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2023 Sector Snapshot: US Consumer

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Executive Summary

- **We provide our Consumer sector strategy for 2023, including key themes, picks and pans, and risks for the coming year.**
- **We are maintaining our Market perform recommendation on the IG Autos sector.** This is based on expected resilient Auto OEM profitability stemming from disciplined dealer inventory rebuilding, durable customer demand amidst an expected rise in unemployment, and normalization of captive finance credit metrics.
- **We are maintaining our Market perform recommendation on the HY Autos sector, which contemplates expected continued positive rating momentum for Ford (F), which accounts for 64% of the index, and expected profit growth among Auto Suppliers related to supply chain stabilization, improving OEM production schedules, and moderating raw material costs.**
- **We are downgrading our recommendation on IG Consumer Goods to Market Perform from Outperform.** With sector spreads—apart from Tobacco, which has idiosyncratic event risk—already firmly inside of the index and a risk-off mindset having benefited sector performance in 2H22, we see less of a case for outperformance under our preliminary base case economic outlook for 2023. Under our base case assumption of modest overall index spread tightening amidst a bumpy economic landing, we would expect higher volatility subsectors to see greater demand than the large consumer staples constituents of the Consumer Goods sector, thus driving greater relative spread compression in the overall index vs the subsector. Our downgrade to a M/P rec versus a full-throated U/P rec considers the 50% probability we assign to our preliminary base case economic outlook in order to account for a potentially rockier landing, which could support further demand for safe haven sectors. For the Tobacco sector, we maintain our Underperform recommendation as heightened regulatory risk and the potential for sizable M&A will limit upside in spreads.
- **We are downgrading our recommendation on the HY Consumer Goods to Underperform from Market perform.** Of the top 50% of index issuers by face value, our coverage spans just over 41%, with our lone Outperform rec being Pilgrim's Pride, which in our view deserves the same IG ratings as its parent co, JBS. Otherwise, we think the individual credit considerations of the top issuers will dictate most of the subsector performance. The subsector trades tight to the broader index and we believe any benefit from a soft landing will be credit metric neutral overall, and we see a risk of rising leverage metrics among top issuers such as Post Holdings, Newell Brands, and Lamb Weston.
- **We are maintaining our Market perform recommendation on IG Healthcare. Looming operating headwinds in Pharma, primarily driven by patent expirations, and an upward bias to leverage, largely due to bolt-on M&A potential, informs our negative bias on sector fundamentals. However, technical tailwinds – including the sector's 'safe haven' status and limited new supply – balances these risks.**
- **We are moving to an Outperform recommendation on HY Healthcare (from Market perform).** For HY Hospitals, operating challenges related to volumes and labor costs are largely priced in at this point and should improve through 2023. For HY Pharma, the widespread resolution of the opioid situation should result in relatively less volatility, with the obvious exception of Bausch Health, which is in the midst of the B+L separation.
- **We are downgrading our recommendation on IG Leisure to Market perform (from Outperform).** While IG Leisure is the widest sector in the IG index, this reflects the significant influence from Sands China bonds (~25%

of the index), which trades well wide to the US IG BBB Index (and wide to HY BB index, as well) with meaningful fallen angel risk. When excluding Sands China, we expect the IG Leisure sector to largely perform in line with the IG Index as the sector shifts out of its deleveraging cycle.

- **We are maintaining our Outperform recommendation on the HY Leisure sector.** We expect 2023 performance to be driven by the cruise recovery as well as continued strength from certain hotel and gaming names (i.e. Hilton and Caesars).
- **We are maintaining our Underperform recommendation on IG Retail, given the sector's relatively tight spreads versus the broader index, despite an average duration nearly a year longer than the index. Changing tides of consumer demand have seen (most) retailer's 2021 margin strength begin to erode amid over-supply of inventory and a return to margin-damaging discounting/promo.**
- **We are maintaining our Market Perform recommendation on HY Retail, reflective of a mix of opportunities in better performing names and pitfalls from overlevered names that will have to carry out turnaround efforts in a softening operating environment with unforgiving capital markets.** The HY Retail index trades ~130bp wide to the overall HY index, at relatively similar duration (4.4 vs 4.0 years).

Relative Value

US IG and HY vs. Autos

	OAS			YTW			$ Price				YTD Returns	
	Current	YE 2021	Change	Current	YE 2021	Change	Current	YE 2021	Change	Duration	Excess	Total
US IG	142 bp	98 bp	44 bp	5.4%	2.4%	306 bp	$89.58	$109.14	-$19.57	6.9 yrs	-1.8%	-15.3%
IG Autos	**131 bp**	**74 bp**	**57 bp**	**5.4%**	**1.8%**	**358 bp**	**$92.03**	**$105.21**	**-$13.18**	**4.1 yrs**	**-1.3%**	**-9.3%**
Difference	-11 bp	-24 bp	13 bp	-3 bp	-54 bp	52 bp	$2.46	-$3.93	$6.38	-2.9 yrs	50 bp	593 bp
US HY	455 bp	310 bp	145 bp	8.6%	4.3%	430 bp	$87.02	$103.31	-$16.29	4.1 yrs	-2.6%	-10.5%
HY Autos	**327 bp**	**219 bp**	**108 bp**	**7.3%**	**3.3%**	**401 bp**	**$89.84**	**$106.55**	**-$16.71**	**4.3 yrs**	**-1.7%**	**-9.8%**
Difference	-128 bp	-91 bp	-37 bp	-132 bp	-103 bp	-29 bp	$2.82	$3.24	-$0.42	0.3 yrs	90 bp	73 bp

Source: CreditSights, FactSet, ICE Data Indices, LLC

US IG and HY vs. Consumer Goods

	OAS			YTW			$ Price				YTD Returns	
	Current	YE 2021	Change	Current	YE 2021	Change	Current	YE 2021	Change	Duration	Excess	Total
US IG	142 bp	98 bp	44 bp	5.4%	2.4%	306 bp	$89.58	$109.14	-$19.57	6.9 yrs	-1.8%	-15.3%
IG Consumer Goods	**125 bp**	**96 bp**	**29 bp**	**5.2%**	**2.4%**	**279 bp**	**$90.13**	**$110.05**	**-$19.92**	**7.7 yrs**	**-0.7%**	**-15.3%**
Difference	-17 bp	-2 bp	-15 bp	-22 bp	5 bp	-27 bp	$0.55	$0.91	-$0.35	0.8 yrs	110 bp	-5 bp
US HY	455 bp	310 bp	145 bp	8.6%	4.3%	430 bp	$87.02	$103.31	-$16.29	4.1 yrs	-2.6%	-10.5%
HY Consumer Goods	**405 bp**	**250 bp**	**155 bp**	**8.1%**	**3.9%**	**425 bp**	**$87.65**	**$107.48**	**-$19.83**	**4.3 yrs**	**-2.4%**	**-11.7%**
Difference	-50 bp	-60 bp	10 bp	-49 bp	-44 bp	-5 bp	$0.64	$4.17	-$3.53	0.3 yrs	18 bp	-113 bp

Source: CreditSights, FactSet, ICE Data Indices, LLC

US IG and HY vs. Healthcare

	OAS			YTW			$ Price				YTD Returns	
	Current	YE 2021	Change	Current	YE 2021	Change	Current	YE 2021	Change	Duration	Excess	Total
US IG	142 bp	98 bp	44 bp	5.4%	2.4%	306 bp	$89.58	$109.14	-$19.57	6.9 yrs	-1.8%	-15.3%
US IG Healthcare	**111 bp**	**84 bp**	**27 bp**	**5.1%**	**2.3%**	**275 bp**	**$89.17**	**$111.25**	**-$22.07**	**8.5 yrs**	**-1.2%**	**-17.2%**
Difference	-31 bp	-14 bp	-17 bp	-34 bp	-3 bp	-32 bp	-$0.40	$2.11	-$2.51	1.6 yrs	60 bp	-191 bp
US HY	455 bp	310 bp	145 bp	8.6%	4.3%	430 bp	$87.02	$103.31	-$16.29	4.1 yrs	-2.6%	-10.5%
US HY Healthcare	**612 bp**	**287 bp**	**325 bp**	**10.1%**	**4.0%**	**611 bp**	**$81.07**	**$102.14**	**-$21.07**	**4.2 yrs**	**-8.4%**	**-16.3%**
Difference	157 bp	-23 bp	180 bp	151 bp	-30 bp	181 bp	-$5.95	-$1.17	-$4.78	0.1 yrs	-580 bp	-580 bp

Source: CreditSights, FactSet, ICE Data Indices, LLC

US IG and HY vs. Leisure

	OAS			YTW			$ Price				YTD Returns	
	Current	YE 2021	Change	Current	YE 2021	Change	Current	YE 2021	Change	Duration	Excess	Total
US IG	141 bp	98 bp	43 bp	5.3%	2.4%	291 bp	$90.68	$109.14	-$18.46	7.0 yrs	-1.7%	-14.2%
IG Leisure	**196 bp**	**148 bp**	**48 bp**	**5.8%**	**2.7%**	**310 bp**	**$92.34**	**$104.95**	**-$12.61**	**4.5 yrs**	**0.2%**	**-8.2%**
Difference	55 bp	50 bp	5 bp	53 bp	33 bp	19 bp	$1.66	-$4.19	$5.84	-2.6 yrs	190 bp	598 bp
US HY	448 bp	310 bp	138 bp	8.4%	4.3%	412 bp	$87.71	$103.31	-$15.60	4.0 yrs	-2.4%	-9.8%
HY Leisure	**432 bp**	**310 bp**	**122 bp**	**8.3%**	**4.2%**	**415 bp**	**$90.19**	**$103.41**	**-$13.23**	**3.5 yrs**	**-0.8%**	**-7.1%**
Difference	-16 bp	0 bp	-16 bp	-12 bp	-15 bp	3 bp	$2.48	$0.10	$2.38	-0.6 yrs	164 bp	278 bp

Source: CreditSights, FactSet, ICE Data Indices, LLC

US IG and HY vs. Retail

	OAS			YTW			$ Price				YTD Returns	
	Current	YE 2021	Change	Current	YE 2021	Change	Current	YE 2021	Change	Duration	Excess	Total
US IG	141 bp	98 bp	43 bp	5.3%	2.4%	291 bp	$90.68	$109.14	-$18.46	7.0 yrs	-1.7%	-14.2%
IG Retail	**100 bp**	**77 bp**	**23 bp**	**4.8%**	**2.2%**	**257 bp**	**$90.48**	**$109.61**	**-$19.14**	**8.2 yrs**	**-0.9%**	**-15.0%**
Difference	-41 bp	-21 bp	-20 bp	-47 bp	-13 bp	-34 bp	-$0.21	$0.47	-$0.68	1.2 yrs	80 bp	-81 bp
US HY	448 bp	310 bp	138 bp	8.4%	4.3%	412 bp	$87.71	$103.31	-$15.60	4.0 yrs	-2.4%	-9.8%
HY Retail	**576 bp**	**294 bp**	**282 bp**	**9.6%**	**4.2%**	**542 bp**	**$81.60**	**$102.85**	**-$21.25**	**4.4 yrs**	**-7.8%**	**5.3%**
Difference	128 bp	-16 bp	144 bp	120 bp	-9 bp	130 bp	-$6.10	-$0.46	-$5.64	0.4 yrs	-537 bp	1514 bp

Source: CreditSights, FactSet, ICE Data Indices, LLC

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US Consumer Snapshot

Autos

Executive Summary

- IG Autos (Market perform). Our Market perform recommendation on the IG Autos sector is based on expected resilient Auto OEM profitability stemming from disciplined dealer inventory rebuilding, durable customer demand amidst an expected rise in unemployment, and normalization of captive finance credit metrics.

- HY Autos (Market perform). Our Market perform recommendation on the HY Autos sector contemplates expected continued positive rating momentum for Ford (F), which accounts for 64% of the index, and expected profit growth among Auto Suppliers related to supply chain stabilization, improving OEM production schedules, and moderating raw material costs.

- IG Picks & Pans. We are constructive on General Motors (GM) profit outlook and potential ratings upside and Aptiv's (APTV) position as a high value add supplier and focus on electrification and automation megatrends. We are cautious on supplier Lear (LEA) owing to exposure to commoditized seating systems and susceptibility to vehicle production volatility.

- HY Picks & Pans. We are constructive on Ford's (F) improved financial performance and outlook and expected near-term ratings upside, along with supplier Dana's (DAN) strong operational track record and alignment to capitalize on sector EV trends.
- New issue outlook. We expect 2023 new issuance in the Autos sector of about $42 bn (IG) and $7 bn (HY), dominated by issuance from captive finance subsidiaries to refinance debt maturities and to fund potential finance receivables growth stemming from increased new vehicle sales and higher penetration.

Key Themes for 2023

- Global Vehicle Production Forecast – As the industry continues to ramp up production to meet pent-up demand, any occurrences that may inhibit production trends would be a negative across our credits.
- Supply Chain Headwinds - Semiconductor availability for electronic control units (ECUs) and component shortages more generally have remained the most pervasive supply chain issue over the past two years, inhibiting the positive trajectory for vehicle production.
- Inflationary Cost Headwinds - Inflationary costs remain in focus and have negatively impacted margin performance through most of 2022, particularly as it pertains to Auto Suppliers. We expect cost inflation to persist in 2023, especially for labor costs, although margins may benefit from moderate raw material and logistics costs.

Top Risks for 2023

- Supply-Demand Balance – Light vehicle production has been constrained by shortages of semiconductors and other components since late 2020, resulting in strong pricing power and profitability for OEMs as demand has outstripped dealer inventories. A key risk in 2023 is the potential confluence of expanded light vehicle production and dealer inventories and demand destruction caused by a recession and rising unemployment.
- European Energy Crisis – The crisis in Europe presents a risk to our credits on two fronts. First, widespread inflation is weighing on consumer discretionary spending and likely reducing automotive industry demand. Second, elevated energy costs will likely be a lingering headwind for Suppliers and OEMs in 2023, partially offsetting lower raw material and logistics costs.
- China Covid Policies – The potential continuation of China's Zero COVID policy could result in further supply chain disruptions and adversely impact production volumes for both Suppliers and OEMs.

Picks, Pans & Recommendations

Investment Grade Picks

- Aptiv (APTV) - The Company remains a strong higher value add Supplier and offers superior positioning to capture the industry megatrend themes of electrification and automation. **Aptiv Company Page**
- General Motors (GM) - The company is on track to post its second consecutive year of 8% consolidated adjusted EBIT margins and management expects to maintain margins in 2023 through more efficient inventory management at both the dealer and plant levels. We believe sustained margin stability could lead to ratings upside by Fitch and Moody's over the intermediate term. **General Motor Company Page**

Investment Grade Pans

- Lear (LEA) – LEA's high leverage to the commoditized seating systems space leaves the Company heavily exposed to vehicle production swings. **Lear Company Page**

US IG Autos Company Recommendations		
Outperform	**Market Perform**	**Underperform**
Aptiv (APTV)	Honda (HNDA)	BorgWarner (BWA)
General Motors (GM)	Hyundai (HYNMTR)	Kia Corp. (KIA)
Nissan (NSANY)	Magna International (MGCN)	Lear (LEA)
	Toyota (TOYOTA)	

Source: CreditSights

High Yield Picks

- Ford (F) – Ford's restructuring efforts in recent years have led to improved margins in North America and led to profitability in its international operations after years of losses. We expect sustained profitability in 2023 to support an S&P rating upgrade to Investment Grade in 1H23, while an upgrade to IG by Fitch is possible in 2H23. **Ford Company Page**

- Dana (DAN) – We like exposure into DAN as offers a proven operational track record as well as a solid EV story. We also recommend the credit for crossover investors willing to dip down to BB-rated names for spread pickup relative to the BBB index. **Dana Company Page**

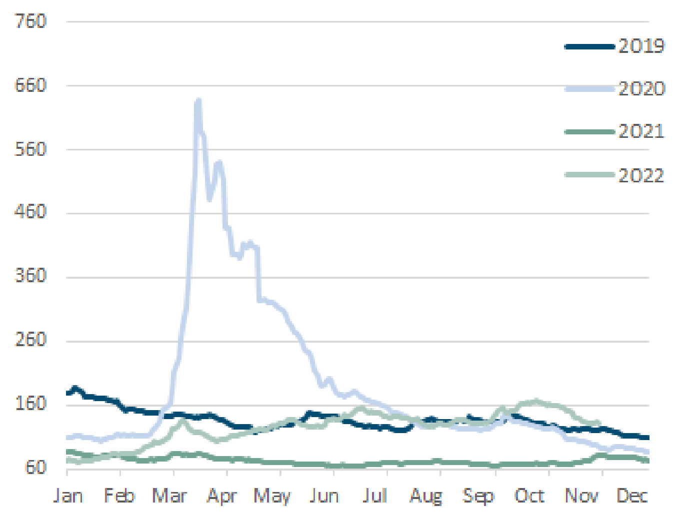
US HY Autos Company Recommendations		
Outperform	**Market Perform**	**Underperform**
Allison Transmission (ALSN)	American Axle (AXL)	
Dana (DAN)	Adient (ADNT)	
Ford (F)		
Goodyear Tire (GT)		

Source: CreditSights

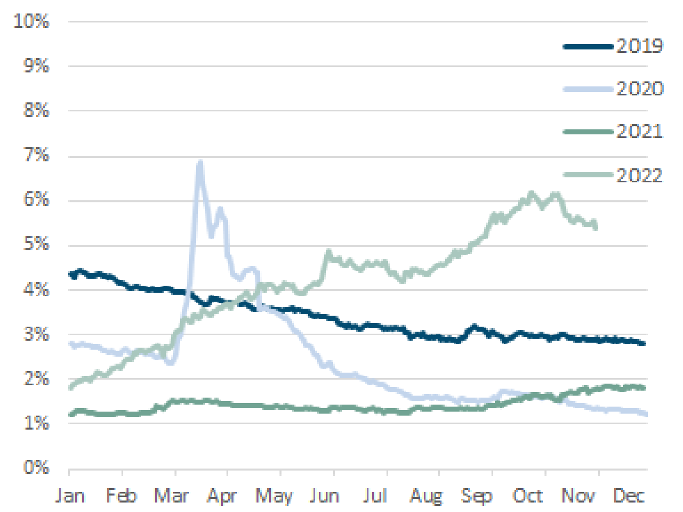
Relative Value

Investment Grade

US IG Autos Annual OAS History: 2019-2022



US IG Autos Annual YTW History: 2019-2022

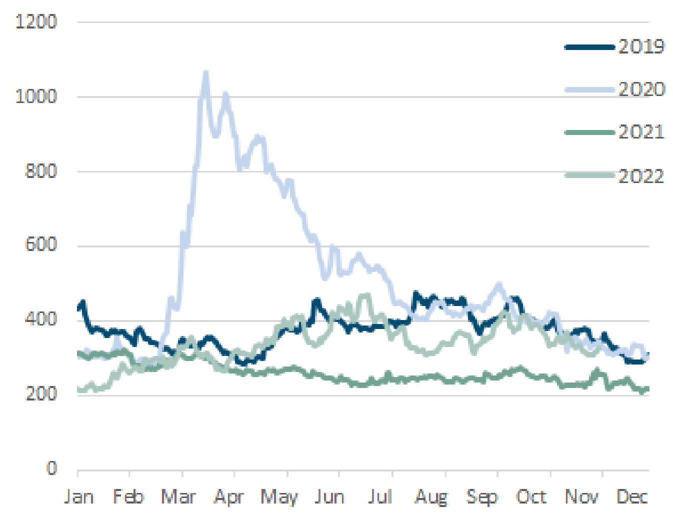


Source: CreditSights, FactSet, ICE Data Indices, LLC

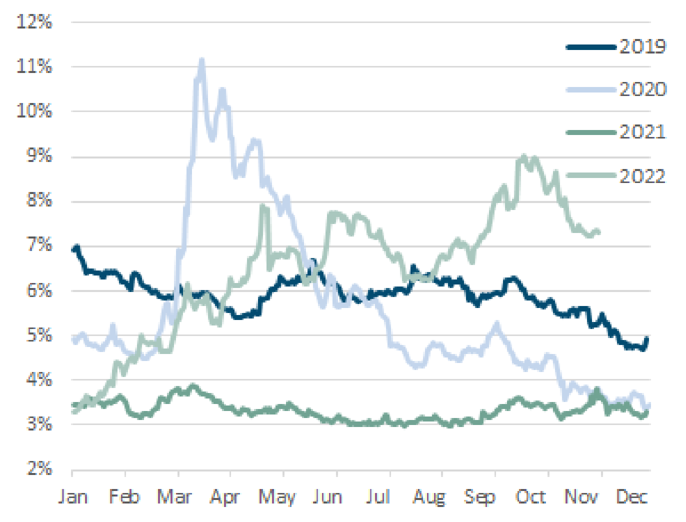
The US IG Auto index is comprised primarily of short-duration paper issued the automaker captive finance subsidiaries. The US IG Auto index is trading roughly 15-20 bp wide of the Corporate IG 3-5 yr index, broadly in line with its historical relationship. In our view, the stable spread relationship reflects a healthy supply-demand balance within the US auto sector, strong consumer balance sheets, and resilient vehicle pricing and profitability. The primary risk to sector spreads is a severe 2023 recession that causes a material spike in unemployment, sharp declines in consumer spending and light vehicle sales, and material increases in captive finance credit losses.

High Yield

US HY Autos Annual OAS History: 2019-2022



US HY Autos Annual YTW History: 2019-2022



Source: CreditSights, FactSet, ICE Data Indices, LLC

The US HY Automotive & Auto Parts index is dominated by Ford and Ford Credit, which together account for 64% of the index, while the next largest index constituent (Goodyear Tire) accounts for 8% of the index. The US HY Automotive & Auto Parts index has a BB composite rating and is trading about 40 bp wide of the US HY BB index, in line with its average over the past decade. We expect Ford's credit trajectory to largely drive the index performance in 2023, with our current expectation of a Ford rating upgrade to IG in 2023 by S&P and potentially Fitch to lead to outperformance compared to the broader market. The primary risk to this expectation is a materially weaker economy that leads to profit and credit metric weakness for Ford, which could put its positive rating momentum on the back burner.

Fundamental Outlook

IG Autos Largest Issuer Fundamental Snapshot

Issuer	Total Outstanding ($B)	Net Leverage Current	Net Leverage YE 2021	YTD Change	FY2023 Leverage Direction
General Motors	$45.5	-0.1x	-0.3x	0.2x	Flat
Toyota	$31.2	-0.5x	-0.5x	0.0x	Lower
Hyundai	$21.2	-0.4x	-0.5x	0.1x	Flat
Honda	$18.4	-1.9x	-1.4x	-0.5x	Lower
Nissan	$12.1	-2.9x	-3.3x	0.4x	Lower
Aptiv	$5.0	0.8x	0.5x	0.3x	Flat
BorgWarner	$2.9	1.6x	1.1x	0.5x	Flat
Harley-Davidson	$2.0	-0.2x	-0.6x	0.4x	Flat

Source: CreditSights, FactSet, ICE Data Indices, LLC, Company Filings

HY Autos Largest Issuer Fundamental Snapshot

Issuer	Total Outstanding ($B)	Net Leverage Current	Net Leverage YE 2021	YTD Change	FY2023 Leverage Direction
Ford	$37.8	-0.8x	-1.2x	0.4x	Flat
Goodyear Tire	$8.8	3.1x	3.2x	-0.1x	Lower
Dana	$2.3	2.5x	2.7x	-0.2x	Flat
Allison Transmission	$2.5	2.5x	2.8x	-0.3x	Flat
American Axle	$3.0	3.3x	3.1x	0.2x	Lower

Source: CreditSights, FactSet, ICE Data Indices, LLC, Company Filings

The Auto OEM sector is expected to exhibit stable or declining leverage as management teams seek to maintain a healthy supply-demand balance as light vehicle production increases to preserve profitability, while the Japanese OEMs strive to improve profitability as supply chain challenges ease, which should reduce leverage over the intermediate term. Five automotive OEMs account for 69% of the US IG Automotive index, while Ford accounts for 64% of the US HY Automotive & Auto Parts, so we expect the OEMs to be the primary drivers of index performance.

However, auto suppliers will also contribute to the index performance, and an expected more stable supply chain and increased light vehicle production volumes should bode well for profitability and modest improvement in leverage.

Primary Market Outlook

Investment Grade

IG Autos 2023 Primary Market Expectations				
Issuer	Rating	Est. Amount ($B)	Use of Proceeds	Anticipated Timing
GM	Baa3/BBB/BBB-	$9.6	GCP, Refinance	1Q/2Q/3Q/4Q
TOYOTA	A1/A+/A+	$17.0	GCP, Refinance	1Q/2Q/3Q/4Q
HYNMTR	Baa1/BBB+/BBB+	$5.2	GCP, Refinance	1Q/2Q/3Q
HNDA	A3/A-/A	$7.0	GCP, Refinance	1Q/2Q/3Q/4Q
NSANY	Baa3/BBB-/NR	$2.5	GCP, Refinance	1Q/3Q
HOG	Baa3/BBB-/BBB+	$0.4	GCP, Refinance	1Q

Source: CreditSights, Bloomberg, L.P.

We expect an active year of issuance by the automotive OEMs, primarily the captive finance subsidiaries, to refinance near-term debt maturities and fund higher finance receivables from increased light vehicle sales. While automakers could also be opportunistic issuers from the automotive portion of their business to fund increased capex or near-term debt maturities, we expect this issuance to be relatively modest compared to the captive finance subsidiaries.

High Yield

HY Autos 2023 Primary Market Expectations				
Issuer	Rating	Est. Amount ($B)	Use of Proceeds	Anticipated Timing
F	Ba2/BB+/BB+	$7	GCP, Refinance	1Q/2Q/3Q/4Q

Source: CreditSights, Bloomberg, L.P.

The larger auto suppliers have no near-term debt maturities in 2023 and, absent potential M&A activity, are unlikely to tap the debt capital markets in 2023. We expect Ford Credit to be an active issuer to refinance near-term debt maturities and fund higher finance receivables, with maturities typically inside 10 years.

Event Risk/M&A Landscape

Auto OEM capital allocation is focused primarily on elevated R&D and capital expenditures to maintain their ICE vehicle offerings and build out robust EV and hybrid vehicle offerings, including EV battery plant capacity. While these investments are expected to be funded via internally generated cash, these investments could require debt funding in the event of profit and cash flow shortfalls. We expect M&A activity to be relatively small and opportunistic, primarily in the form of EV or software technologies that are complementary to OEM existing initiatives.

Suppliers are likely to continue to grow EV offerings to meet the demands of the shift industry landscape towards electrification. While we expect investments in the space to be internal or moderate tuck-in acquisitions, we do not rule out the possibility for a larger transaction to occur similar to what we saw in early 2022 with APTV's $3.9 bn acquisition of Veoneer.

ESG Considerations

Automotive OEMs and suppliers are focused on shifting the mix of parts and vehicle offerings that represent clean energy offerings and reduce their carbon footprint over time. Most OEMs target roughly 40% of their light vehicle sales being comprised of EVs by 2030, up from less than 5% among traditional automakers in 2022. Many of the

OEMs have issued green bonds tied to various ESG initiatives within their respective companies, a trend we expect to continue primarily on the automotive side of the business, although GM Financial has signaled it could issue a green bond as early as 2023.

Consumer Goods

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- HY Consumer Goods (downgrading to Underperform from Market perform). Of the top 50% of index issuers by face value, our coverage spans just over 41%, with our lone Outperform rec being Pilgrim's Pride, which in our view deserves the same IG ratings as its parent co, JBS. Otherwise, we think the individual credit considerations of the top issuers will dictate most of the subsector performance. In that regard, we are downgrading our recommendation on the sector to Underperform. The subsector trades tight to the broader index and we believe any benefit from a soft landing will be credit metric neutral overall and we see a risk of rising leverage metrics among top issuers such as Post Holdings, Newell Brands, and Lamb Weston.
- IG Picks: Kraft Heinz, Campbell Soup, Constellation Brands, Philip Morris
- IG Pans: Clorox Co, ConAgra Brands, Altria
- HY Picks: Restaurant Brands, Perrigo
- HY Pans: Lamb Weston, Post Holdings
- For high quality issuers near- to medium-term maturity calendars were advantageously addressed during the low-rate pandemic environment making for manageable maturity schedules in the coming year. We expect issuance to largely be refi driven and given the rate environment and a generally more conservative balance sheet posturing we do not expect meaningful debt funded shareholder rewards. There are select HY issuers still speaking to M&A opportunities, which could see some debt issuance; otherwise maturity calendars are fairly light and we think some management teams could still be looking towards debt reduction.

Key Themes for 2023

- Cost inflation and potential for margin erosion to impact leverage metrics.
- Consumer price sensitivity as branded food companies pass through cost inflation.
- Shift to increase at-home consumption in the event of increased recessionary mindsets.
- Sizable regulatory risk arising from a potential menthol ban in the U.S.

Top Risks for 2023

- Increased price elasticity conflating margin pressure.
- Private label trade down.
- Additional downward pressure on cigarette volumes due to elevated gas prices, down trading activity, and an increase in illicit trade.

Picks, Pans & Recommendations

Investment Grade Picks

- **Kraft Heinz** (Baa3/BBB-/BBB) – KHC has done a good job managing margin impacts from cost inflation on credit metrics. Organic sales trends remain favorable, we like that management recently lowered its long-term leverage target to 3x from sub-4x. We view KHC as good name for spread pickup relatively mid- to high-BBB rated peers, particularly at the long-end of the curve. See: **Kraft Heinz 3Q22: Demand Remains Robust**
- **Haleon** (Baa1/BBB/NR): Haleon operating trends remain favorable with management having recently increased its outlook for 2022 organic sales growth. We see a clear path for the company to progress toward its deleveraging target of 3x by 2024 (vs 4x post-spin). Spreads are wide to our other Home & Personal Care names due to slightly lower ratings on overhangs from potential Zantac liabilities, but we view HLNLN's level of exposure as highly manageable in the context of maintaining strong IG credit metrics and we see current valuations as overly cautious given the strong operating fundamentals.
- **Philip Morris** (A2/A-/A): We maintain our favorable view on Philip Morris' operational profile. And also anticipate near-term event risk will be lower as Philip Morris focuses on repairing the balance sheet following the Swedish Match acquisition.

Investment Grade Pans

- **ConAgra Brands** (Baa3/BBB-/BB B-) – CAG has seen margin erosion have a more meaningful impact on the credit profile with leverage rising to levels that increase ratings downgrade risk. Management has lowered its long-term target from 3.5x to 3x, but the company could be challenged to reduce leverage.
- **Altria** (A3/BBB/BBB): There remains uncertainty Altria's harm reduction portfolio, particularly as it relates to Juul's potential ban in the U.S. We believe it is likely that Altria will use M&A to remain in vapor category to the extent Juul is removed from the market and, therefore, continue to see downside risk in the bonds.

US IG Consumer Goods Company Recommendations		
Outperform	**Market Perform**	**Underperform**
Campbell Soup	Kimberly-Clark	Altria
Church & Dwight	Kellogg Co	Clorox Co
Haleon	McDonald's	Colgate-Palmolive
Phillip Morris	Procter & Gamble	ConAgra Brands
Kraft Heinz	J.M. Smucker	Mondelez

Source: CreditSights

High Yield Picks

- **Restaurant Brands** (Ba2/BB+/NR) – The quick service restaurant industry is well positioned to management a recessionary environment. Return to office trade is a tailwind for Tim Hortons and growth restaurant growth is strong at Popeyes and Firehouse. Management recently lowered its leverage target. We prefer the yield pickup in the 2L bonds. See: **Restaurant Brands 3Q22: Plans to Reclaim the Flame**
- **Perrigo** (Ba2/BB-/BB+) – PRGO trades just inside the BB index, but we see current valuations as attractive given the favorable operating environment from increased demand for cough/cold products and the ongoing infant formula shortage. We expect these tailwinds to support credit metric improvement even while the company

works through several margin headwinds, and like that management has consistently spoken to leverage reduction as a key priority. See: **Perrigo: Coverage Transition and 3Q22 Results**

High Yield Pans

- **Lamb Weston** (Ba3/BB+/NR) – Operationally, LW has faced significant cost headwinds across all facets of the potato product business, but F1Q23 results displayed a strong margin recovery due to pricing pass throughs and resilient demand across key customers in the quick service restaurant (QSR) space. As a result, leverage metrics moved further below management's targeted range of 3.5-4.0x (vs 2.7x at MRQ) and management has guided to increased optionality for M&A or additional capacity investments. We note that management has placed these priorities ahead of pursuing higher credit ratings and we anticipate leverage could move higher through the near-to medium-term.

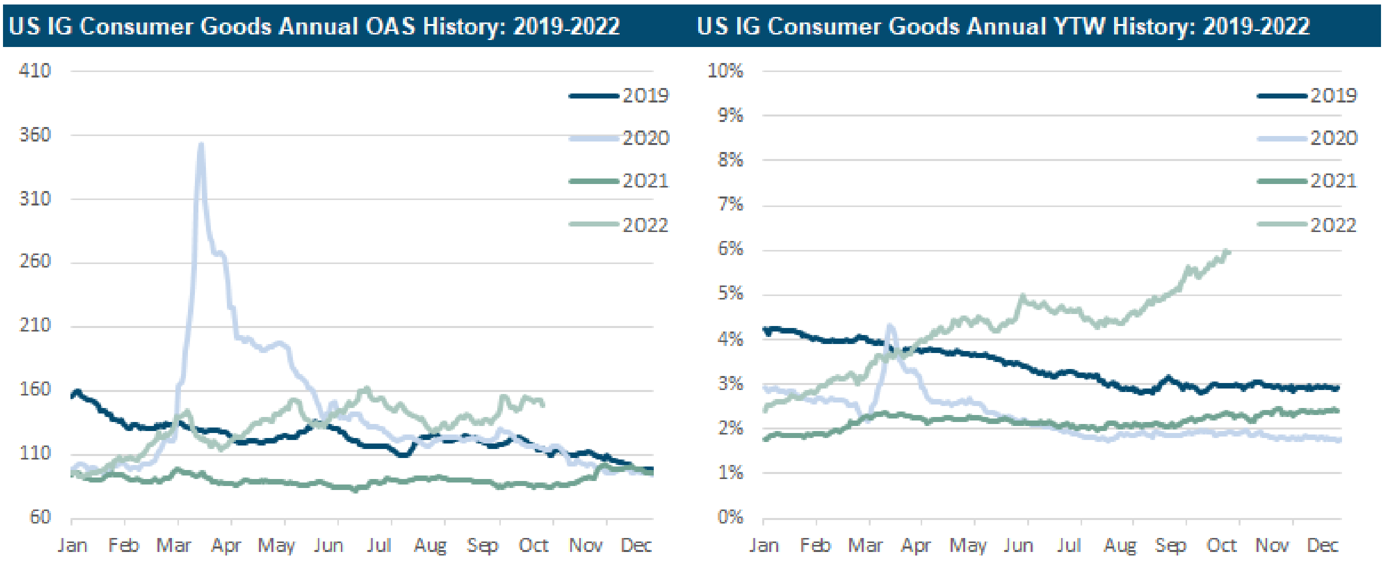
US HY Consumer Goods Company Recommendations

Outperform	Market Perform	Underperform
Perrigo	Mattel	Lamb Weston
Pilgrim's Pride	Newell Brands	Post Holdings
Restaurant Brands		

Source: CreditSights

Relative Value

Investment Grade

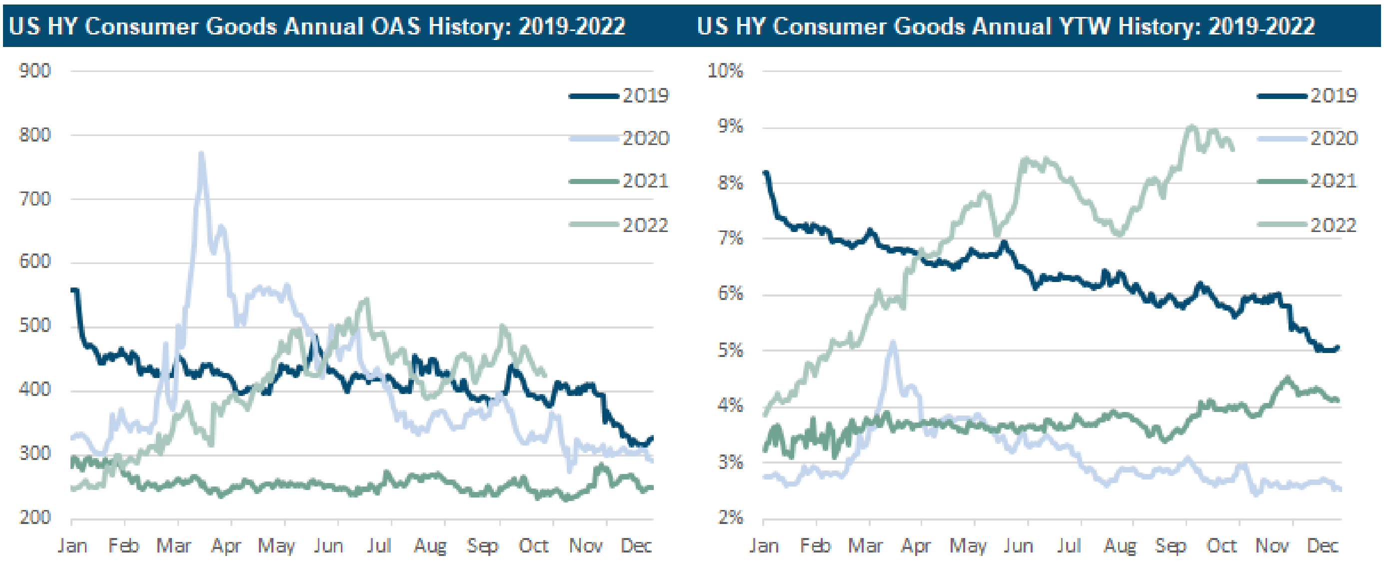


Source: CreditSights, FactSet, ICE Data Indices, LLC

Consumer Goods spread levels are wider than recent years as valuations across the index have slipped on rising interest rates and economic concerns. In early 2022, fears that inflation pressures would erode margins and push leverage higher had overshadowed the traditional safe haven mindset for consumer staples, but the market has grown more comfortable with companies' abilities to navigate the environment. If we do in fact enter a recessionary environment demand for staples, which is significant driver of Consumer Goods performance, should hold up better than more discretionary categories, but we do not think there would be outsized spread tightening relative to the broader index in a soft landing environment that sees increased risk appetite. Few of the major issuers (e.g. PG, KO, PEP, etc) are focused on leverage improvement as balance sheets had largely been shored up in 2020-2021. Inflation will remain a key headwind, as will FX, which could serve to temper benefits from higher consumer demand, but overall we expect credit metrics to remain fairly flat, outside of a few instances of discretionary exposure and greater commodity cost volatility.

Relative Value

High Yield



Source: CreditSights, FactSet, ICE Data Indices, LLC

Several of the top sector issuers have exposure to discretionary spending categories (e.g. Newell, Mattel) that have already seen or could see a pullback in 2023. A shift to risk-on investing mindset could overpower underlying sector fundamentals, though we would not expect the sector to significantly outperform broader market movements.

Fundamental Outlook

IG Consumer Goods Largest Issuer Fundamental Snapshot

Issuer	Total Outstanding ($B)	Net Leverage Current	Net Leverage YE 2021	YTD Change	FY2023 Leverage Direction
ABIBB	$55.4	3.9x	4.0x	-0.1	Lower
BATSLN	$34.3	3.8x	3.1x	0.7x	Lower
PEP	$26.4	2.2x	2.4x	-0.2x	Flat
KO	$21.8	1.9x	2.3x	-0.4x	Flat
MO	$21.7	2.0x	2.0x	0.0x	Higher
NESNVX	$18.5	2.6x	2.1x	0.5x	Flat
KHC	$16.4	3.3x	3.2x	0.1x	Lower
PM	$15.0	1.6x	1.7x	-0.1x	Higher
PG	$13.1	1.3x	1.2x	0.1x	Flat
KDP	$11.5	2.8x	2.9x	-0.1x	Higher

Source: CreditSights, FactSet, ICE Data Indices, LLC, Company Filings

HY Consumer Goods Largest Issuer Fundamental Snapshot

Issuer	Total Outstanding ($B)	Net Leverage Current	Net Leverage YE 2021	YTD Change	FY2023 Leverage Direction
POST	$5.4	5.4x	6.1x	-0.7x	Higher
NWL	$4.6	3.9x	3.0x	0.9x	Higher
PPC	$2.8	1.3x	2.2x	-0.9x	Flat
USFOOD	$2.4	3.7x	4.6x	-0.9x	Lower
MAT	$2.4	2.0x	1.8x	0.2x	Higher
PFGC	$2.3	3.7x	4.5x	-0.8x	Lower
LW	$2.2	3.1x	3.7x	-0.6x	Higher
COTY	$2.0	4.4x	6.8x	-2.4x	Lower

Source: CreditSights, FactSet, ICE Data Indices, LLC, Company Filings

Several top issuers have leverage below management targets and have spoken to M&A as a means of utilizing balance sheet capacity (e.g. LW, POST). Overall, we see a risk of leverage metrics weakening in 2023 and expect that the impact combined with potentially weaker operating results for discretionary names, will cause valuations to weaken.

Primary Market Outlook

Investment Grade

IG Consumer Goods 2023 Primary Market Expectations				
Issuer	Rating	Est. Amount ($B)	Use of Proceeds	Anticipated Timing
BATS	Baa2/BBB+/BBB	$2.9	Refi	1Q/2Q
PM	A2/A-/A	$2.3	Refi	1Q/2Q
GIS	Baa2/BBB/NR	$0.5	Refi	4Q
CAG	Baa3/BBB-/BBB-	$0.9	Refi	1Q/3Q
PEP	A1/A+/NR	$3.0	Refi	1Q/2Q/3Q/4Q
PG	Aa3/AA-/NR	$1.0	Refi	3Q
KMB	A2/A/NR	$0.4	Refi	2Q
MCD	Baa1/BBB+/NR	$1.0	Refi	2Q
KDP	Baa2/BBB/NR	$0.5	Refi	4Q
CL	Aa3/AA-/NR	$0.9	Refi	1Q
K	Baa2/BBB/NR	$0.8	Refi	1Q
TSN	Baa2/BBB+/BBB	$0.5	Refi	3Q
CPB	Baa2/BBB/BBB	$0.5	Refi	1Q

Source: CreditSights, Bloomberg, L.P.

Consumer Staples and Household Personal Care issuance expectations are primarily for refinancing purposes. Even so, many issuers were extremely proactive with refinancing activity in 2020-2021 and maturity calendars are light over the next couple of years. We expect the largest issuance to come from high-quality bellwether names like PEP or PG. Although there are 1-2 names that have spoken to M&A, the main acquisition considerations in the space are bolt-on in nature.

In the Tobacco sector, we expect issuance to relate largely refinancing near-term maturities. However, given our expectation for M&A, we could also see acquisition related issuance. In November, Philip Morris issued $6 billion of debt to fund the $16 billion Swedish Match acquisition.

High Yield

HY Consumer Goods 2023 Primary Market Expectations				
Issuer	Rating	Est. Amount ($B)	Use of Proceeds	Anticipated Timing
POST	Ba3/BB+/NR	$1.0	M&A	2Q/3Q
LW	Ba3/BB+/NR	$0.5	M&A	2Q/3Q

Source: CreditSights, Bloomberg, L.P.

Maturity calendars are well paced out for the largest constituents of the HY Consumer Goods index and we do not see a large need to tap the primary market. There are a few names that have spoken to M&A ambitions, but we suspect financing will depend on market conditions. In the table above we have included two examples where we have earmarked new issue amounts for speculative M&A.

Event Risk/M&A Landscape

There is limited LBO, activist or large scale M&A risk among Consumer Staples and Household Personal Care names. Those names with elevated event risk include Keurig Dr Pepper which has spoken to larger M&A capacity than peers. Also, Third Point recently took an activist stake at the super high-quality Colgate-Palmolive, pushing for a divestiture of the pet food business and some additional M&A (see **Colgate-Palmolive: Third Point Takes Stake**). We see limited LBO risk in the space.

In the Tobacco sector, M&A risk is elevated. We expect companies to pursue acquisitions that will help facilitate the transition away from combustible tobacco products toward less harmful products. Philip Morris' $16 billion acquisition of Swedish Match is the largest example of this trend and we expect other companies in the sector to follow suit.

ESG Considerations

From an ESG standpoint, adverse regulatory developments and litigation remain the primary risks in the Tobacco sector. The most concerning near-term risk in the sector relates to a potential ban on menthol cigarettes in the U.S., which could occur in mid-to-late 2023. Governance issuance have long been the leading driver of ESG considerations for Consumer Staples and Household Personal Care names, and recent attention has been drawn to concentrated shareholder stakes, as in Constellation Brands (see **Constellation Brands: Voting Control Being Ceded?**). In cases where the controlling shareholders look to cede control, there could be a negative balance sheet impact. However, apart from STZ, we've generally seen little interest from controlling shareholders, who tend to have generational family stakes, in changing the shareholder structure.

Healthcare

Executive Summary

- We have a Market perform recommendation on IG Healthcare. Looming operating headwinds in Pharma, primarily driven by patent expirations, and an upward bias to leverage, largely due to bolt-on M&A potential, informs our negative bias on sector fundamentals. However, technical tailwinds – including the sector's 'safe haven' status and limited new supply – balances these risks.

- We are moving to an Outperform recommendation on HY Healthcare (from Market perform). For HY Hospitals, operating challenges related to volumes and labor costs are largely priced in at this point and should improve through 2023. For HY Pharma, the widespread resolution of the opioid situation should result in relatively less volatility, with the obvious exception of Bausch Health, which is in the midst of the B+L separation.

- Top IG Healthcare picks include Abbvie and AstraZeneca. Pans include Biogen and Humana.

- Top HY Healthcare picks include Teva and Organon. Pans include DaVita and Bausch Health's senior unsecured notes.

- We expect refinancing to drive the bulk of new issuance activity in 2023, with many names landing on the 'potential issuers' list. M&A could also drive volumes, though the anticipated bolt-on nature of deals should provide management with discretion on funding sources.

Key Themes for 2023

- For IG Pharma, decelerating new drug approvals at the FDA and looming patent expirations are worthy of attention. These risks will be somewhat mitigated by strong drug launches in recent years – particularly in the innovative areas of oncology, immunology and rare disease. Operational challenges, even if a few years out, will likely influence capital allocation priorities, including bolt-on M&A.

- IG Health Insurance represents a safe haven to the extent pressures associated with either macroeconomic weakness, inflationary costs, and/or global conflict persist. Both the operating and political backdrops looks favorable for health insurers.

- IG Medical Products companies will experience more consistent growth in surgical volumes in 2023 when compared to previous years. However, component shortages and persistent supply chain headwinds will hamper demand growth. As in previous years, we also see downside risk related to M&A.

- HY Hospitals face a complex backdrop in 2023, including shifting volume, acuity and payor mix dynamics as well as elevated labor costs, though we expect conditions to incrementally improve throughout the year. Thankfully, maturity calendars have been extended, providing some space for operational disruption.

- HY Pharma has largely resolved its opioid exposure, whether through comprehensive settlement (Teva) or bankruptcy protection (Endo and Mallinckrodt). This will allow investors to focus on sector fundamentals, including generic/biosimilar approvals, pricing dynamics, and trends in established brands.

Top Risks for 2023

- Operational risks in IG Pharma include patent expirations, which are expected to ramp heavily over the next several years, as well as commercial pricing pressure in certain therapy areas. These risks could imperil future revenue growth/diversification and drive an increase in M&A activity. We expect leverage metrics in IG Pharma to drift higher as companies bolster pipelines and commercial platforms through bolt-on M&A.

- For IG Health Insurance, risks are primarily associated with DOJ inquiry into Medicare coding practices and the potential for M&A, though outside of Cigna, the likelihood of transformative deals looks remote.

- The primary risk in IG Medical Products remains medium-to-large scale acquisitions as companies continue to diversify their portfolios. Other risks include product-related liabilities and litigation arising from patent infringements – both of which could translate into sizable cash outflows.

- HY Hospitals could see an unwind of acuity and payor mix benefits experienced through the pandemic as well as recession-related volume headwinds. This could be compounded by sustained cost pressure tied to wage inflation and contract labor utilization.

- Event risk remains somewhat thematic in HY Pharma, albeit less so than past periods, even with the opioid issue largely put to bed. Bausch Health's separation transaction will infuse volatility given its weight in the index, but valuations more broadly in the space look to have bottomed out.

Picks, Pans & Recommendations

Investment Grade Picks

- **Abbvie** enjoys solid diversification and has demonstrated an ability to grow across multiple therapeutic platforms. This should allow a quick return to growth following the Humira loss of exclusivity in 2023. Management has also right-sized the balance sheet with net leverage of ~2x (and moving lower).

- **AstraZeneca** benefits from a deep portfolio of innovative medicines and one of the strongest revenue/EBITDA growth trajectories in the space. It also employs a credit-friendly capital allocation strategy. We expect M&A and shareholder rewards to be managed at <2x net leverage going forward.

- **Elevance** is likely the 'safest' name within the Health Insurance space and we like ELV as an incremental yield generator versus UnitedHealth – M&A risk is low, legal risk is low, and the operational environment is favorable.

- **Centene** is among the best positioned to benefit from macroeconomic weakness and its transition to margin expansion as opposed to growth-through-M&A should benefit its credit profile.

- **Baxter** is a top pick despite recent operational headwinds owing to component shortages and supply chain headwinds. M&A risk at Baxter is considerably lower when compared to its peers and we expect spreads to tighten in 2023 as the company gradually reduces leverage and focuses on integration efforts following the Hill-Rom acquisition.

Investment Grade Pans

- **Johnson & Johnson** could experience downward ratings pressure tied to leveraging M&A, loss of diversification related to the Consumer Healthcare separation, and upcoming patent expirations (including for Stelara).

- **Biogen's** operational deficiencies – including its heavy reliance on Alzheimer's and multiple sclerosis therapies – could force its hand on leveraging M&A. We would expect spread weakness and ratings action on a material M&A announcement, particularly one that pushes net leverage to ~2-3x.

- **Humana** could be most negatively impacted by DOJ scrutiny into Medicare Advantage coding practices given that it derives ~75% of its membership from MA. In addition, we believe that medium-sized M&A is a risk factor into the medium-term as HUM builds out its physical provider center footprint.

- **Boston Scientific** continues to carry elevated event risk. We expect management to prioritize M&A and other shareholder friendly activities.

US IG Healthcare Company Recommendations		
Outperform	**Market Perform**	**Underperform**
ABBV	AMGN	BIIB
AZN	GILD	BMY
NVS	GSK	JNJ
PFE	LLY	UNH
ROSW	MRK	CI
HCA	VTRS	HUM
ELV	ABT	MDT
CNC	DHR	TMO
SYK	BDX	A
BAX		BSX

Source: CreditSights

High Yield Picks

- **Teva** settled the vast majority of its opioid exposure through a nationwide settlement, the size and structure of which look highly manageable. We expect Teva's operations to incrementally improve in 2023 and believe leverage will move lower on solid FCF generation.

- **Organon** benefits from diversification by both product and region. While adjusted EBITDA will contract in 2022, pressures related to losses of exclusivity and China's volume-based procurement program will ease in 2023 and beyond, setting the company up for growth. OGN manages to relatively conservative <3.5x net leverage, a target which looks sustainable.

High Yield Pans

- **DaVita** faces operating pressures tied to weaker volumes (excess mortalities, lower new patients starts, higher missed treatments) and higher costs (wage inflation, higher incentive pay, increased contract labor utilization). These pressures are magnified by the recent SCOTUS ruling, which has infused significant uncertainty into commercial mix and reimbursement rates, at least over the near to medium term.

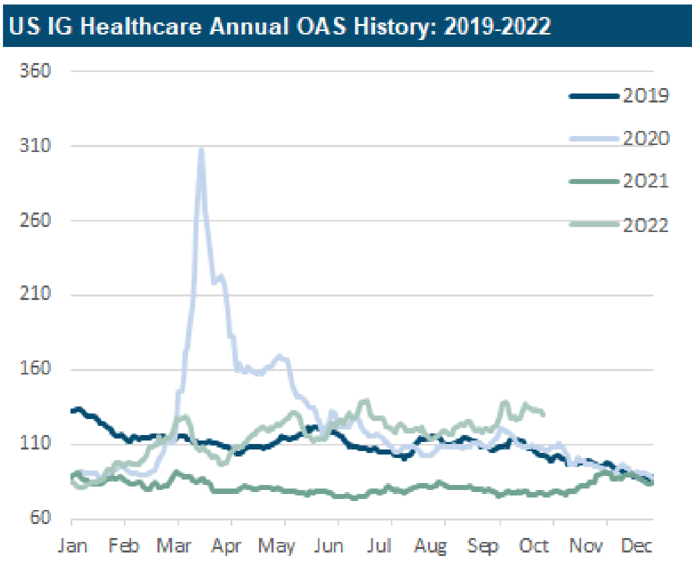
- **Bausch Health's** senior unsecured notes are projected to receive extremely low recoveries under a medium-term bankruptcy scenario, the most likely outcome under a B+L spin-off come early 2023.

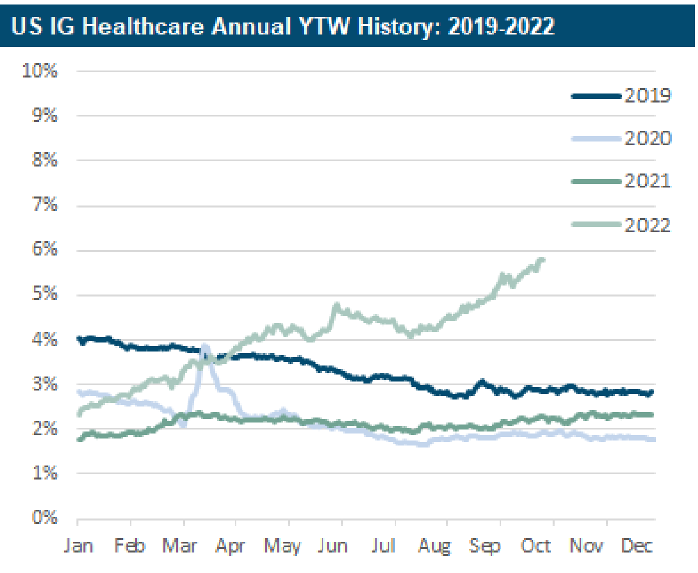
US HY Healthcare Company Recommendations		
Outperform	**Market Perform**	**Underperform**
THC 1Ls	THC 2Ls & Snr Unsecs	CYH Snr Unsecs
CYH 1Ls	CYH 2Ls	BHC 2Ls & Snr Unsecs
TEVA	BHC 1Ls	DVA
OGN	MOH	

Source: CreditSights

Relative Value

Investment Grade



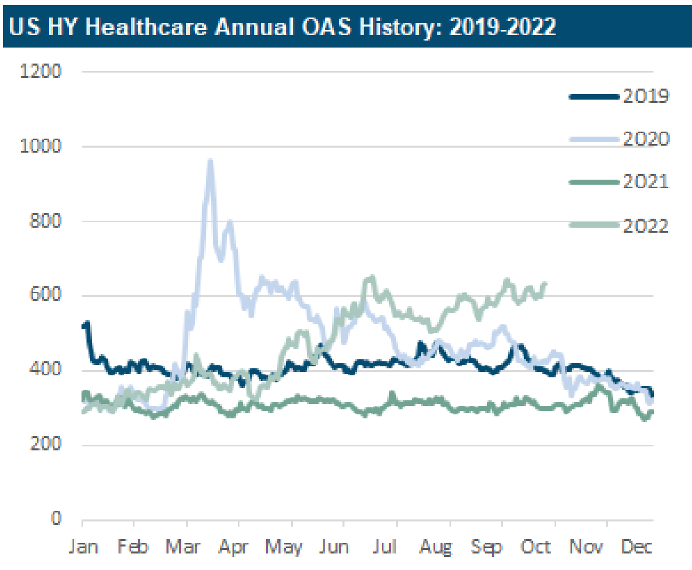


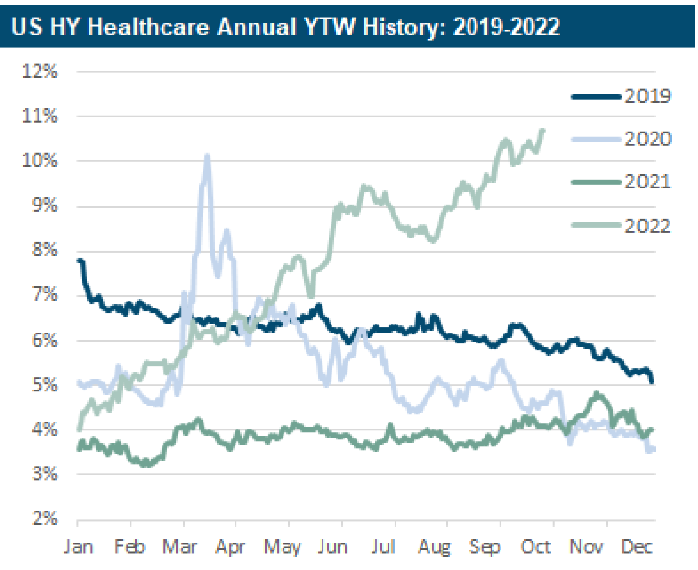
Source: CreditSights, FactSet, ICE Data Indices, LLC

IG Healthcare outperformed the US IG Index on an excess return basis in 2022 (through 11/14/2022) due, in large part, to a flight-to-safety trade. The sector – which is comprised of ~50% Pharma – exhibits defensive, non-cyclical characteristics due primarily to the inelastic nature of drug demand. This proves supportive of excess returns during periods of market volatility and/or risk-off sentiment, as witnessed through much of this year.

IG Healthcare spreads now sit ~36 bp tight to the US IG Index, well above the 5Y average differential (mid-20s bp). While this relationship implies room for underperformance in 2023, we expect recession risk and economic pressure to keep some bid alive for IG Healthcare. This will be further supported by limited technical headwinds driven by a relatively light new issuance calendar.

High Yield





Source: CreditSights, FactSet, ICE Data Indices, LLC

As is somewhat typical in HY Healthcare, performance in 2023 will be heavily influenced by large index constituents, including CYH, BHC, THC, and CNC. In fact, underperformance in 2022 was driven by weakness for names such as (i) Community Health, which was hit with multi-faceted operating headwinds, (ii) Bausch Health, which suffered self-inflicted wounds related to an overly aggressive eye health separation (pending), and (iii) Endo, which filed for bankruptcy in the face of large opioid liabilities. While challenges for CYH and BHC are far from over, we believe that trading levels – particularly at the secured layers of these structures (which are sizeable) – have largely bottomed out, providing a case for attractive relative value.

Performance elsewhere in the sector in 2023 should be supported by large, relatively more stable names such as Tenet, Centene and Organon. We believe excess/total return weakness in 2022 leaves limited room for additional downside in 2023, outside of additional defaults (which we do not anticipate).

Fundamental Outlook

Investment Grade

IG Healthcare Largest Issuer Fundamental Snapshot

Issuer	Total Outstanding ($B)	Net Leverage Current	Net Leverage YE 2021	YTD Change	FY2023 Leverage Direction
Abbvie	$65.5	1.9x	2.3x	-0.4x	Flat
UnitedHealth	$57.1	1.6x	1.9x	-0.3x	Higher
Amgen	$40.8	1.7x	1.8x	-0.1x	Higher
HCA	$38.3	3.1x	2.6x	0.5x	Higher
Bristol-Myers	$38.2	1.3x	1.3x	0.0x	Higher
Pfizer	$35.0	0.2x	0.2x	0.0x	Higher
Cigna	$31.5	2.6x	3.1x	-0.5x	Flat
Merck	$30.7	0.7x	1.2x	-0.5x	Higher
Johnson & Johnson	$29.8	0.0x	0.1x	-0.1x	Higher
Roche	$26.2	0.7x	0.1x	0.6x	Flat
AstraZeneca	$24.3	1.5x	2.1x	-0.6x	Flat
Gilead	$24.3	1.5x	1.6x	-0.1x	Flat

Source: CreditSights, FactSet, ICE Data Indices, LLC, Company Filings

IG Healthcare is a high-quality sector with stable operating fundamentals, strong free cash flow generation, and conservative leverage. We expect credit fundamentals to remain healthy in 2023 but believe that operational storm clouds – primarily those related to large patent losses in the years ahead – could fuel bolt-on M&A activity. Furthermore, after deliberate efforts to reduce debt by many companies in 2022 – including Abbvie, Bristol-Myers, Gilead, and Viatris – we anticipate some preference for shareholder payouts in 2023. Net-net, we see an upward bias to leverage in the year ahead.

High Yield

HY Healthcare Largest Issuer Fundamental Snapshot

Issuer	Total Outstanding ($B)	Net Leverage Current	Net Leverage YE 2021	YTD Change	FY2023 Leverage Direction
Bausch Health	$26.5	6.1x	6.4x	-0.3x	Higher
Teva	$21.5	4.0x	4.3x	-0.3x	Lower
Tenet	$14.9	3.9x	3.8x	0.1x	Flat
Community Health	$12.2	7.6x	6.1x	1.5x	Higher
Organon	$8.9	3.5x	3.8x	-0.3x	Flat
DaVita	$8.7	3.9x	3.4x	0.5x	Lower

Source: CreditSights, FactSet, ICE Data Indices, LLC, Company Filings

HY Healthcare fundamentals will vary considerably across Hospital and Pharma sub-sectors. For the Hospitals, cost pressures – specifically around wage inflation and contract labor utilization – will be thematic in 2023, representing a pressure point on EBITDA margins, though we expect improvement throughout the year. Volume dynamics around recession and/or general economic weakness represents another area of concern, as will the potential unwind of acuity and payor mix benefits experienced through the pandemic. The good news is that balance sheets are in better shape than pre-COVID times and maturity calendars have been extended, providing leeway for what could be short-lived operational volatility. For Pharma, the opioid issue has largely played out, allowing Teva to focus on generic/biosimilar approvals and branded uptake without existential overhang. Organon will also look to foster organic growth through its Women's Health and Biosimilar divisions. Bausch Health remains a standout in the space. Fundamentals for the credit will be heavily dictated by the timing/nature of the B+L separation, which could occur by early 2023 and leave bondholders facing almost certain default (albeit not for another ~2-3 years). Even with that overhang, asset coverage on BHC's 1L secured notes looks solid versus current trading levels.

Primary Market Outlook

Investment Grade

IG Healthcare 2023 Primary Market Expectations				
Issuer	Rating	Est. Amount ($B)	Use of Proceeds	Anticipated Timing
ABBV	Baa2/BBB+/NR	$3	Refinancing	2Q/3Q
AZN	A3/A-/BBB+	$3	Refinancing	1Q/2Q
BMY	A2/A+/NR	$4	Refinancing	1Q/2Q
GILD	A3/BBB+/NR	$2-3	Refinancing	2Q
MRK	A1/A+/A+	$2	Refinancing	1Q/2Q
PFE	A1/A+/A	$3	Refinancing	2Q/3Q
UNH	A3/A+/A	$7	Refinancing/M&A	1Q/2Q
ELV	A/Baa2/BBB	$1.5	Refinancing	1Q
CI	Baa1/A-/BBB+	$3	Refinancing	3Q
HUM	Baa3/BBB+/BBB	$1.5	Refinancing	3Q
ABT	A1/AA-/NR	$2	Refinancing	2Q
TMO	A3/A-/BBB+	$2.5	Refinancing	1Q/2Q
SYK	Baa1/BBB+/NR	$1.1	Refinancing	1Q/2Q

Source: CreditSights, Bloomberg, L.P.

IG Healthcare issuance picked up in 2022 versus very depressed levels in 2021. However, volumes fell well short of past years (2019-20) due to limited large-scale M&A activity. Notable deals in 2022 came from (i) BMY ($6 bn), which tapped the market to fund a tender offer, (ii) Roche ($5 bn), which partially financed a sizeable share buyback, (iii) Haleon ($9 bn), which funded its separation from Glaxo, (iv) Amgen ($7 bn), which tapped twice for various general purposes, (v) UnitedHealth ($15 bn), which financed M&A, and (vi) GE Healthcare ($8 bn), which issued debt fund its separation from General Electric.

For 2023, we expect refinancing to drive the bulk of issuance activity, with names such as Abbvie, Bristol-Myers, Pfizer, AstraZeneca, and UnitedHealth all landing on the 'potential issuers' list. Bolt-on M&A could also drive volumes though the manageable size of these deals generally provides management with discretion on funding sources (i.e., cash on hand versus new money). For example, JNJ intends to fund its $16.6 bn acquisition of Abiomed with cash on hand and short-term financing rather than traditional debt issuance. UnitedHealth is the likely exception, with ~$6 bn in pending deals which we expect will be largely (if not entirely) debt funded.

High Yield

HY Healthcare 2023 Primary Market Expectations				
Issuer	Rating	Est. Amount ($B)	Use of Proceeds	Anticipated Timing
TEVA	Ba2/BB-/BB-	$5	Refinancing	1Q/2Q/3Q
THC	B3/B-/B+	$2	Refinancing	2Q

Source: CreditSights, Bloomberg, L.P.

HY Healthcare issuance was also light in 2022, with much of the heavy lifting on maturity calendars completed in past years. Tenet issued $2 bn of secured notes in June to refinance outstanding unsecureds, while HCA issued $6 bn in March for GCP, including debt reduction, ahead of its full IG upgrade. Bausch Health also issued $3 bn of secured debt in September to fund a distressed debt exchange. The offering included new 1L and 2L secured notes issued by BHC as well as new senior secured notes issued out of an unrestricted subsidiary.

For 2023, potential HY issuers include Tenet and Teva. Tenet has $1.4 bn of senior secured notes maturing in mid-2024, though we expect management to show patience with its next market tap, particularly if operating results are weak. Teva has a whopping $4.6 bn of debt coming due by YE24. The company has been focused on utilizing FCF to reduce debt in recent years. It also issued $5 bn of USD and EUR senior notes in late 2021 to fund a tender offer. Management has disclosed plans to tap the debt markets for refinancing in late 2023/2024.

Event Risk/M&A Landscape

Event risk in IG Healthcare is moderately lower than past years as transformational M&A is largely off the table. Many companies with an appetite for large deals have now executed (i.e., ABBV+AGN and BMY+CELG). The regulatory environment (vis a vis antitrust) has also discouraged large-scale attempts. In Health Insurance, for example, Cigna is likely the only name with a hope of pulling off a significant transaction within the managed care vertical without drawing the ire of antitrust regulators. Instead, we expect to see elevated non-core divestiture activity, particularly in Pharma. J&J plans to separate its consumer healthcare business in 2023, while Novartis expects to spin off its generics unit, Sandoz. These transactions will result in a loss of much-coveted diversification. We see the potential for other non-core separations in 2023, including Merck's animal health business, Novartis' ophthalmology/respiratory segments, and Viatris' OTC/women's health business. For the Medical Products sector, we expect companies such as Thermo Fisher and Danaher to continue to grow via medium-to-large scale acquisitions. We also see the risk that both Boston Scientific and Agilent could pursue leveraging acquisitions given recent management commentary.

For HY Healthcare, event risk primarily relates to Bausch Health and Community. BHC is likely to effectuate the spin-off of B+L in 2023, leaving bondholders saddled with a greatly weakened RemainCo. Management could also look to execute another coercive exchange to help facilitate the separation. Community Health faces operational challenges as well as questions about its ability to ever grow into its capital structure. These pressures, as well as the presence of one large holder in the structure (Franklin), could ultimately drive financial maneuvering, perhaps in the form of non-guarantor subsidiary debt issuance. In Health Insurance, we could see continued bolt-on acquisitions from health insurer, Molina, as it executes its strategy of acquiring single-state/regional health insurers. And while these deals could be debt-funded we don't expect anything beyond the bolt-on level.

ESG Considerations

On the ESG front, all roads in Healthcare lead to product liability issues. Endo will look to resolve its opioid liabilities under bankruptcy protection following settlements from most other large drugmakers. J&J will look to separate its talc liability – which could prove sizeable – through a Texas two-step maneuver, the success of which is still very much up in the air. The sector also faces lawsuits tied to Zantac, specifically related to the presence of cancer-causing contaminants. These suits have embroiled Glaxo, Pfizer and others. While product liability suits are somewhat normal course in Pharma, the magnitude and visibility of these issues could raise valid ESG concerns in the year ahead.

In Health Insurance, elevated levels of regulatory scrutiny into potentially fraudulent Medicare Advantage 'upcoding' practices is coming to center stage. The DOJ has active inquiries into UnitedHealth, Humana, Elevance, CVS/Aetna, and others, with the most recent development being **the DOJ's formal intervention in litigation against Cigna**.

In Medical Products, product liability risk has been largely subdued aside from Abbott Labs' infant powder formula issues, which we do not, at this point, expect to translate into significant off-balance sheet risk.

Leisure

Executive Summary

- We are lowering our recommendation to Market perform (from Outperform) for IG Leisure. While IG Leisure is the widest sector in the IG index, this reflects the significant influence from Sands China bonds (~25% of the index) which trades well wide to the US IG BBB Index (and wide to HY BB index, as well) with meaningful fallen angel risk. When excluding Sands China, we expect the IG Leisure sector to largely perform in line with the IG Index as the sector shifts out of its deleveraging cycle.

- We maintain our Outperform recommendation on the HY Leisure sector. We expect 2023 performance to be driven by the cruise recovery as well as continued strength from certain hotel and gaming names (i.e. Hilton and Caesars).
- Our preferred picks in IG Leisure are Expedia and Hyatt. Both look attractive relative to peers, and we expect Hyatt will continue to deleverage on the back of the ongoing recovery in business travel. We would opt to pass on Choice Hotels given management's increased appetite for M&A and (or) shareholder rewards.
- For HY leisure, Carnival, Service Properties Trust, and Caesars remain our preferred ways to play the space based on their more protracted recoveries which should pick up steam in 2023. Our top pan in the space is Wyndham where we see the potential for leveraging M&A.
- We expect new issuance in the sector to be relatively modest given the relatively light maturity wall in 2023, the difficult rate environment, and lack of obvious M&A funding needs. 2025 represents the biggest maturity slug in the medium term, however we don't expect to see a lot of issuers address these maturities until rates become more favorable.

Key Themes for 2023

- After early Omicron-related headwinds in 2022, demand for leisure activities/services was robust through the remainder of 2022. While the potential for a recession threatens to dampen consumer discretionary spending, the outlook for 2023 leisure demand so far remains robust.
- The ongoing recovery in business travel and convention demand picked up in the back half of 2022 as corporations reestablish post-pandemic business practices. We expect this will continue to be a tailwind for growth as we move through 2023.
- The U.S. witnessed a strong recovery in leisure during 2022, while international markets were slower to rebound. We expect to see a continued recovery in most international markets. Although, economic and geopolitical risks represent a threat to this recovery.
- China's determination to maintain its strict zero-tolerance COVID policies, will continue to inhibit a recovery in travel and leisure-based services in the region, including Macau.
- In Gaming, we saw meaningful margin improvements for operators during the pandemic as they improved cost efficiencies and scaled back margin deteriorating services. The operators will likely have to sacrifice some of these margin improvements for the sake of maintaining customer interest/satisfaction, but nearly all are signaling plans to enjoy a permanent/structural margin improvement from pre-pandemic margins.

Top Risks for 2023

- Macroeconomic headwinds lead to a pullback in consumer demand for leisure (not yet the case).
- Economic and geopolitical risks (i.e. Russia's war with Ukraine) weaken consumer demand and disrupt the recovery in international markets.
- The potential for another COVID-related outbreak and consequential shutdowns. This is a lower probability, especially in the U.S., but could slow down business travel or international travel if the outbreak is severe enough and leads to restrictions on cross-border travel.

- China maintains its strict zero-tolerance COVID policies, delaying the possibility of a recovery in the region. This would be most impactful for leisure names with high exposure to the region, notably the Macau gaming operators.

Picks, Pans & Recommendations

Investment Grade Picks

- **Expedia –** we believe spreads on the bonds have been penalized more than warranted, compared to manager franchisers (i.e. Marriott). We also like management's commitment to IG and their prioritization of deleveraging even with leverage near pre-pandemic levels.

- **Hyatt –** trades wide to peers (Marriott and Choice) on a more protracted leverage recovery, due in part to leveraging M&A in late 2021. That said, we like management's focus on deleveraging and see a path for leverage to return to pre-pandemic levels in the near to medium term.

Investment Grade Pans

- **Choice Hotels –** has solid operations, including meaningful exposure to leisure-based travel. This has led to a quick recovery in leverage metrics (to pre-pandemic levels), which in turn has increased management's appetite for M&A and shareholder rewards.

US IG Leisure Company Recommendations		
Outperform	Market Perform	Underperform
Expedia (EXPE)	Booking Holdings (BKNG)	Choice Hotels (CHH)
Hyatt (H)	Host Hotels (HST)	
	Marriott International (MAR)	

Source: CreditSights

High Yield Picks

- **Hilton –** is our top pure play hotelier for IG investors able to dip in BBs as a way to pick up more spread, we also favor the name over BB peer Wyndham. While management is content running leverage slightly higher than IG peers, we continue to comp Hilton's operating dynamics to the likes of Marriott.

- **Service Properties Trust –** continues to make meaningful strides in its balance sheet clean up, and we expect continued recovery in 2023 on the back of improving trends in its hotel portfolio and stable rental income from its triple net lease assets. We think the company has a path to improve leverage to BB levels in 2023.

- **Carnival Cruise –** is poised for a strong operational recovery in 2023 as booking trends are at the high-end of historical ranges and at higher prices. We prefer to play the cruise recovery story through Carnival which offers additional yield over cruising peer Royal Caribbean.

- **Boyd –** represents one of our more defensive plays in the HY gaming space. We favor management's newfound conservative approach to leverage as well as the retained ownership of its casino properties, providing another layer of balance sheet protection.

- **Caesars** – has a path to break into high-5x lease adjusted leverage in 2023 and further improve leverage through EBITDA growth and a concentrated effort to reduce debt.

- **International Game Technology –** benefits from its lottery business which provides a layer support if the gaming business were to experience a pullback. We also like management's more cautious approach to leverage relative to its peer, Light & Wonder.

- **Wynn Macau –** continues to be plagued by strict China's strict zero-tolerance COVID policies. However, for investors comfortable riding the roller coaster of the Macau recovery story, we continue to like high yields offered at WYNMAC.

High Yield Pans

- **Light & Wonder –** has streamlined its operations, shedding its lottery and sports betting businesses and focusing on gaming supply, social gaming, and igaming. On a relative value basis, we prefer exposure to IGT, who maintains exposure to a more resilient lottery business and is taking a more cautious approach with leverage.

- **Wyndham –** quickly restored leverage to pre-pandemic levels on the back of robust leisure demand. Consequently, management's appetite for M&A has increased, which could be to the detriment of its recently improved credit profile.

US HY Leisure Company Recommendations

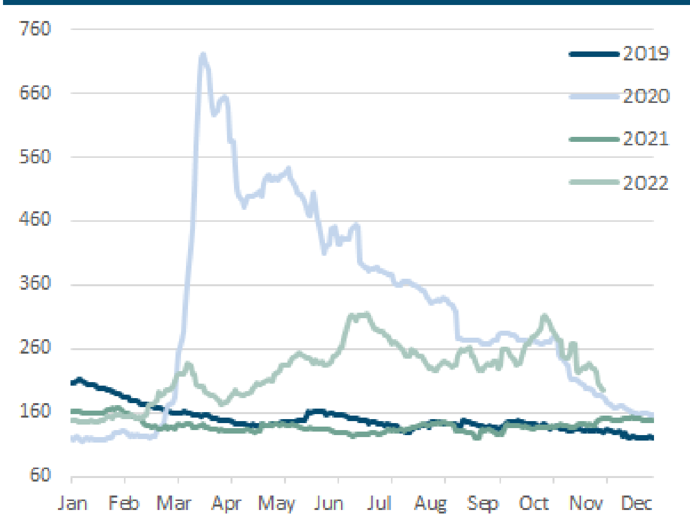
Outperform	Market Perform	Underperform
Boyd (BYD)	Accor (AC FP)	Light & Wonder (LNW)
Carnival Cruise (CCL)	Caesars Resorts (CRC)	Wyndham Hotels & Resorts (WH)
Caesars Entertainment (CZR)	Las Vegas Sands (LVS)	Wynnn Las Vegas (WYNNLV)
Hilton (HLT)	MGM Resorts (MGM)	
International Game Technology (IGT)	Penn Entertainment (PENN)	
Service Properties Trust (SVC)	Royal Caribbean (RCL)	
Wynn Macau (WYNMAC)	Travel & Leisure (TNL)	
	Wynn Financial (WYNFIN)	

Source: CreditSights

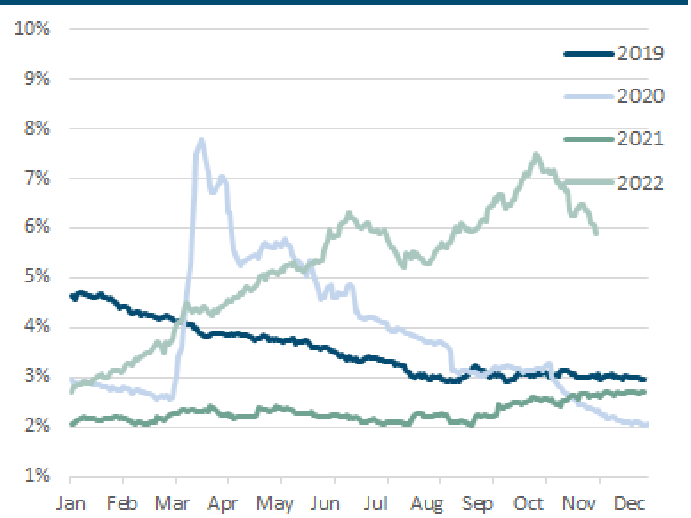
Relative Value

Investment Grade

US IG Leisure Annual OAS History: 2019-2022



US IG Leisure Annual YTW History: 2019-2022

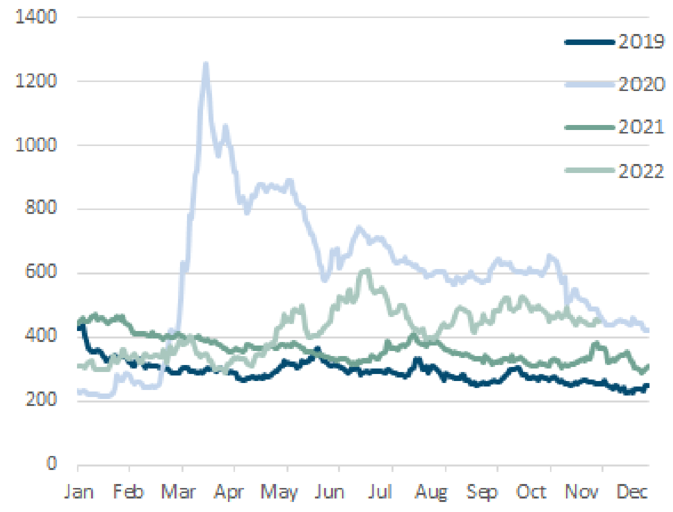


Source: CreditSights, FactSet, ICE Data Indices, LLC

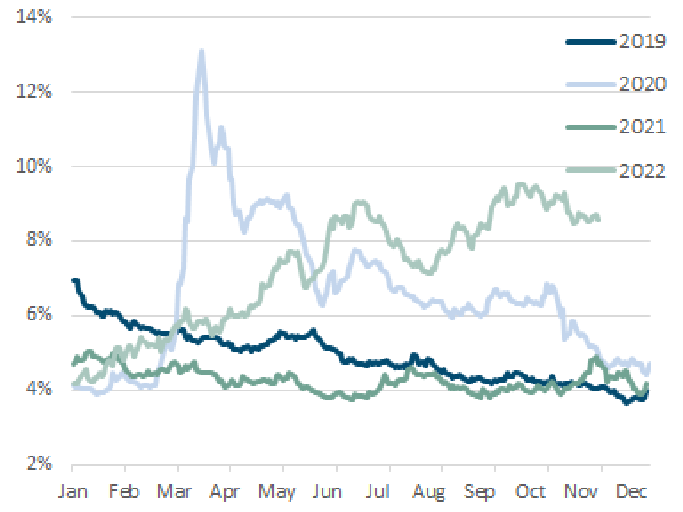
IG Leisure currently sits ~82 bp wide to the IG index, this has widened by ~35 bp YTD in 2022. Marriott represents the largest issuer in the index (~30% of the index). However, the underperformance in 2022 was primarily driven by Sands China (~25% of the index) which was heavily impacted by the ongoing headwinds in Macau. IG Leisure continues to be the widest sector in the IG Index, reflecting the influence from Sands China – which sports a weighted average OAS of ~429 bp (~4.1 average duration) compared to the US BB Index (~287 bp; ~4.3 average duration). For 2023, we have a Market perform on the IG Leisure sector as we see a high risk that Moody's downgrades its rating on Sands China dropping the bonds out of the index, especially if the Chinese government stands pat on their current COVID-policies. Ex-Sands China, we expect the IG Leisure index to largely perform in line with the IG Index.

High Yield

US HY Leisure Annual OAS History: 2019-2022



US HY Leisure Annual YTW History: 2019-2022



Source: CreditSights, FactSet, ICE Data Indices, LLC

HY Leisure yields currently sit at 8.7%, roughly ~20 bp tight to the US HY index (8.9%). On a relative basis (YTD), the HY Leisure index has slightly outperformed the HY index (by ~1 bp). This was driven by outperformance in HY gaming and hotels, partially offset by an underperformance from cruise and entertainment. For 2023, we continue to hold an Outperform on HY leisure and expect 2023 performance to be driven by the cruise recovery as well as continued strength from Hilton and Caesar.

Fundamental Outlook

IG Leisure Largest Issuer Fundamental Snapshot

Issuer	Total Outstanding ($B)	Net Leverage Current	Net Leverage YE 2021	Net Leverage YTD Change	FY2023 Leverage Direction
Marriott International	$9.4	2.4x	3.8x	-1.4x	Higher
Booking Holdings	$9.2	0.0x	0.0x	0.0x	Higher
Expedia	$6.2	0.7x	2.8x	-2.1x	Flat
Host Hotels	$4.2	2.4x	7.7x	-5.3x	Higher
Hyatt	$3.8	3.3x	11.7x	-8.5x	Lower
Choice Hotels	$1.2	2.4x	1.4x	1.0x	Higher

Source: CreditSights, FactSet, ICE Data Indices, LLC, Company Filings

HY Leisure Largest Issuer Fundamental Snapshot

Issuer	Total Outstanding ($B)	Net Leverage Current	Net Leverage YE 2021	Net Leverage YTD Change	FY2023 Leverage Direction
Carnival Cruise	$34.1	n/a	n/a	n/a	Lower
Royal Caribbean	$23.3	n/a	n/a	n/a	Lower
Las Vegas Sands	$15.3	n/a	n/a	n/a	Lower
Caesars Entertainment	$13.3	6.1x	6.9x	-0.8x	Lower
Wynn	$12.2	13.7x	17.7x	-3.9x	Lower
Hilton	$8.8	3.2x	4.6x	-1.4x	Flat
MGM Resorts	$8.6	6.7x	6.5x	0.2x	Flat
Service Properties Trust	$5.7	10.1x	14.7x	-4.6x	Lower
IGT	$5.5	3.1x	3.5x	-0.4x	Lower
Travel + Leisure	$5.3	5.9x	6.4x	-0.4x	Flat
Light & Wonder	$3.9	3.0x	10.2x	-7.2x	Flat
Accor	$3.4	n/a	n/a	n/a	Lower
Boyd	$2.9	2.6x	2.5x	0.1x	Flat
Penn Entertainment	$2.8	4.3x	4.1x	0.2x	Flat
Wyndham Hotels & Resorts	$2.1	2.7x	3.2x	-0.5x	Higher

Note: leverage is adjusted to reflect lease liabilities for the gaming names (BYD, CZR, MGM, PENN, and WYNN). Caesars Entertainment net leverage excludes EBITDAR losses from Digital business.
N/A: reflects negative EBITDA levels in 2022 and 2021
Source: CreditSights, FactSet, ICE Data Indices, LLC, Company Filings

The leisure sector is mostly bifurcated between companies that have restored leverage back to pre-pandemic levels, and are now shifting to a more aggressive capital allocation strategies, and companies that have had a more protracted recovery and are still focused on deleveraging. On the former, this is primarily the case with IG lodging names. On the latter, this pertains mostly to the cruise industry – where the recovery has had a slower uptake – as well as destination gaming operators (especially those with exposure to Macau) and some business travel focused lodging names.

Primary Market Outlook

IG Leisure 2023 Primary Market Expectations				
Issuer	Rating	Est. Amount ($B)	Use of Proceeds	Anticipated Timing
BKNG	A3/A-/NR	$1	Refinancing	1Q
MAR	Baa2/BBB/NR	$1	Refinancing	2H

Source: CreditSights, Bloomberg, L.P.

In 2022, the only name in our IG leisure coverage to tap the primary US bond market was Marriott, issuing $1 bn of 5.00% 2027 senior unsecured notes. For 2023, refinancing needs look relatively light, with only $1.9 bn of total debt maturing within the leisure IG coverage universe. This includes $500 mn at BKNG, $700 mn at Hyatt, and ~$676 mn at Marriott (including $291 mn in February and $350 mn in December). We also wouldn't be surprised to see Hyatt repay its $700 mn bond maturing in October 2023, given the current primary market and management's focus on debt repayment. Outside of refinancing, we currently don't have any names in our IG coverage with meaningful M&A financing needs.

HY Leisure 2023 Primary Market Expectations				
Issuer	Rating	Est. Amount ($B)	Use of Proceeds	Anticipated Timing
WYNNLV	B2/B+/NR	$0.5	Refinancing	1H
SVC	B1/B+/NR	$0.5	Refinancing	2Q
TNL	Ba3/BB-/BB+	$0.40	Refinancing	1Q

Source: CreditSights, Bloomberg, L.P.

In 2022, we saw meaningful primary market activity from our cruise names (Carnival Cruise and Royal Caribbean). This includes an aggregate issuance of ~$4.5 bn from CCL (~$1 bn of senior unsecured notes, ~$2 bn of senior priority notes, and ~$1.4 bn of convert exchanges) and ~$5.4 bn from RCL (~$2.3 bn of senior unsecured notes, $1 bn of senior guaranteed notes, $1 bn of 1Ls, and $1.2 bn of converts). Outside of cruise, we didn't see any primary market issuance in lodging or gaming.

There is ~$3.5 bn of HY leisure corporate debt (in our coverage) maturing in 2023. However, ~$1.25 bn of this is from MGM, who has indicated that they plan to pay down the debt with cash on hand. Outside of MGM, in gaming and lodging, there is $500 mn from Wynn (WYNNLV), $500 mn from Service Properties Trust, and $400 mn from Travel & Leisure coming due in 2023. In cruise, CCL and RCL have done a nice job of already addressing the majority of their 2023 debt and are starting to focus on 2024 maturities. Given this, we could see additional balance sheet management from both CCL and RCL for their remaining 2024 debt and future 2025 maturities. Outside of refinancing, we currently don't have any names in our HY coverage with obvious M&A financing needs.

Event Risk/M&A Landscape

For 2023, we believe the leisure sector has low to moderate event / M&A risk. In lodging, we expect to see some healthy interest in M&A, especially for names that have already recovered leverage to pre-pandemic levels. However, there are still a number of companies taking a more cautious approach with leverage and the current rate environment could dampen activity. In gaming, we expect to see a healthy level of business development – especially for greenfield projects – and could see additional investments in the digital gaming space. In cruise, we don't expect to see much M&A activity as the operators focus on optimizing their current fleet and managing their balance sheets.

ESG Considerations

ESG is not a sector-wide consideration in leisure and is limited to Social and (or) Governance considerations for a few specific names. Within gaming, we see Las Vegas Sands and Wynn as showing elevated Social risk, due to their dependence on foreign government regulators in China/Macau. There are also some Governance at Las Vegas Sands, given the majority equity holding (57% of LVS share) by the estate of former company founder/CEO, Sheldon Adelson. In lodging, Service Properties Trust has some longstanding Governance concerns stemming from the web of interrelated parties and ownership stakes across its leading hotel brand, Sonesta, its external manager, RMR, and its senior leadership. Of note, Sonesta is majority owned by SVC's CEO Adam Portnoy and his affiliates. Mr. Portnoy is also a director of Sonesta.

Retail

Executive Summary

- US IG Retail (Underperform). We maintain our underperform recommendation on IG retail, given the sector's relatively tight spreads versus the broader index, despite an average duration nearly a year longer than the index. Changing tides of consumer demand have seen (most) retailer's 2021 margin strength begin to erode amid over-supply of inventory and a return to margin-damaging discounting/promo.
- US HY Retail (Market Perform). We maintain our market perform recommendation on US HY Retail, reflective of a mix of opportunities in better performing names and pitfalls from overlevered names that will have to carry out turnaround efforts in a softening operating environment with unforgiving capital markets. The HY Retail index trades ~130bp wide to the overall HY index, at relatively similar duration (4.5 vs 4.1 years).
- While core HY names like Macy's have shown some resilience through strong operating performance and cautious inventory management, further down the credit spectrum, names like Party City and Rite Aid have deeper problems to solve against a backdrop of a softening consumer-led economy.
- IG Picks & Pans: In the IG space, we seek spread, and like Lowe's, Dollar General, and Best Buy. On a relative value basis, we would underallocate to tight spreads at Walmart, Home Depot. We also remain caution on split-rated Kohl's.
- HY Picks & Pans: In the HY space, we like Macy's and Bath & Body Works, while we'd avoid Rite Aid, Gap and Hanesbrands.
- New Issue Outlook
    - For IG names, we ultimately think that the trajectory of rates will influence the extent to which names issue to fund share repurchase activities. We think the majority of issuance will be driven by M&A ambitions – most notably a $15bn+ take from KR/ACI – as well as smaller servings to fund the healthcare service ambitions of WBA and CVS.
    - For HY names in our universe, there are relatively few 2023 maturities, and relatively little ambition for an organic increase in total debt outstanding at this stage in the cycle.

Key Themes for 2023

- US consumers are continuing to come down from the "sugar-high" of Federal stimulus and other transfer payments, and resetting demand expectation in hot pandemic-era discretionary goods categories amid inflationary pressure in non-discretionary categories like rent and food.
- Supply chain and ocean freight constraints are rapidly easing, which will reverse a cost headwind endured for much of the pandemic.

- On the other hand, pockets of raw material cost inflation/volatility remain, and we expect rising labor costs endured in the past two years will be persistent.

Top Risks for 2023

- Supportive elements of consumer spending may wane in 2023, as shoppers spend down pandemic era savings surpluses, and some normalization of labor markets erodes worker's "upper-hand" in wage demands.
- The lure of low equity price after a damaging run for retailers in 2022 may push names to increase allocations towards share repurchase programs.
- M&A activity has ticked up for retailers in a few areas, including Grocery (Kroger's attempts to buy Albertsons) and retail pharmacy, where efforts to branch out from relatively low margin retail/PBM businesses have names like WBA and CVS setting sights on healthcare services acquisitions at lofty multiples.

Picks, Pans & Recommendations

Investment Grade Picks

- **Lowe's** – Demand in home improvement remains resilient, despite clouds on the housing horizon. We like LOW for incremental spread vs HD, despite modestly higher leverage appetite.
- **Dollar General** – Consumables-heavy operator should enjoy a steady run with customers seeking to stretch nondiscretionary spend. Potential to pick up new customers in a recession provides some cushion if our consumer view proves too optimistic.
- **Best Buy** – While consumer electronics has seen weaker demand YoY after a stimulus/stay-at-home driven surge in 2020/21, BBY remains well positioned in the space, and employs a conservative balance sheet while offering incremental spread vs similar rated retail peers.

Investment Grade Pans

- **Home Depot** – HD has enjoyed a strong performance during the pandemic, but we like the incremental spread pickup at LOW.
- **Walmart** – Similar to HD, our view on WMT is not driven by expectations of significant operational weakness, but relatively tight spreads vs other operators in the space, like TGT.
- **Kohl's** – KSS has been the subject of activism and a push to either sell the company or pursue broad sale-leaseback of owned retail and distribution properties to fund share buybacks. Recent CEO departure opens the door to more creditor-unfriendly actions spurred by activists.

US IG Retail Company Recommendations

Outperform	Market Perform	Underperform
Lowe's (LOW)	Target (TGT)	Walmart (WMT)
Dollar General (DG)	Kroger (KR)	Home Depot (HD)
Best Buy (BBY)	VF Corp (VFC)	Kohl's (KSS)
CVS Health (CVS)	Walgreens (WBA)	

Source: CreditSights

High Yield Picks

- **Macy's** – M has operationally outperformed peers such as KSS and JWN during the pandemic, and focused on balance sheet management, including relatively conservating inventory ordering and debt reduction, with the latter bringing M to IG-worthy 2x lease adjusted leverage metrics.

- **Bath & Body Works** - Optically, the extremely strong performance during the pandemic gave BBWI a tough comp in 2022, but the name is still running ahead of pre-pandemic earnings, and targets relatively low long term leverage for its rating.

High Yield Pans

- **Hanesbrands** – Efforts to adapt aging innerwear brands to younger customers are underway, but bring some execution risk. Leverage is rising quickly as retailers pull back on orders to right-size inventory.

- **Rite Aid** – RAD remains an overlevered/underscaled operator in both its retail and PBM businesses. Despite promises of profit improvement from management, the company will need to successfully pivot to replace waning COVID-related demand from test and vax sources with more traditional sources. RAD sat out recent nationwide opioid settlement, leaving some overhang for a company that can ill afford a payout.

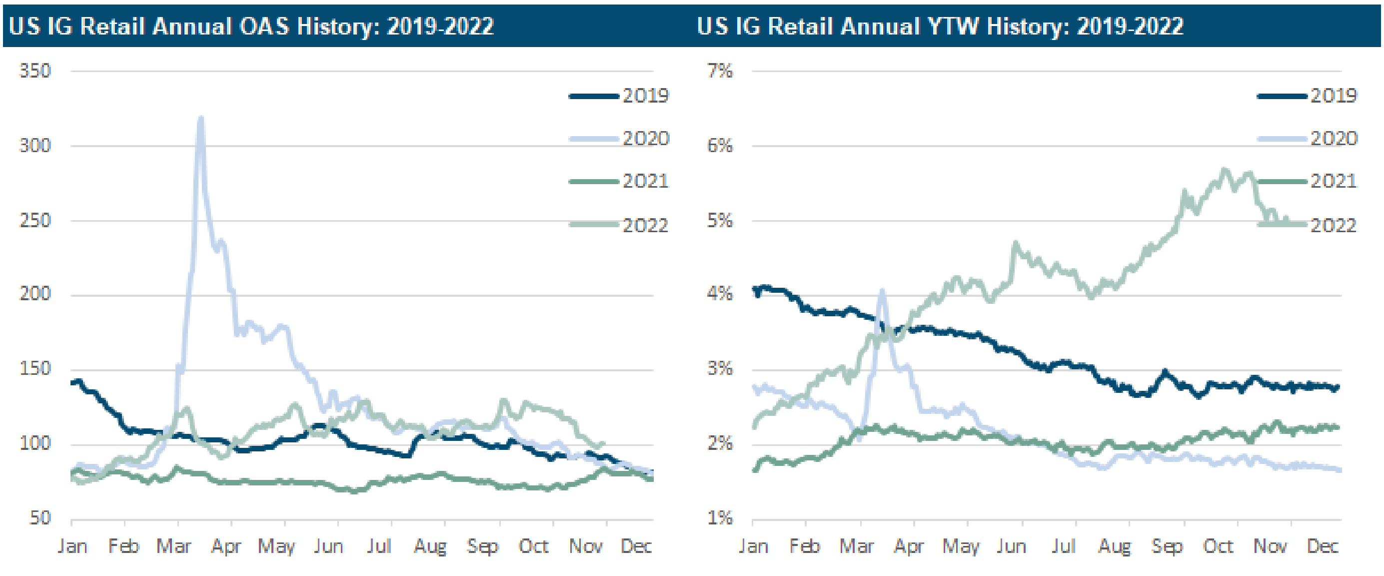
US HY Retail Company Recommendations

Outperform	Market Perform	Underperform
Macy's (M)	Nordstrom (JWN)	Gap (GPS)
Bath & Body Works (BBWI)	Victoria's Secret (VSCO)	Hanesbrands (HBI)
	Mattel (MAT)	Rite Aid (RAD)
		Party City (PRTY)

Source: CreditSights

Relative Value

Investment Grade

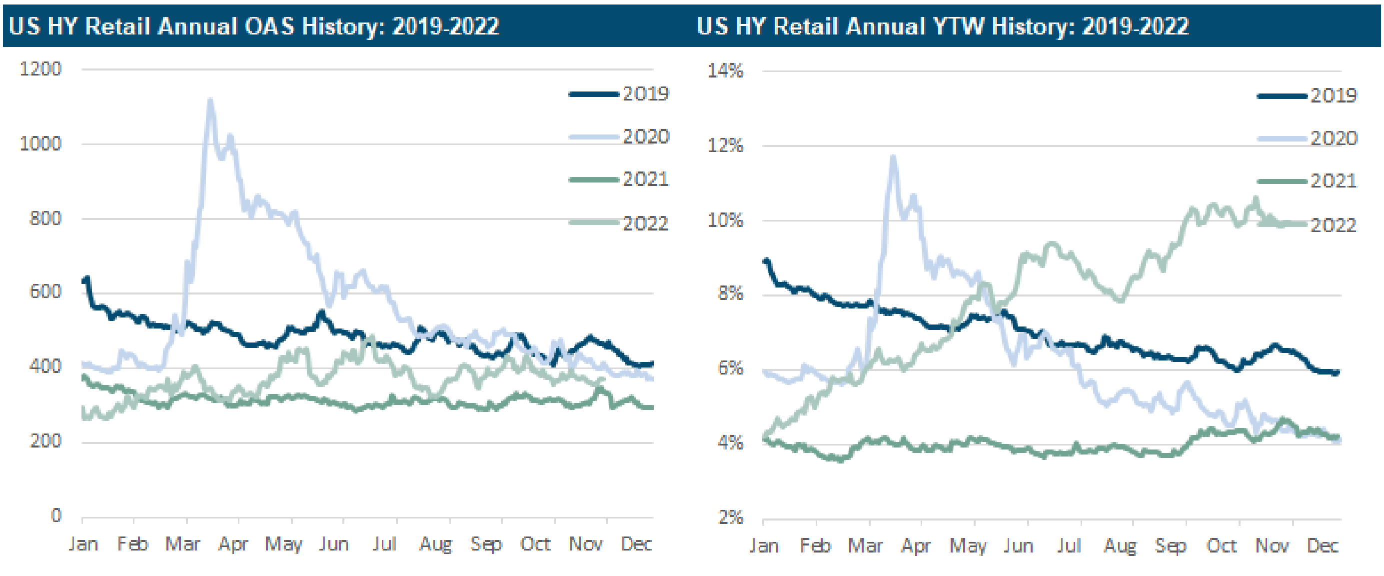


Source: CreditSights, FactSet, ICE Data Indices, LLC

We maintain our underperform recommendation on IG retail, given the sector's relatively tight spreads versus the broader index, despite an average duration nearly a year longer than the index. Changing tides of consumer demand have seen (most) retailer's 2021 margin strength begin to erode amid over-supply of inventory and a return to margin-damaging discounting/promo.

Catalysts for widening could include stronger evidence of a downturn in consumer's spending ambitions (thus far fairly resilient), backtracking of recent progress on supply chain (possibly driven by China-centric production amid some rising discontent among workers/citizens with harsh COVID-zero policy), or headwinds if commodity-centric names (grocery, home improvement) see top line pressure from a reversion to deflationary trends.

High Yield



Source: CreditSights, FactSet, ICE Data Indices, LLC

We maintain our market perform recommendation on US HY Retail, reflective of a mix of opportunities in better performing names and pitfalls from overlevered names that will have to carry out turnaround efforts in a softening operating environment with unforgiving capital markets. The HY Retail index trades ~130bp wide to the overall HY index, at relatively similar duration (4.5 vs 4.1 years).

Fundamental Outlook

IG Retail Largest Issuer Fundamental Snapshot

Issuer	Total Outstanding ($B)	Net Leverage, Lease Adj Current	YE 2021	YTD Change	FY2023 Leverage Direction
CVS Health Corporation	$52.2	2.2x	2.8x	-0.6x	Flat
Walmart Inc	$51.3	1.4x	1.1x	0.4x	Flat
Home Depot, Inc	$43.0	1.7x	1.7x	0.0x	Flat
Lowe's Companies, Inc	$33.5	2.3x	1.9x	0.4x	Higher
Target Corporation	$16.4	2.2x	0.8x	1.4x	Flat
Kroger Co	$13.3	2.2x	2.2x	0.0x	Higher
Walgreens Boots Alliance, Inc	$11.7	3.6x	3.4x	0.1x	Higher
VF Corporation	$6.1	3.1x	2.2x	0.9x	Flat
Kohl's Corporation	$5.5	3.7x	1.8x	1.9x	Flat
Dollar General Corporation	$5.2	2.8x	2.6x	0.3x	Flat

Source: CreditSights, FactSet, ICE Data Indices, LLC, Company Filings

HY Retail Largest Issuer Fundamental Snapshot

Issuer	Total Outstanding ($B)	Net Leverage, Lease Adj Current	YE 2021	YTD Change	FY2023 Leverage Direction
Bath & Body Works, Inc	$4.9	2.8x	1.6x	1.2x	Higher
Hanesbrands Inc	$3.9	4.0x	2.6x	1.4x	Higher
Rite Aid Corporation	$3.3	5.0x	4.4x	0.6x	Flat
Macy's Inc	$3.2	1.8x	1.3x	0.5x	Flat
Nordstrom, Inc	$3.0	3.0x	3.2x	-0.1x	Lower
Gap, Inc	$1.8	3.5x	2.1x	1.3x	Higher
Party City Holdco, Inc	$1.7	6.7x	4.3x	2.4x	Higher
Victoria's Secret & Company	$1.0	1.7x	1.3x	0.3x	Flat

Source: CreditSights, FactSet, ICE Data Indices, LLC, Company Filings

The return of discounting and promotion to clear excess inventories in many pandemic-era favorite categories (consumer electronics, casual apparel, small appliances, home furnishings, etc) has weighed on gross margins for most retailers in 2H22, and is likely to carry through into early 2023 as well. The impact here has generally been one of modest re-leveraging, although we would highlight that names which have taken a balance-sheet focused capital allocation approach during the heightened free cash flow period of the pandemic (like Macy's, Mattel, etc) have been able to offset some or all of the leverage creep. In addition, aggressive rounds of cost cutting activity early in the pandemic left many names poised to sustain some improvement in SG&A margins.

Primary Market Outlook

On the issuance front, we expect the calendar to be dominated by normal-course refi needs, which are relatively modest and not specifically highlighted in the table below.

On the M&A funding front, Kroger is likely to tap markets for borrowings of at least $15 bn to fund its acquisition of Albertsons, assuming it can clear regulatory hurdles. A pending slate of deals for Walgreens is also likely to bring some issuance in the multibillion-dollar range to fund transactions including its indirect purchase of Summit Health/City MD (see **Walgreens: VillageMD Buys Summit Health, Pares ABC**). CVS has achieved its deleveraging goals following the big-ticket AET acquisition, and is now preparing for a future with greater capital allocation flexibility. An unexpected hit from a Medicare Advantage ratings change may prompt it to buy back more shares to hit EPS growth targets, while the company is also openly in search of a primary healthcare acquisition.

Names like Home Depot and Lowe's (in particular) have been active debt issuers to fund share repurchase activities, with LOW growing issuance faster than EBITDA as it recalibrates around a higher long-term lease adjusted leverage target (2.75x). With that target likely to be achieved following the disposal of Canada operations for a relatively paltry sum, we expect future issuance will be tempered in proportion to EBITDA growth.

IG Retail 2023 Primary Market Expectations

Issuer	Rating	Est. Amount ($B)	Use of Proceeds	Anticipated Timing
CVS	Baa2/BBB/NR	6.0	M&A/Share Repurchase	2Q-3Q
WBA	Baa2/BBB/NR	4.0	M&A	1Q-2Q
KR	Baa1/BBB/NR	15.0	M&A	2H

Source: CreditSights, Bloomberg, L.P.

Most HY retailers have cleared the decks of near term maturities (or have incorporated repayment of those maturities as part of a broader deleveraging plan) - with core performing HY names like Macy's, Victoria's Secret and Gap not facing any meaningful maturities until 2028 or later. Deeper into distressed territory, we've seen names like RAD flirt with coercive plans to address not-so-near term maturities, although ultimately fall back to discounted tender offer to chip away at future maturity walls.

HY Retail 2023 Primary Market Expectations

Issuer	Rating	Est. Amount ($B)	Use of Proceeds	Anticipated Timing
JWN	Ba1/BB+/BBB-	0.25	Refi '24 maturities	2H
HBI	Ba2/BB/NR	0.95	Refi '24 maturities	2H

Source: CreditSights, Bloomberg, L.P.

Event Risk/M&A Landscape

Retail saw pockets of M&A appetite in 2022 – most notably KR/ABS - but ultimately we expect relatively little peer-to-peer merger activity. Kroger's immediate political headwinds on the Albertson's deal announcement are indicative of an uphill battle with government regulators for any horizontal mega-mergers, particularly in an environment where concerns over consumables inflation reign strong.

Retail Pharmacy saw an active slate of M&A in 2022, and remains an area where we expect to see more deals in 2023, as retailers/PBMs/insurers look to diversify into healthcare services in search of both higher margins and synergies with existing portfolios. While retail has shouldered its share of big ticket LBOs over the years, not many have ended successfully. We expect very high deal financing costs and the looming risk of a leg down in consumer demand will keep PE at bay.

ESG Considerations

Most of our ESG considerations for Retail are focused on governance issues. One worthy of note is the evolution of the activist story at Kohl's, which has now seen a CEO depart amid lagging performance, and effort to find a replacement being led by activist nominated board members. On Social issues, we've seen a growing number of retailers fall victim to negative public perception around celebrity partnerships – a la Gap (and Adidas') Kayne West moment, but these are difficult to predict and quantify.

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