



Morningstar Credit Research

Phone: 800 549-9585
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*7 Unmute line

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Morningstar's Equity and Credit Research Staff

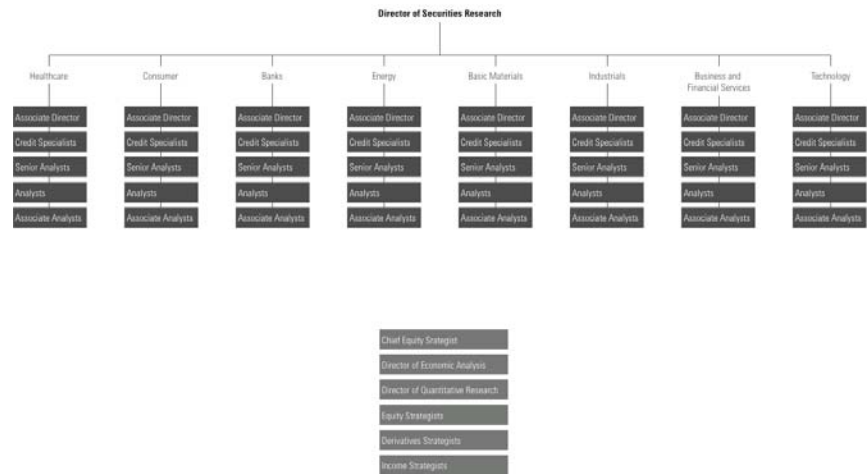
- ▶ 80 Equity Analysts
 - ▶ Organized into eight sector teams (Industrials, Consumer, Energy, Banks, etc.)
 - ▶ Each analyst is an industry specialist, covering 20-25 companies
 - ▶ Main analyst research duties: field research, analyst notes and reports, five years of detailed financial modeling

- ▶ 10 Credit Analysts
 - ▶ Sector specialists, embedded within each sector team
 - ▶ Primary voting members of Credit Rating Committee
 - ▶ Surface bond investment ideas from across their sector

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Industry Specialization



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Equity and Credit Analysts Work In Tandem

- ▶ **Equity Analyst**
 - ▶ Conducts primary research on the firm
 - ▶ Analyzes competitive position, works with Equity Strategists to assign Economic Moat rating (e.g., Narrow)
 - ▶ Writes company report, including assessment of financial health and capital structure
 - ▶ Builds DCF model, including five years of explicit forecasts
 - ▶ Determines equity fair value estimate and Uncertainty rating; has primary responsibility for the stock call
 - ▶ Participates in discussing company with the Credit Committee
- ▶ **Credit Analyst**
 - ▶ Reads equity analyst's research
 - ▶ Works with equity analyst to hone the debt analysis in the model, including the Cash Flow Cushion and Business Risk assessment
 - ▶ Acts as a voting member of the Credit Committee for firms within sector
 - ▶ Writes credit initiation note
 - ▶ Monitors credit ratings for all firms within sector
 - ▶ Mines the sector for investment ideas among bonds of Industrial firms
 - ▶ Publishes bond investment idea lists and additional commentary on credit opportunities in the sector

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Comprehensive Coverage



By industry:

Information		Service		Manufacturing	
Software	74	Healthcare	182	Consumer Goods	164
Hardware	121	Consumer Services	175	Industrial Materials	232
Media	65	Business Services	166	Energy	146
Telecommunications	114	Financial Services	333	Utilities	80

By market cap:

Large-cap stocks	512	Mid-cap stocks	741	Small-cap stocks	599
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As of: May 2010

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Our Approach: Equity and Credit Research

- ▶ We evaluate stocks as small pieces of a business. We evaluate debt as a claim on a company's future cash flows.
- ▶ We do primary research, formulating our own opinions by reading financial filings & trade journals, visiting companies, talking to competitors & customers, and attending industry conferences.
- ▶ We have a long-term perspective.
- ▶ Our recommendations are driven by valuation, but we are not "value investors" in the most traditional sense.
- ▶ We believe that competitive advantages—"economic moats"—are key from both an equity and credit perspective, and we rigorously assess the competitive position of the companies we cover.
- ▶ We believe that the ability of a business to generate ROIC above cost of capital is the primary test of value creation.
- ▶ We use scenario analysis to analyze upside and downside cases, as well as to challenge our own assumptions.

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Differentiators: Our Value Proposition in Credit Research

- ▶ Independence
 - ▶ We don't have an issuer-pay model
 - ▶ We're focused on the investor
- ▶ Depth
 - ▶ We have full cash-flow models on each company, which include 5-year forecasted income statements, balance sheets, and cash-flow statements
 - ▶ We build off the industry and company knowledge we've acquired over the past 10 years in equity research
- ▶ Breadth
 - ▶ We'll cover the companies bond investors care about
 - ▶ Our coverage will be broader than any other independent provider
- ▶ Proven Philosophy
 - ▶ Focus on Economic Moats and free cash flows
 - ▶ Scenario Analysis and the "cone of possibilities"
 - ▶ Unique combination of qualitative and quantitative measures
- ▶ Timeliness
 - ▶ Our credit ratings include market-based measures (distance to default), which reflects the latest information
 - ▶ Our forecasts and models are updated at least quarterly

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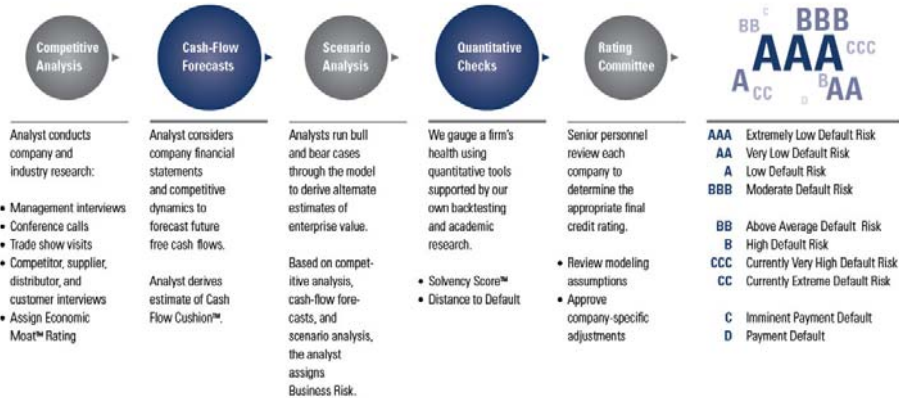
Morningstar's Credit Coverage (as of 9/15/10)

	Issuer Ratings	Investment Grade	Speculative Grade
Consumer	103	72	31
Industrials	91	60	31
Healthcare	61	48	13
Banks	49	45	4
Energy	59	48	11
Tech & Telecom	58	45	13
Business & Fin Services	38	31	7
Basic Materials	48	29	19
Total	507	378	129

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Morningstar's Corporate Credit Rating Process



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Four Scores that Determine the Morningstar Credit Rating

- ▶ Business Risk
 - ▶ Economic Moat, Uncertainty, Stewardship
 - ▶ Size, Concentration, Dependence on Capital Markets
- ▶ Cash-Flow Cushion™
 - ▶ Based on our proprietary cash-flow models. Uses our five-year forecasts of cash flow, and compares that to debt coming due
 - ▶ No one else has systematic cash-flow forecasts that they can compare with debt coming due
- ▶ Solvency Score™
 - ▶ Based on equation we derived from historical backtesting
 - ▶ Four variables: leverage, interest coverage, liquidity, and profitability
- ▶ Distance to Default
 - ▶ Market-based measure of financial health
 - ▶ Academically tested

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Morningstar Credit Ratings for Banks

- ▶ Business Risk
 - ▶ Economic Moat, Uncertainty, Stewardship
 - ▶ Size, Concentration, Dependence on Capital Markets
- ▶ Stress Test Score TM
 - ▶ Our assessment of the bank's ability to withstand credit losses.
 - ▶ Incorporates a bank's loan mix, along with our analysts' estimates of underwriting prowess and future income.
- ▶ Solvency Score TM
 - ▶ Based on six key accounting ratios measuring capital adequacy, asset quality, earnings power, and liquidity.
 - ▶ Each quarter, approximately 1,500 bank holding companies are ranked based on these metrics.
- ▶ Distance to Default
 - ▶ Market-based measure of financial health
 - ▶ Academically tested

From Four Scores to Final Credit Rating

- ▶ Four scores map to a preliminary credit rating
- ▶ Each preliminary rating reviewed by Credit Committee
 - ▶ Meet with analysts
 - ▶ Review inputs
 - ▶ Stress test model
- ▶ Each initiation accompanied by an Analyst Note explaining rationale
- ▶ Credit analysts and Credit Committee monitor individual scores for possible upgrades/downgrades

Morningstar Credit Research
December 31, 2009

Industry Member	Business Risk Rating	Solvency Score	Distance to Default	Stress Test Score	Distance to Default	Final Rating
Bank of America	A-	85	High	1	High	A
Wells Fargo	A	80	High	1	High	A
Citigroup	B+	75	High	1	High	B+
JP Morgan Chase	A-	85	High	1	High	A-
PNC	B+	75	High	1	High	B+
U.S. Bancorp	B+	75	High	1	High	B+
TD Bank	B+	75	High	1	High	B+
Capital One	B+	75	High	1	High	B+
Bank of Montreal	B+	75	High	1	High	B+
Bank of the West	B+	75	High	1	High	B+
First Interstate	B+	75	High	1	High	B+
First Security	B+	75	High	1	High	B+
First Tennessee	B+	75	High	1	High	B+
Frost Bank	B+	75	High	1	High	B+
Heritage Commerce	B+	75	High	1	High	B+
Home Bancshares	B+	75	High	1	High	B+
KeyBank	B+	75	High	1	High	B+
Marathon	B+	75	High	1	High	B+
Midway	B+	75	High	1	High	B+
North Carolina	B+	75	High	1	High	B+
Oldemark	B+	75	High	1	High	B+
Regions	B+	75	High	1	High	B+
Southwest	B+	75	High	1	High	B+
Southern	B+	75	High	1	High	B+
Texas Capital	B+	75	High	1	High	B+
Trustmark	B+	75	High	1	High	B+

Morningstar's Credit Rating Model

- ▶ Fully transparent model-driven credit-rating methodology, showcasing the four pillars of our process
- ▶ Model functionality allows users to test the sensitivity of credit ratings to changes in underlying forecasts and inputs
- ▶ A full build-out of the forward-looking Cash Flow Cushion and graphical depictions of key credit-relevant metrics



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Morningstar Ratings: Where We Differ from the Agencies

Morningstar More Positive

Company	Notch Difference	Company	Notch Difference
Zimmer Holdings	5.5	KLA-Tencor Corporation	3.5
CACI International, Inc.	5.0	Bristol-Myers Squibb Company	3.5
Biogen Idec, Inc.	5.0	Applied Materials	3.0
Thermo Fisher Scientific, Inc.	4.5	Oracle Corporation	3.0
Xilinx, Inc.	4.0	CA, Inc.	3.0
Amphenol Corporation	4.0	Johnson Controls, Inc.	3.0
TRW Automotive Holdings Corporation	4.0	Owens & Minor, Inc.	3.0
American Medical Systems Holdings, Inc.	4.0	AmerisourceBergen Corporation	3.0
Stryker Corporation	4.0	ITT Corporation	3.0
Molson Coors Brewing Company	4.0	AGCO Corporation	3.0
St. Jude Medical, Inc.	4.0	Kohl's Corporation	3.0
Maxim Integrated Products	3.5	Hormel Foods Corporation	3.0
Church & Dwight Company, Inc.	3.5	Amgen, Inc.	3.0
NVR, Inc.	3.5	Becton, Dickinson and Company	3.0

Based on difference between Morningstar rating and the average of S&P and Moody's.
Data as of 9/15/2010

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Morningstar Ratings: Where We Differ from the Agencies

Morningstar More Negative

	Notch Difference		Notch Difference
Royal Caribbean Cruises, Ltd.	-3.5	ThyssenKrupp AG	-1.5
Morgan Stanley	-3.0	Casella Waste Systems, Inc.	-1.5
United Parcel Service, Inc.	-3.0	Veolia Environnement	-1.5
Bank of New York Mellon	-2.5	New York Community Bancorp, Inc.	-1.5
Coca-Cola Enterprises Inc.	-2.5	Comerica Incorporated	-1.5
Pitney Bowes Inc.	-2.5	Goldman Sachs Group, Inc.	-1.5
Sirius XM Radio Inc.	-2.0	OfficeMax, Inc.	-1.5
Toyota Motor Corporation	-2.0	Boyd Gaming Corporation	-1.5
Linde AG	-2.0	SunTrust Banks, Inc.	-1.5
Deutsche Telekom AG	-2.0	BB&T Corporation	-1.5
State Street Corporation	-2.0	Citigroup, Inc.	-1.5
Automatic Data Processing	-2.0	Weatherford International Ltd	-1.5

Based on difference between Morningstar rating and the average of S&P and Moody's.
Data as of 9/15/2010

Morningstar Ratings: Where We Differ from the Agencies

Morningstar makes a High-Yield call

	Morningstar Rating	S&P Rating	Moody's Rating
Alcoa Inc.	BB+	BBB-	Baa3
CBS Corporation	BB+	BBB-	Baa3
CenturyLink, Inc.	BB+	BBB-	Baa3
Sunoco, Inc.	BB+	BBB-	Baa3
Telecom Italia SPA	BB+	BBB	Baa2
Valero Energy Corporation	BB+	BBB	Baa2

Morningstar makes an Investment-Grade call

	Morningstar Rating	S&P Rating	Moody's Rating
Actuant Corporation	BBB-	BB	Ba2
Clean Harbors, Inc.	BBB+	BB	Ba3
Compass Minerals International, Inc.	BBB-	BB+	Ba2
Kinetic Concepts, Inc.	BBB+	BB+	Ba2
Pioneer Natural Resources Company	BBB-	BB+	Ba1
Range Resources Corporation	BBB-	BB	Ba2

Ratings as of 9/15/2010

Morningstar Ratings: Leading Indicator of Agency Moves

Company	Morn. Rating	Rating Date	Agency	Old Rating	New Rating	Change Date
Rayonier	BBB+	11/18/2009	Moody's	Baa3	Baa2	4/26/2010
International Paper	BBB	11/18/2009	S&P	BBB negative	BBB stable	3/16/2010
Pitney Bowes	BBB	12/2/2009	S&P	A	BBB+	8/5/2010
Dr Pepper Snapple	BBB+	1/13/2010	Moody's	Baa3	Baa2	3/9/2010
Dr Pepper Snapple	BBB+	1/13/2010	S&P	BBB-	BBB	3/22/2010
Starbucks	A-	2/8/2010	Moody's	BBB stable	BBB positive	4/27/2010
Starbucks	A-	2/8/2010	S&P	BBB	BBB+	8/10/2010
Darden	BBB+	2/9/2010	Moody's	Baa3	Baa3 positive	7/20/2010
Sears Holdings	BB	3/22/2010	Fitch	B+	BB-	3/31/2010
ArvinMeritor	B	3/29/2010	Moody's	Caa1	B3	7/9/2010
Dynegey	B-	3/29/2010	Moody's	B2stable	B2negative	4/7/2010
Staples	BBB+	3/30/2010	S&P	BBB	BBB positive	7/28/2010
Weatherford Intl.	BBB-	4/5/2010	S&P	BBB+	BBB	4/27/2010
UAL Corp	B	5/10/2010	Moody's	Caa1 positive	B3 positive	8/2/2010
Ford	BB	5/24/2010	S&P	B-	B+	8/2/2010
Ford	BB	5/24/2010	Fitch	B	BB-	8/6/2010
Limited Brands	BB+	6/1/2010	Fitch	BB	BB+	7/1/2010
Cummins	BBB+	6/23/2010	Moody's	Baa3	Baa2	7/13/2010
Transocean	BBB	9/3/2010	S&P	BBB+	BBB	9/8/2010

Analysis Across the Capital Structure

- ▶ We're unique in that we can offer investors an opinion on both a company's debt and its equity.
- ▶ We seek to highlight cases in which the equity offers a better risk/return trade-off than the debt, and vice versa.
- ▶ Our credit analysts work closely with our equity team to uncover such situations.

Company/Issue	Issuer	Stock/Bond	Div Yield -	Equity Star			
	Ticker	Rating	Yield	10 Yr. (bp)	Rating	Uncertainty	Moat
Verizon Communications	VZ	A-	7.1%	282	★★★★	Medium	Narrow
April 2019, 6.35%			4.3%				
March 2039, 8.95%			5.9%				
AT&T, Inc.	T	A-	6.8%	266	★★★★	Medium	Narrow
Feb 2019, 5.8%			4.1%				
July 2043, 7.375%			7.2%				
Eli Lilly & Company	LLY	AA	5.6%	214	★★★★	Medium	Wide
March 2018, 4.5%			3.4%				
November 2037, 5.95%			5.2%				
GlaxoSmithKline PLC	GSK	AA-	5.7%	212	★★★★	Medium	Wide
May 2018, 5.65%			3.6%				
May 2038, 6.375%			5.2%				
Pfizer Inc.	PFE	AA	4.6%	86	★★★★	Medium	Wide
March 2019, 6.2%			3.7%				
February 2024, 6.45%			4.6%				
Merck & Co Inc	MRK	AA	4.2%	65	★★★★	Medium	Wide
June 2019, 5.0%			3.6%				
January 2026, 6.3%			5.1%				
Kimberly-Clark Corporation	KMB	A+	4.1%	39	★★★★	Low	Narrow
November 2018, 7.5%			3.7%				
August 2037, 6.625%			4.9%				

Benefits of Analysis Across the Capital Structure

- ▶ Our primary focus is on the underlying business fundamentals
 - ▶ Competitive analysis helps us determine the Economic Moat
 - ▶ We formulate an explicit forecast of cash flows over the next five years
 - ▶ Scenario analysis helps us evaluate a wide range of possible outcomes
- ▶ From there we can evaluate the best investment opportunities for a given company
 - ▶ Bonds vs. stocks with strong dividend yields (LLY, PFE)
 - ▶ Investments that offer capital preservation vs. high return potential
 - ▶ Convertible bonds (ATU)
 - ▶ Higher risk, higher return opportunities in equity or high-yield bonds

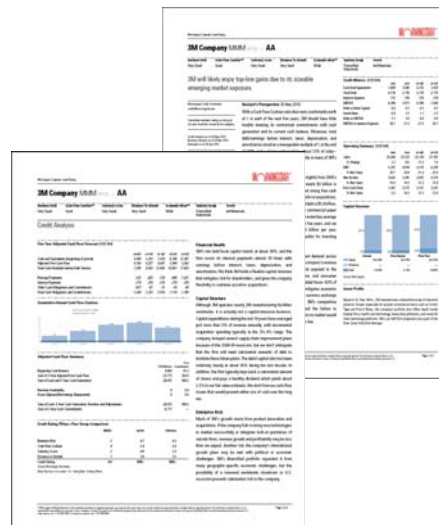
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Advisor

Credit Research and Ratings for Advisors

- ▶ Analyst commentary
 - ▶ Credit Rating Rationale
 - ▶ Financial Health
 - ▶ Capital Structure
 - ▶ Enterprise Risk
- ▶ Data
 - ▶ Four "pillars" of our framework
 - ▶ Key credit metrics
 - ▶ Annual cash-flow forecasts
 - ▶ Bond issues and related data (prices, yields, maturities)
- ▶ Related Services
 - ▶ Feed of credit ratings and rating changes
 - ▶ Conference calls with analysts
 - ▶ Access to Research Liaison Desk



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Credit Research Weekly

- ▶ Analyst Commentary
- ▶ Rating Initiations
- ▶ Rating Changes
- ▶ Credit Trends and Model Changes
- ▶ Credit-Relevant Research
- ▶ Highlighted Issuers and Bonds
- ▶ Bond Market Commentary
- ▶ Complete Ratings List



Morningstar Credit Research Weekly

January 11, 2010

This Week

Issuer News and Notes

- ▶ Rail traffic is showing signs of life.
- ▶ Cimarex sets its 2010 capital budget.
- ▶ Capital gets cheap again for Energy MLPs.
- ▶ Financial risk is high for some in casual restaurants.

Highlighted Issuers

This week, we take a look at two of the biggest names in breakfast: General Mills (GIS) and Kellogg (K). We like these credits (General Mills in particular) better than the folks at Moody's and S&P. Judging by the yields on their senior unsecured issues, though, the market likes them even more than we do, making it tough to recommend either.

The chart below shows the ratings implied by current average spreads on each firm's debt and the spreads we would expect to see based on our ratings and those of the NRSROs.

General Mills				
	The Market	Our View	Moody's	S&P
Credit Rating	AAA	A	Baa1	BBB+
Spread	83	148	185	185

Kellogg				
	The Market	Our View	Moody's	S&P
Credit Rating	AAA	A-	A3	BBB+
Spread	45	161	161	185

Note: Shaded figures are those implied by the corresponding spread or rating

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For more information on Morningstar's corporate credit ratings (or if you have questions, comments, or feedback), please contact Morningstar's credit team at: credit@morningstar.com

Institutional

Credit Research and Ratings for Institutional Investors

Full access to our extensive research capabilities:

- ▶ 1,500 in-depth research reports, with full 5-year forecasted financials
- ▶ Interactive cash-flow models
 - ▶ Full pro-forma income statement, balance sheet, cash-flow statement
 - ▶ Scenario analysis
- ▶ Access to 80 industry specialists and a team of 10 credit specialists
- ▶ Actionable bond ideas
- ▶ Weekly credit research report highlighting our best ideas, credit-rating changes, new coverage launches, and other notable developments
- ▶ Conference calls with our analyst team
- ▶ Daily research notes on recent company activities
- ▶ Annual forum where our clients connect with company management teams
- ▶ Quarterly market outlook from a bottom-up perspective
- ▶ Weekly sector updates that leverage our team approach to deliver cross-industry insights

Institutional Services: Actionable Credit Research

Credit Research Pick List

- ▶ Our top bond picks by sector
- ▶ Bonds selected on a relative value basis
- ▶ Issuer- and Issue-level analysis

Credit Research
Top Picks | August 2010

Industrials

Contact: Rick Tauber, CFA
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Company	Ticker	Issuer rating	vs. NRSRO avg.	Maturity	Coupon	Price	YTM	T-spread
Actuant	ATU	BBB-	+2.00	06/15/17	6.875%	\$101.66	6.47%	+444

Our investment-grade rating reflects the firm's solid positioning in niche markets and relatively sound financial metrics. Actuant's senior note trades at over 100 bps wider than the Morningstar BBB- index, offering compelling compensation for the risk. Further, we believe two potential catalysts could drive spreads tighter: the conversion of the firm's convertible bond to equity in November, should the stock price stay above the \$19.95 strike price, or ongoing deleveraging as the company recovers from the depths of the recession.

KB Home	KBH	BB	+1.67	02/01/14	5.750%	\$96.00	7.06%	+616
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KB Home, like many of the builders, has a very well laddered debt maturity structure. All of the bonds are senior unsecured, and the spread curve is very flat. One of the issues that we would highlight and recommend is the 5.75% of 2014, which offers spreads around +100 bps wide of an average BB. This is the next meaningful maturity for the company, albeit only \$250 million, and thus it is positioned well in the capital structure. KB's \$1.2 billion of cash easily covers all debt through this bond over 2x, so there is a healthy amount of room for a downturn before this maturity becomes a concern. We expect this spread to steadily decline as the maturity shortens and KB returns to profitability in line with our forecast.

L-3 Communications	LLL	BBB+	+2.00	01/15/15	5.875%	\$101.77	5.09%	+383
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This Senior Subordinated bond offers compelling value relative to both L-3's Senior Unsecured bonds and Morningstar's BBB- index (+262 bps). The bond is trading to the par call date of 1/15/13, offering a yield to call of about 5% and a spread of about +430 bps. Meanwhile, L-3's Senior Unsecured bond due 2019 offers a spread of about +160 bps. We think the spread differential is far

Institutional Services: Access to Analysts and Cash-Flow Models

The screenshot displays the Morningstar Select Equity + IPO interface. On the left, there are sections for 'Company Visit Notes', 'Strategists', and 'Best Ideas'. The main area features a 'Credit Rating' table with columns for 'Rating', 'Date', and 'Agency'. Below this is a 'Cumulative Annual Cash-Flow Cushion (FCF)' bar chart showing values from 2008 to 2014. The interface also includes various financial metrics and a 'Company Risk Score' section at the bottom right.

More Information

- ▶ For more information, including our detailed methodology document and white papers, please visit:
 - ▶ <http://corporate.morningstar.com/US/asp/subject.aspx?xmlfile=374.xml&filter=2977>
- ▶ Or contact:
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