. While breast health only ticked up slightly on a sequential basis to 2% constant-currency growth in the quarter, two new mammography system launches (the first since 2011) should help accelerate growth in future periods. We were also pleased to see positive trends continue in Hologic's international division, which organically grew nearly 18% in constant currency versus 11% last quarter and only 1% growth from the United States during the fourth quarter.

Management cited the international division's growth acceleration in recent quarters as proof that it knows how to turn around businesses, which will be required in the recently acquired Cynosure business. During the quarter, this business only generated $82 million in sales, down from $110 million in the third quarter and down significantly from the run rate of over $430 million in annualized sales when Hologic acquired Cynosure in early calendar 2017. Hologic's management team declared a bottom of results in the fourth quarter, as new leadership in that business continues to fill out its salesforce and new products and indications look set to boost growth in the next few quarters. In general, though, the trends in the Cynosure business have been very disappointing in the early months of this acquisition. With this business as a key drag, management provided initial guidance for fiscal 2018 that skewed lower than consensus. Management expects 4%-7% constant-currency growth to $3.2 billion-$3.3 billion in revenue (versus consensus of $3.3 billion) and 3%-6% growth to earnings per share of $2.10-$2.15 (versus consensus of $2.15).

From a credit perspective, Hologic's leverage remained close to its 2.5 times long-term target with management citing 2.7 times net leverage as of September. The team has previously commented that it feels comfortable operating with net leverage in the mid-2s. Therefore, we continue to think the company operates on the strong end of its BB+ rating.

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 recently traded at 101.88, a yield to worst (2022 call date) of 3.95%, and a spread to maturity of +195 basis points.
Fresenius' 4.75% notes due 2024 recently traded at 108.56, a yield to maturity of 3.31%, and a spread to maturity of +114 basis points.
DaVita's 5.00% notes due 2025 recently traded at 97.25, a yield to maturity of 5.37%, and a spread to maturity of +315 basis points.

United Parcel Service Issuing New Notes to Retire Debt and Make Pension Contributions
Market Data
United Parcel Service Inc (A+, stable) is in the market issuing a multitranche deal with a mix of floating- and fixed-rate notes. According to the preliminary prospectus filed Nov. 9, the company will use the funds to make early contributions to its primary domestic pension plan, repay its $750 million January 2018 maturity, and retire its $375 million outstanding commercial paper balance.

According to pricing service Interactive Data, bonds with similar maturities to the UPS 10-year new offering and key comparables are indicated over the nearest Treasury as follows:

The UPS 2.40% notes due in 2026 are indicated at +53 basis points.
The Canadian National Railway Co (A, stable) 2.75% notes due in 2026 are indicated at +56 basis points.
The Union Pacific Corp (A, stable) 3.0% notes due in 2027 are indicated at +59 basis points.

MCR Credit Risk Assessment
We compare UPS with rails Canadian National and Union Pacific because of their similar credit ratings and difficult-to-replicate networks. Moreover, rent-adjusted leverage of 2.2 times is comparable across the rails, although UPS benefits from a slightly better Solvency Score.

Our A+ credit rating for United Parcel Service blends the company's strong competitive advantages with the high leverage attributed to its large unfunded pension liabilities and operating leases on facilities and aircraft. UPS has developed a massive, integrated global shipping network with breadth that is almost impossible to replicate, helping the firm garner a wide economic moat rating, as assigned by Morningstar's Equity Research Group, which supports its Business Risk pillar. UPS has monetized this competitive advantage into high returns on invested capital and solid interest coverage ratios that bolster its Solvency Score. Reported leverage is reasonable, with gross leverage of 1.8 times as of Sept. 30. However, UPS' substantial operating leases and unfunded pension liabilities increase adjusted debt/EBITDAR closer to 3.0 times, which constrains our rating.

UPS reported mixed results last month. High-single-digit revenue growth was insufficient to help the company expand EBITDA margins. Yet, a meaningful decline in its quarterly pension contributions, which we think this issuance will fund, helped free cash flow increase $300 million versus last year. This is impressive considering that capital spending swelled by $825 million versus the year-ago period to expand its network capabilities further.

Perrigo Raises Earnings Outlook for 2017 Amid Solid Strategic Execution; Repurchases Accelerate
MCR Credit Risk Assessment
Perrigo Co PLC (BBB-, stable) is successfully working through its transformation strategy to build durable businesses, which led the firm to increase its earnings outlook for 2017 on its third-quarter teleconference on Nov. 9. The firm's commitment to an investment-grade rating, demonstrated by a much-improved balance sheet, affords it some time to execute on its strategy to reinvigorate flagging operational performance and informs our stable outlook.

Perrigo reported decent operating results for the third quarter, with adjusted earnings increasing 13% to $1.39 per share despite reported revenue falling 2.4%. This decline was composed of a 2.0% drop in consumer healthcare America segment sales, a 3.2% revenue decrease from consumer healthcare international, and flat performance from the prescription pharmaceuticals business. In general, new product sales of $55 million, including the launch of a store-brand Nexium in the quarter, helped mitigate price erosion in certain over-the-counter and generic drug medicines. Despite these pressures, the firm held its sales outlook for 2017 at $4.70 billion-$4.85 billion. Given solid operating performance so far this year, Perrigo revised its earnings-adjusted diluted EPS guidance upward to $4.80-$4.95 from $4.45-$4.70 (and $4.15-$4.50 previously). As Perrigo repairs struggling segments and contends with greater-than-historical generic drug pricing pressures, we anticipate revenue to increase in the low single digits and EBITDA in the midsingle digits compounded annually from 2017 to 2021, excluding any contribution from Tysabri (multiple sclerosis) sold in February 2017.

Perrigo sees increased flexibility in its balance sheet after the firm repaid more than $2.2 billion in debt following the divestment of its royalty-bearing stream in Tysabri. At the end of the third quarter, Perrigo owed debt of $3.69 billion and had a cash balance of $776 million, leading to gross debt leverage and net debt leverage of around 3.1 times and 2.4 times, respectively, by our estimates. Despite earnings erosion after the sale of the Tysabri asset that represented nearly one third of total profits, these credit measures improved from gross debt leverage and net debt leverage around 3.6 times and 3.2 times, respectively, at the end of 2016. Furthermore, Perrigo plans to pay down $370 million in maturing debt in December, which should keep leverage relatively steady at the end of 2017. This increased balance sheet strength helps mitigate potential earnings and cash flow volatility as Perrigo increases internal investment and prunes its corporate structure to stimulate operational performance, and informs our stable outlook. We remain cautious, though, on Perrigo's capital deployment going forward, as the firm saw its newfound financial flexibility as a reason for returning to share repurchasing recently. Perrigo repurchased around $133 million of shares during the third quarter, bringing the total over the past two quarters to $191 million, versus none in the first half of the year. In the long run, we would not be surprised to see the firm pursue a transformative acquisition that may once again stress the balance sheet.

Market Data

For closest comparisons to Perrigo's notes, we look to similarly rated companies, Mylan NV (BBB-, negative), and Shire PLC (BBB-, positive). Within this comparable group and adjusted for bond maturities, Perrigo's 10-year bonds trade between the comparables, trading wider than those at Shire and tighter than those at Mylan. Perrigo's 10-year bonds also trade in line with Morningstar Inc.'s Corporate Bond Index at BBB-. All of the following bond data is sourced from Interactive Data.

In the approximate five-year maturity bucket, bonds from these issuers recently traded over the nearest Treasury as follows:
Perrigo's 4.00% notes due 2023 at +121 basis points.
Shire's 2.88% notes due 2023 at +104 basis points.
Mylan's 4.20% notes due 2023 at +124 basis points.

In the approximate 10-year maturity bucket, bonds from these issuers recently traded over the nearest Treasury as follows:
Perrigo's 4.38% notes due 2026 at +158 basis points.
Shire's 3.20% notes due 2026 at +133 basis points.
Mylan's 3.95% notes due 2026 at +175 basis points.

For comparison with the approximate 10-year maturities, the Morningstar Corporate Bond Index is at +132 basis points in the BBB category and at +159 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:
Perrigo's 4.90% notes due 2044 at +188 basis points.
Shire's (Baxalta) 5.25% notes due 2045 at +162 basis points.
Mylan's 5.25% notes due 2046 at +218 basis points.

Endo Expects to Reach High End of EBITDA Range for 2017; Debt Leverage Remains Elevated

MCR Credit Risk Assessment

On Nov. 9, Endo International PLC (B, negative) reported operating results that were in line with the firm's damped revenue and earnings expectations for the year. We expect continued instability of Endo's credit profile as it transforms into a leaner, growth-oriented drug manufacturer. These activities may limit the firm's ability to improve its inflated debt leverage, which is reflected in our negative outlook.

For the third quarter, Endo experienced damped operational performance, with revenue falling 11% and each operating segment facing headwinds that led to sales declines year over year. The U.S. generic pharmaceuticals segment dropped 7% as a strong increase in sterile injectables did not offset a 27% decline of the base business. In addition, the U.S. branded pharmaceuticals segment fell 16%, pressured by the voluntary market withdrawal of the pain treatment Opana ER on Sept. 1. The firm's international pharmaceuticals business decreased 20% in the third quarter thanks to the divestment of Litha (South America operations) in July. Furthermore, the recent divestment of Somar (Mexico) in October will damp fourth-quarter growth of this segment. Despite these headwinds, Endo held its sales guidance for 2017 of $3.38 billion-$3.53 billion for 2017, which was lowered on its second-quarter conference call from $3.45 billion-$3.60 billion. But, the firm believes that it may reach the top end of its outlooks for adjusted EBITDA in the range of $1.48 billion-$1.56 billion (that was also lowered on its prior teleconference from $1.50 billion-$1.58 billion) and adjusted diluted EPS of $3.35-$3.65. We see a rocky path ahead for Endo during its transformation into a leaner, growth-oriented drug manufacturer, with revenue modestly growing in the low single digits compounded annually through 2021. Significant headwinds still exist for the company, as it faces continued pricing and volume pressures on its generic drug segment in the U.S. and has a thin research program to drive growth of the branded pharmaceuticals business, which is mainly focused on increasing utility of Xiaflex for the reduction of cellulite.

Endo's credit profile remains unsettled from a tough U.S. generic drug pricing environment, corporate portfolio restructuring, and ongoing product liability litigation. The combination of these factors along with inflated leverage informs our negative outlook for the firm. The firm remains focused on reducing elevated debt leverage and reiterated its commitment on its third-quarter conference call. For the trailing 12 months at the end of the third quarter, net debt leverage was 4.7 times (total debt of $8.28 billion less unrestricted cash of $739 million), which remains above Endo's target of 3-4 times. Endo sees net leverage in the high 4 times at the end of 2017, but offered no details on the timing of ultimately reaching its leverage goal on its quarterly call. Perrigo will start to make settlement payments in the fourth quarter (through the fourth quarter of 2019) on its mesh product liability, which will constrain cash flows over this time frame. Though, we see Endo having adequate liquidity to service these legal liabilities with its cash balance and near full availability under its $1 billion revolving credit facility maturing in 2022. In addition, the firm expects to generate free cash flow after paying mesh settlements in the range of $165 million-$245 million in 2017 (operating cash flows of $305 million-$385 million less capital spending of $140 million). Endo is favored by limited long-term debt obligations over the next five years solely consisting of scheduled amortization (around $34 million annually) of seven-year term loan facilities established in April 2017 that replaced term loans due in 2019 and 2022. Endo has ample cushion under the lone financial covenant in its secured credit facilities that requires secured leverage at or below 3.50 times that compares with secured leverage around 2.3 times for the latest 12 months at the end of the third quarter.

Market Data

We compare Endo's bonds to key peers that are also rated in the general B category in the healthcare industry, which includes specialty pharmaceutical firm Valeant Pharmaceuticals International Inc. (B-, negative) and healthcare provider Tenet Healthcare Corp (B-, stable). In the approximate 10-year maturity bucket, Endo's bonds are roughly 290 basis points wider than Valeant's bonds and wider than those at Tenet by about 590 basis points. All bond data is sourced from Interactive Data, which can be seen as follows:

Endo's 6.00% notes due in 2025 traded at 72.00, yield to maturity of 11.88%, and spread to maturity of +966 basis points.
Valeant's 6.13% notes due in 2025 traded at 84.63, yield to maturity of 9.01%, and spread to maturity of +679 basis points.
Tenet's 5.13% notes due in 2025 at 94.75, yield to maturity of 6.01%, and spread to maturity of +378 basis points.

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