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ESG Industry Report Card: Retail

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*(**Editor's Note:** Our ESG Industry Report Cards include an analysis of ESG factors for a selection of companies. We intend to expand our ESG Industry Report cards to include more companies throughout the year.)*

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Key Takeaways

- Ratings in the global retail industry have a moderate exposure to environmental and social factors.
- Consumer behavior is a key facet in the impact of environmental and social factors (whether favorable or not).
- Customers' preferences, perception of brands, and demographics are risks because most products in the retail industry are discretionary.

The ESG Risk Atlas

To calibrate the relative ranking of sectors, we use our environmental, social, and governance (ESG) Risk Atlas (see "The ESG Risk Atlas: Sector And Regional Rationales And Scores," published May 13, 2019). The Risk Atlas provides a relative ranking of industries in terms of exposure to environmental and social risks (and opportunities). The sector risk atlas charts (shown below) combine each sector's exposure to environmental and social risks, scoring it on a scale of 1 to 6. A score closer to 1 represents a relatively low exposure, while 6 indicates a high sectorwide exposure to environmental and social risk factors (for details see the Appendix). This report card expands further on the Risk Atlas sector analysis by focusing on the credit-specific impacts, which in turn forms the basis for analyzing the exposures and opportunities of individual companies in the sector.

We consider changing consumer behavior a key facet in our assessment and view governance factors as specific to each company, rather than the industry as whole.

Environmental Exposure (Risk Atlas: 3)

The environmental risks for the retail sector are weighted toward the inherent exposure to direct and indirect impacts from climate change and emissions and use of plastics. Weather is already a significant swing factor in a company's results, more serious long-term shifts in seasonal shopping would require retailers to have adaptable selling seasons.

Emissions regulations are a long-term environmental risk as the complexity of logistics has increased for most retailers. This includes tighter regulation of greenhouse gas emissions, the cost to comply, and the impact on optimal customer delivery options. A retailer can own and outsource capacity for logistics to provide flexibility in addressing this risk because they can select lower emission service providers.

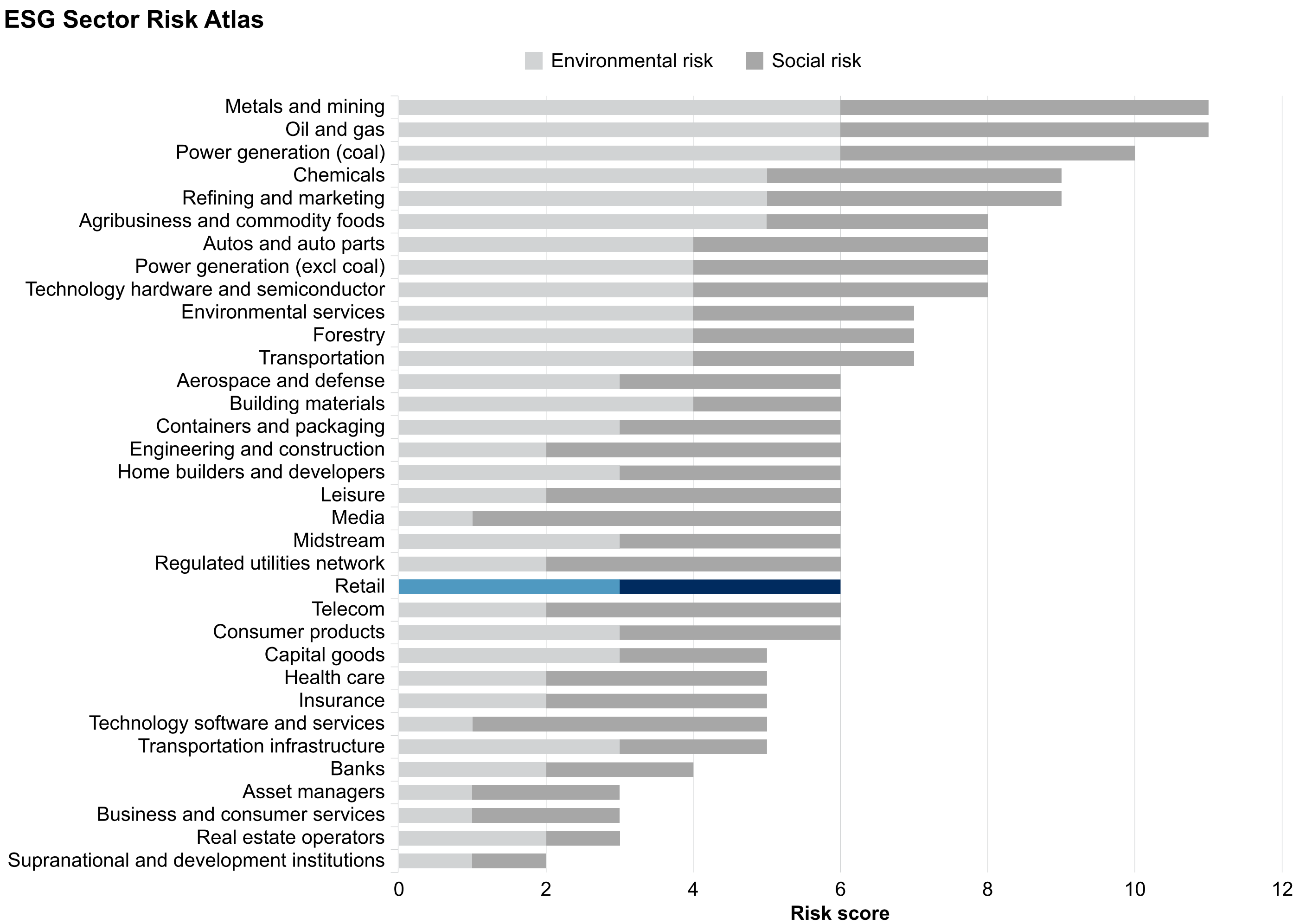
We also see a risk of future regulations to reduce the use of plastic packaging for consumer products. In line with FMCGs, retailers across Europe have been working with national governments and local municipalities to reduce single-use plastic bags.

Social Exposure (Risk Atlas: 3)

Social risks and opportunities intersect when retailers address consumers' preference for rapid delivery, price transparency, traceability of products, and increased focus on clearer and meaningful labelling in diverse markets (urban, suburban, and rural).

Retail's exposure to social risk leans toward customer brand perception, preferences, and demographics. Retailers must adapt their product offering and distribution strategies as buying patterns shift for environmental (or health) reasons and/or rapid delivery trends. Price transparency and fairness for suppliers and customers influence retailers' public image, yielding potentially immediate adverse political or customer actions. In France, the government passed various regulations including field-to-fork bill which apart from including price transparency for suppliers/farmers, also ensures a ceiling to the price points the end consumer pays to curb price wars. It also includes a ban on plastic water bottles in school canteens, plastic straws, and hot-drink stirrers, animal welfare regulations, and wide environment-friendly practices. Another sensitivity is the safety of goods and food as retailers are indirectly held accountable for quality issues and swift corrective action, notably when safety or health issues have been detected.

Human capital management is critical in this labor-intensive sector as mobile applications and technology change the retail landscape. Accordingly, risks that retailers have to manage include the quality of the customer-facing workforce and an organization's ability to execute change. The compensation, health, and safety of a retailer's direct and indirect (through supply chain transparency) workforce is another social risk for retailers.



Source: S&P Global Ratings.

ESG Risks In Retail

Table 1

Company/Issuer Credit Rating/Comments	Country	Analyst
Auchan Holding (BBB-/Negative/A-3)	**France**	**Mickael Vidal**
Environmental and social risks are relatively modest for Auchan. Brand perception, food traceability, safety, and waste management are key considerations as the group plans to increase the share of products distributed under its own brand. Strict quality and safety control of Auchan-brand products is essential to minimize recalls and outbreaks and avoid material earnings declines, litigation risk, and other penalties for not meeting regulatory standards. For instance, Auchan, Carrefour, Casino, and all other major food retailers were involved in the Lactalis-contaminated baby milk scandal in 2018. Auchan, alongside other retailers, admitted some responsibility for contaminated products remaining on the store shelves. In addition to these challenges, as one of largest retailers in Europe, the company is also in a position to encourage transparent supply chain and logistics with fewer waste and energy consumption, which entails larger capital expenditures in the short term but lower operating expenditures in the longer term. On social aspects, as part of its transformation plan, we expect Auchan to implement cost-cutting plans, which could disrupt its business organization and alter its brand reputation, in particular in France. That said, we believe Auchan stands out as a relative virtuous employer, as it has developed an employee ownership program aimed at adding incentives for the group's employees. We also factor governance into our rating. It remains a private company and is		

therefore subject to less stringent disclosure rules vis-à-vis its financial partners. A new Chairman was appointed in 2018, which will likely represent better with shareholders priorities, as he is part of the Mulliez family, the group's main shareholder.

Ahold Delhaize N.V. (BBB/Stable/A-2)	**Netherlands**	**Patrick Janssen**

We currently do not anticipate ESG factors to materially influence Ahold Delhaize's credit quality. However, given the nature of the products, Ahold Delhaize is exposed to important global topics including human health (compensation and health of its workforce), sustainability of the resources (especially waste from product packaging), and brand perception. Ahold Delhaize faces risks of shifting consumer preferences in the U.S. and Europe toward increasing demand for regional, organic, and sustainably produced food. The company has a track record in rolling out private-label products, which reached 30% of total merchandise in the U.S. and 50% in Europe. Many of these products focus on fresh, organic, regional, and sustainable aspects for a still-affordable price, placing the business well in the context of changing consumer trends. In conjunction with human capital management, through its North American Stop & Shop banner, for instance, the group is exposed to a unionized workforce. This generally results in higher wages compared with non-unionized peers and makes disruptive labor strikes generally more likely, in our view. Despite the recent strike lasting 11 days in the New England region, the company has been able to cooperate with unions to secure a high-quality workforce required for the numerous customer-facing tasks and to successfully execute targeted multi-channel initiatives supporting its competitive advantage. As one of largest retailers in the U.S. and Europe, the company is also in a position to encourage transparent supply chain and logistics with less waste and energy consumption. Governance factors support the current rating. We continue to view positively management's expertise and sufficient oversight as well as the independence of the supervisory board.

Carrefour S.A. (BBB/Stable/A-2)	**France**	**Solene Van Eetvelde**

Social and environmental factors pose a moderate risk for Carrefour, through such factors as brand perception, food safety, and waste management. As the group plans to increase products distributed under its own brand to 33%, strict control over the quality and safety is essential to minimize product recalls and outbreaks, and avoid material earnings declines, litigation risk, and other penalties for not meeting regulatory standards. We understand Carrefour's approach to consumer safety is stricter than current regulatory requirements. Carrefour is adapting to changing consumer tastes and preferences toward healthy and organic products. In 2018, the group accelerated growth in organic products, with sales of €1.8 billion versus about €1.3 billion in 2017, a first step toward achieving its target sales of €5 billion in 2022. As part of its business transformation program, Carrefour implemented several redundancy plans in France, Belgium, and Argentina in 2018. These plans were handled with limited business disruption, even in France where the workforce is unionized. Its management team has been in place since 2017 and the CEO and CFO have held similar roles at Fnac Darty. We believe they have significant experience in e-commerce and should be well placed to help advance Carrefour's digital and omnichannel retail strategy.

Casino (BB-/Negative/B)	**France**	**Mickael Vidal**

Governance is a very important risk factor for our rating on Casino. Social and environmental factors are ongoing moderate risks, involving brand perception, product traceability, and waste management. Regarding governance, Casino has a complex corporate structure. Firstly, it partly owns subsidiaries in LatAm and as per accounting principles, fully consolidates them, as it has control over them. On a consolidated basis, these subsidiaries represented 43% of revenues in 2018. Yet the bulk of the group's debt is located in France. The LatAm businesses upstream cash to the French holdco essentially through modest dividends, with material leakages to minorities, thereby contributing marginally to the group's debt servicing. Because of that, in our view, Casino's consolidated numbers do not fully reflect the group's creditworthiness. Secondly, the CEO, Jean-Charles Naouri, is also Chairman of the main shareholder holding company Rallye, which has high level of debt and relies on Casino to service it through dividends, ultimately constraining Casino's credit quality even if Casino is partly insulated from Rallye. Regarding environmental aspects, the group is one of the leading sellers of organic products in France, representing more than 5% of revenues. In our view, the ability to develop a large organic food offering at affordable prices will be a key differentiating factor in the years to come. We expect Casino to increase its overall volume of organic sales to €1.5 billion in 2021, in particular through its dedicated subsidiary Naturalia. As part of the group's effort to minimize costs and its energy consumption, its subsidiary called Green-Yellow focuses on the development of photovoltaics panels to minimize the energy consumption. Regarding social risks, we note Casino undertook several cost cutting plans over the past years with limited disruption to the business. Like many other important employers in France, Casino granted a one-off bonus to its employees in early 2019 in the aftermath of the yellow vest protest.

Esselunga SpA (BBB-/Watch Neg/--)	**Italy**	**Marta Bevilacqua**

Underlying Esselunga's strong brand awareness is the quality of its fresh food, which accounts for more than half of its sales. Moreover, private-label typically represents about 20% of total sales. To address traceability and supply, Esselunga is preparing most of its fresh food in its two owned processing plants and in two automated production plants. This supports its rigorous control and qualification program in selecting suppliers and checking production both internally and externally. We believe this helps minimize recalls, litigation risk, and other penalties for not meeting regulatory standards. After Mr. Caprotti (Esselunga's previous sole shareholder) passed away in 2016, Esselunga is divided 70%/30% between majority and minority shareholders (Mr. Caprotti's heirs). We placed the ratings on CreditWatch negative, reflecting Esselunga's majority shareholders' decision to exercise an option to purchase the remaining 30% stake in the parent (Supermarkets Italiani S.p.A.). We believe a change in the ownership structure, which has a direct link to the governance structure going forward, could mean higher debt and dividends, because debt could fund a material part of the transaction. We therefore see this transaction as critical for governance and credit quality.

Marks & Spencer plc (BBB-/Negative/A-3) **U.K.** **Abigail Klimovich**

We currently do not anticipate ESG factors to materially influence M&S' credit quality. As typical for retailers, M&S is exposed to plastic packaging waste, food safety and traceability issues and health and safety of its workforce, both direct and across the supply chain. We view positively the extended track record in addressing environmental and social risk factors via its comprehensive Plan A program first launched in January 2007 well ahead of its peers. Traceability is becoming an increasingly important factor in consumers' decisions across retail industry affecting both food and apparel markets. With a £10.7 billion topline, M&S' sheer size and reliance on mostly own label products across divisions afford the group bargaining power to address such risks when choosing suppliers, in particular as M&S pursues the consistently high quality of fresh produce in its food division. In addition, the company's efforts to reduce plastic packaging will boost margins over time and help engage with socially responsible customers. We view M&S' management and governance as fair, reflecting its board independence and risk management standards. We consider, however, management continuity as somewhat weaker compared with other publicly listed companies. For example, multiple high-profile board and senior management changes were implemented in relatively short period of 2016-2018. As the group advances in transforming its business and operations, its overall success will rely on the long-term stability of board priorities. If continued, frequent changes in senior executives' team could temper our confidence level in such consistency.

Metro AG (BBB-/Stable/A-3) **Germany** **Patrick Janssen**

Environmental and social factors are embedded in our analysis for Metro AG but are not currently material to the rating. As a supplier to restaurants, hotels, and neighborhood stores, the group's wholesale business has moderate social risk factors with exposure to consumer trends, brand perception, and the compensation and health of its workforce. At the same time, environmental risks also constitute a moderate risk through emissions, energy consumption, and waste streams from product packaging. Metro faces risks arising from changing consumer preferences for more healthy, sustainably produced and organic food products, especially emerging with clients in the eating out segment. We view the group's food merchandise with a high share of fresh products as well positioned. Particularly for restaurants and caterers, Metro's fresh offering is attractive because of the increasing share of semi-processed fresh food (e.g. cut or pealed), which saves substantial processing time and adds value for smaller businesses. Metro also understands the success of small and mid-sized enterprises is key for its own business strategy. As Europe's largest wholesaler, the company is also in a position to encourage transparent supply chains with fewer waste. Metro also actively promotes energy saving with, for instance, the installation of solar panels on stores. Governance factors support credit quality. We continue to view positively the management's expertise, depth, and breadth combined with its forward-looking strategic planning process.

REWE Group (BBB-/Stable/A-3) **Germany** **Patrick Janssen**

We currently do not anticipate environmental and social factors to have a material impact on our rating. REWE is exposed to sustainability of resources, human health, pollution, and waste management among others. We consider food retail, the group's largest segment, as the main driver for our ESG analysis. REWE faces changing consumer preferences across Europe toward regional, organic, and sustainably produced food. REWE has a strong track record in rolling out private-label products, which have emphasized regional and organic products (the strongest growing category) in recent years. REWE Bio has become the largest organic food brand in Germany. In conjunction with human capital management, the group supports individual entrepreneurship through its cooperative structure with independent retailers in Germany and Austria, giving independent retailers discretion on compensation and store-level decisions. This secures a high-quality workforce required for customer-facing tasks and the company's ability to successfully execute multi-channel initiatives to maintain a competitive advantage. As one of largest retailers in Europe, the company also encourages transparent supply chains and logistics with less waste and energy consumption. REWE was the first German supermarket to remove plastic bags and cut its carbon emissions by half since 2006. Governance factors support credit quality and we continue to view management's expertise and experience positively. The group's financial reporting and transparency is generally in line with other non-publicly listed companies.

Tesco PLC (BB+/Stable/B) **U.K.** **Abigail Klimovich**

Tesco, as the largest food retailer in the U.K., is heavily scrutinized regarding environmental, social, and governance risks, with particular attention on its labor, carbon footprint and sourcing decisions. Its private-label brands represent about 51% of total revenues in the U.K., so strict control over the quality and safety of these products are essential to minimize product recalls and outbreaks and avoid material earnings declines, litigation risk, and other penalties. We think Tesco's expansion of its low-price "Exclusively at Tesco" range and of its fresh produce offering will support the company's brand image among customers in the long term as customers pursue healthier eating habits and seek the best value. Tesco's comprehensive waste management, including product donations, waste recycling, and waste to energy programs are strengthening its brand perception and profitability over time, in part due to its economies of scale in selecting its partners and suppliers. Tesco faces the longer-term environmental risks across its logistics and fulfilment network because of tighter greenhouse gas emissions regulation. This underscores the necessity of rigorous assessment of environmental risk management by the company and its counterparties. The group mitigates such risks by sourcing electricity from renewable sources, using low-emission vehicles, raising space utilization in its delivery vehicles, and planning routes to minimize the distances. Tesco also invests in relevant skillset of its workforce and in its IT systems to support efficiency of its supply, logistics, and warehousing network while enhancing the management of environmental risks. For example, investment in IT systems accounted for about 10%-15% of annual capex in recent years. Cyber security is becoming an important governance factor. Tesco's exposure is somewhat higher than a typical food retailer as it runs one of the largest online food retail platforms in the U.K., maintains extensive pool of customer data, and owns Tesco Bank. In the near term, we don't expect any direct costs related to cyber risks to be material for the group's financial position as evidenced in the aftermath of the cyber attack on Tesco Bank in 2016 with direct settlement costs totaling £18 million. The group's multi-year security program addresses multiple faces of managing cyber security risks, including those of relevant suppliers. Over the long run, the cyber security risk will likely rise as more transactions migrate to digital devices thus exposing the company to settlement costs, potential customer remediation aimed to limit reputational damage, and tighter regulatory oversight and related costs. We view Tesco's management and governance as fair, reflecting its independent board, risk management standards, and management's track record in executing its product, markets, and cost saving strategy while minimizing balance sheet risk by paying down debt.

JD.com Inc. (BBB-/Positive/--) | **China** | **Sophie Lin**

JD.com faces ongoing moderate social risks. The most significant for online retailers are the assurance of product authentication and the protection of user data. Compared with online retailers mainly operating marketplace platforms, JD.com has higher assurance of product authentication and quality given its direct sales model. The compensation, health, and safety of JD.com's workforce in its logistics and fulfillment networks is another social risk that may affect the company' growth and profit margin. To counter these risks, JD.com provides safety trainings and purchases insurance for its front line employees along the supply chain. Environmental factors do not play a major role for our ratings but tightening emissions regulations in China could increase fulfillment costs in the long term, given the carbon emissions from vehicles and waste from product packaging. JD.com is implementing various initiatives such as using "green and reusable" delivery bags and "e-invoices" and new energy vehicles to lower the amount of waste generated along its supply chain. We see "key man" risk in the company's management and governance. JD.com's founder is the chairman and CEO of the company, with 80% of the voting rights. Any change in leadership could have a large impact on the company's strategic direction, but may not affect daily operations.

Coles Group Ltd. (BBB+/Stable/--) | **Australia** | **Craig Parker**

Coles Group's geographic footprint of more than 2,500 retail outlets could present significant social and environmental impact within Australia, but these factors are not explicit rating drivers. The group has outlined 10 key environmental and social initiatives to achieve efficiency across its store network that will further improve profitability. The initiatives include working with suppliers to reduce food waste, reduce excess packaging, and change product labels to promote recycling. These measures will maintain a positive brand perception with an emphasis on ethical sourcing and sustainable supply chain procurement, and promote a safe and fair work environment for Coles' large workforce. Collectively, these social commitments represent a moderate risk to the brand. Coles' governance framework supports the rating.

Woolworths Group Ltd. (BBB/Stable/A-2) | **Australia** | **Craig Parker**

Woolworths faces increasing scrutiny over its environmental and social footprint, particularly because the Australian consumer is increasingly concerned with these issues, but they are not an explicit rating driver. Woolworths is pursuing a number of initiatives to reduce its environmental impact and encourage suppliers to consider their impact. For example, reducing carbon emission intensity, innovating refrigeration management, and mitigating landfill waste (i.e. removing plastic bags) are key priorities. From a social perspective, Woolworths is pursuing strategies to move away from generating income streams from its hotel business, which involves elements of gambling. The company's social commitments represent a moderate risk. The group aims to source key raw materials and commodities sustainably, recycle and reduce waste, as well as create a safe work environment. The company's emphasis on ethical sourcing and sustainable supply chain procurement supports its brand. As a large employer, Woolworths promotes a safe and fair work environment.

Wesfarmers Ltd. (A-/Stable/A-2) | **Australia** | **Craig Parker**

Wesfarmers' more than 1,065 retail outlets and 18,000 suppliers could present social and environmental risks, though but are not an explicit rating driver. Wesfarmers faces increased pressure over supply chain transparency and has identified ethical sourcing and human rights as the key areas of concern. It has sought to reduce the complexity in supply chain management and mitigate the risk of partnerships with unethical suppliers through establishing an audit of suppliers' product sourcing. The non-retail businesses of Fertilizers and Chemical is not a key rating driver in our ESG assessment due to its contribution to group earnings. The chemical industry has very high exposure to environmental risks and is subject to stringent regulation. The company's investment in carbon reduction, low emissions, and renewable technologies, as well as recycling and waste reduction support the brand, albeit with some costs. There is a strong track record of management and governance, underpinned by solid strategic positioning, risk management, and organizational effectiveness across its diverse business lines.

Seven & i Holdings Co. Ltd. (AA-/Stable/--) | **Japan** | **Ryohei Yoshida**

The most relevant and material risk factors are social, including brand perception, customer preference, and population decline. Japan's population is shrinking and aging and consumer behavior is changing. There is successful record of addressing these issues by taking advantage of its scale, brand recognition, and a strong store network that includes various formats. For example, it has consistently rolled out private-label products that meet consumer needs and over time taken market share from competitors in the Japanese convenience store market. Managing staff has become increasingly important for the country's retailers amid a labor crunch. Convenience store chain operator Seven-Eleven Japan Co. Ltd., the group's main earnings driver, recently cut the royalty fees it charges franchisees (member stores) to help address issues such as rising labor costs. This initiative has a negative impact on its earnings in the short term. However, it supports our favorable assessment of its management expertise.

AEON Co. Ltd. (BBB/Stable/--) | **Japan** | **Ryohei Yoshida**

Population decline and changes in consumer behavior are the most material ESG rating drivers. These factors are currently exerting downward pressure on AEON's retail business. Its core general merchandise store (GMS) retail format is suffering from low profitability because of changes in consumer preferences and a decrease in its target customers, including families with children. We believe the net impact of social factors is negative for the company's credit. However, a recently acquired drug store business is expanding rapidly thanks to the aging population and growing demand for health care products. AEON's shopping center business remains steady despite headwinds amid shifting consumer preferences, thanks to the group's strong brand and operational expertise. Our positive assessment of the expertise and experience of AEON's management considers the successes mentioned above, even though there are challenges for its core GMS format.

Albertsons Cos. Inc. (B/Stable/--)	**U.S.**	**Diya Iyer**

We believe Albertsons' highest ESG risk exposure is related to food safety, labor relationships, and governance issues surrounding potential mergers and acquisitions, as the company is controlled by a private equity sponsor and has a new CEO. On the environmental front, the company, has been growing its portfolio of organic, health conscious, and environmentally sustainable offerings with some success. For instance, 100% of eggs sold under its O Organics and Open Nature brand are cage free, and more than 300 Own Brands canned goods are now packaged and labeled in non-BPA lined cans, representing more than 80% of Own Brands canned offerings. Given elevated consumer expectations for these types of improvements, however, we view these as necessary costs to remain competitive in the cutthroat U.S. grocery space. Lastly, 64% of Albertsons' employees were covered with collective bargaining agreements through year ended Feb. 23, 2019. The company says it expects health care, pension contributions, and wage costs will remain important topics for negotiations, with the expiration of such agreements without contracts possibly resulting in strikes that would disrupt operations.

Amazon.com Inc. (AA-/Stable/A-1+)	**U.S.**	**Helena Song**

ESG risks vary by segment, but none are material rating drivers. Amazon faces increasing government scrutiny of their business models, which could lead to regulations that are unfavorable for its competitive position. Factors supporting consumer demand include brand perception, waste streams from product packaging, and the compensation, health, and safety of its direct and indirect workforce, including in its fulfillment networks. Its complex owned and sourced global transport logistics businesses face longer-term environmental cost risks, mainly because of tighter greenhouse gas emissions regulation. The cost to comply and how compliance affects optimal customer delivery options are also longer-term risks for delivery reliant businesses. Amazon faces low-likelihood, high-impact risk to its position of trust as a cloud-computing provider. But Amazon has a good track record of reliable, secure cloud operation. From a governance standpoint, Amazon's founder remains a significant presence in his role as President, CEO, Chairman of the Board, and a significant shareholder, but we consider Amazon's governance under its independent board, and management depth as strong.

Costco Wholesale Corp. (A+/Stable/A-1)	**U.S.**	**Andy Sookram**

The company's private-label brands represents about 25% of total revenues, so strict control over the quality and safety of these products are essential. The company is also expanding its fresh and organic product offerings, which we think helps improve its brand image among its warehouse members. Product donations, waste recycling, and waste to energy programs are additional considerations that strengthen brand perception. We assess Costco's management and governance as satisfactory, primarily reflecting the presence of a seasoned management team that delivers consistent robust performance and cash flows.

CVS Health Corp. (BBB/Stable/A-2)	**U.S.**	**Andy Sookram**

There are ongoing public debates around the role of pharmacy benefit managers, price transparency, spiraling health care costs, and the opioid crisis. CVS' recent acquisition of Aetna creates opportunities to address some of these concerns. Quality and safety of products and services, data privacy, and cybersecurity breaches are also an area of focus. We believe CVS has ample financial resources to address moderate issues, should they occur, or proactively invest in its systems and labor workforce. We assess CVS' management and governance as strong, based on the company's good operating track record, though we continue to anticipate some performance softness from reimbursement payments by health plans for drugs dispensed by CVS.

Dollar Tree Inc. (BBB-/Stable/--)	**U.S.**	**Diya Iyer**

Activist investor Starboard recently launched a public campaign to promote strategic and financial policy changes at Dollar Tree. Given the success activists have had at other retailers in the past year, Starboard has the potential to drive major shifts in the company's operating strategy in 2019. Whether any such changes would shift leverage metrics away from an investment-grade rating remains to be seen. Dollar Tree also faces social risks of rising minimum wages and potential labor shortages, and plans to invest $100 million of the expected cash benefit from the Tax Cuts and Jobs Act of 2017 into the business and its employees. We note the majority of its products are manufactured in the U.S., reducing foreign trade war exposure and supply chain transparency concerns.

Home Depot Inc. (A/Stable/A-1)	**U.S.**	**Andy Sookram**

Home Depot proactively manages ESG risks. With substantial cash flow generation, the company has ample resources to invest in its systems and workforce, which should help minimize risks associated with customer service issues and data breaches. Its track record of executing operationally and achieving above-target financial results lead us to assess its management and governance as strong. The company also has well-defined sustainability goals, is well positioned to achieve these targets, and in some instances is ahead of plans. For instance, in 2017 the company reported nearly 24% less electricity usage than 2010, surpassing its plan for a 20% reduction by 2020.

Kroger Co. (BBB/Stable/A-2)	**U.S.**	**Diya Iyer**
A key social risk is labor because a majority of Kroger's 449,000 U.S. employees were covered with collective bargaining agreements through local unions as if fiscal-year ended 2017. There are about 360 such agreements, according to the company, usually with terms of three to five years, so there is a significant exposure to strikes if Kroger cannot negotiate new contracts, as well as an exposure to rising health care, pension, and wage costs. In 2018, the company raised its minimum age to buy firearms and ammunition, joining Walmart Inc. and Dick's Sporting Goods (not rated). While these sal.es account for a minor share of Kroger's sales, risks related to this topic are substantial. From an environmental perspective, Kroger is focused on supply chain accountability and higher-quality sourcing of fish and other food items. It has a goal of dramatically reducing how much waste it sends to landfills by 2020, and plans to optimize its private-label products by that year, in terms of food safety, shelf life, quality, and recyclability (including packaging).		
L Brands Inc. (BB/Negative/--)	**U.S.**	**Sumaira Ghazi**
Social issues have become increasingly important to L Brands. In the past few years, competitors of its Victoria's Secret business have launched marketing campaigns focusing on empowerment and self-esteem (by publicly abstaining from photo retouches) as well as diversity and inclusivity (by featuring women with different body types and ages). Compared with Victoria's Secret, these companies claim to offer a broader assortment of merchandise catering to plus-size customers, with an emphasis on fashion in addition to comfort and fit. We believe L Brands' perceived failure to adapt to the evolving social attitudes of its customers has contributed to decreased pricing power.		
Loblaw Cos. Ltd. (BBB/Stable/--)	**Canada**	**Aniki Saha-Yannopoulos**
ESG risks are not material rating drivers but still play a role. The key risk in the short term is the potential civil liability associated with the class action lawsuits brought against the company in response to their role in an industrywide price-fixing arrangement. We assume any adverse ruling against the company would not be material enough to affect the ratings, but this is subject to additional developments. Minimum wage increases have inflated company's costs. While cost savings and operating efficiency through reduced store hours, less staff, and more self-checkout options should help manage cost pressures, execution risks could raise social risks. On the environmental front, the company has focused on emission reduction and improving its offerings. For example, Loblaw's PC Free From livestock are raised without the use of antibiotics, and the company purchases almost 50% of produce during peak growing season from Canadian growers. We view this as a necessary strategy to maintain a competitive advantage in the Canadian market. We assess management and governance as satisfactory, based on the company's strong operating record under current management.		
Lowe's Cos. Inc. (BBB+/Stable/--)	**U.S.**	**Andy Sookram**
With new management and board members in place following a push by activist investors, Lowe's shifted its leverage target to 2.75x from 2.25x in December 2018, leading to a one-notch downgrade to 'BBB+'. The company outlined changes to its business strategies to increase store productivity, expand the professional business, and increase supply chain and technology investments as key priorities. We believe Lowe's is well positioned to execute these initiatives given management's substantial retail experience. Quality of customer service and customer data protection are moderate risks, as a vast majority of Lowe's employees are customer-facing and critical for engagement across all sales channels. Lowe's dedicates significant resources to managing these risks, including employee training and technology initiatives, so we are not anticipating any issues in the near term.		
Macy's Inc. (BBB-/Negative/A-3)	**U.S.**	**Helena Song**
Macy's faces a number of ESG risks, although none are currently a rating driver. In particular, social and environmental factors are becoming increasingly important for sustainability-focused consumers and could affect brand perception and margins if not effectively managed. Macy's has not followed the steps of other retailers such as Target Corp., Walmart Inc., or Amazon in adopting a minimum wage, which may make it more difficult to attract workers in an economy where employment is particularly strong. Macy's governance risks pertain to strategic execution. Management implemented a variety of strategic initiatives over the last year, including closing underperforming stores, store renovations, and e-commerce development, but we acknowledge the company has suffered from meaningful industry headwinds.		
McDonald's Corp. (BBB+/Stable/A-2)	**U.S.**	**Diya Iyer**
The company views ESG through a Scale for Good platform focused on global priorities related to items including beef sustainability and packaging. For instance, it is eliminating foam from its packaging globally and make 100% of packaging renewable, recycled, or certified by 2025, which would be moderately favorable. We believe the company has more substantial resources to address such issues than many competitors and may be positioned to lead an industrywide change, although we think there would not be immediate ratings implications. From a governance and social perspective, McDonald's has shifted to a more franchised operating model and so governance of franchisee relationships is critical. Franchisees operate about 95% of the company's 14,000+ restaurants in the U.S., up from about 80% in 2015. The main risk is potential confrontation with franchisees, many of whom formed an independent franchisee association last year. On the cost side, rising wages, better food quality, and improving source transparency amid growing consumer demand could add further pressure to both franchisees		

and company-operated units. We assess management and governance as strong, based on stabilized global sales, an improving operating record, and a general ability to navigate employee relations and food safety headlines.		
Restaurant Brands International Inc. (BB-/Positive/--)	**U.S.**	**Helena Song**
Shifting consumer preferences toward more transparent and sustainable food practices could affect margins and brand reputation. In our view, RBI has managed these risks across its global operations and supply chain. The company and its franchisees have increased access to nutrition information both in-store and online, and maintained high food safety and quality standards. From a governance perspective, RBI is indirectly exposed to risks with regard to wages, labor relations, and employee safety because it is highly franchised. Under its independent board, the company has managed costs and implemented necessary initiatives and acquisitions to maintain growth.		
Starbucks Corp. (BBB+/Stable/A-2)	**U.S.**	**Declan Gargan**
We believe Starbucks has a fairly good track record managing ESG factors while expanding its store footprint. Starbucks invests heavily in training frontline employees and provides attractive employment benefits relative to other quick-service restaurants. The company is also investing in ethically sourced products and sustainable farming practices for coffee and tea, which it widely communicates to customers. Efforts such as using recyclable cups and offering discounts for reusable cups also improve the company's brand perception among its customers. We assess the company's management and governance as strong, reflecting management's largely consistent ability to achieve its financial and operational goals, although we note several shifts to a more aggressive financial policy in recent years. Activist investor Pershing Square has an ownership stake in Starbucks, but we haven't yet seen any onerous demands, such as shifts in financial policies or board membership.		
Target Corp. (A/Stable/A-1)	**U.S.**	**Diya Iyer**
Target's ESG risks are less material to the rating than other big box discounters like Walmart or Amazon, which face more global scrutiny. We note Target was early in establishing an $11 starting wage in 2017 and committing to a $15 per hour rate by 2020. It raised its starting wage again in 2018 to $12. We expect other cost savings to offset this rise in labor expenses, as they did through the latest quarter. On the governance front, more than 90% of its board are independent directors.		
Walgreens Boots Alliance Inc. (BBB/Stable/A-2)	**U.S.**	**Andy Sookram**
We view social and governance factors as moderate risks in our analysis of Walgreens because of ongoing public scrutiny on spiraling health care costs and opioid abuse. Health care costs have been rising and the U.S. government has held several inquiries into the drug pricing transparency and costs (among other areas). If current proposals are passed into legislation, new drug pricing mechanisms aimed at lowering costs could affect Walgreens' profits, albeit less so than peers (CVS or Rite Aid) because it does not have a pharmacy benefits manager business. Another focus is adequate controls related to dispensing prescription drugs or selling tobacco and cigarettes to minors. The FDA recently cited Walgreens for sale of more tobacco products to minors than other pharmacy chains, and we understand from press reports that the agency could block certain Walgreens stores from temporarily selling tobacco products. If these point-of-sale issues are not remediated and if potential issues arise from dispensing prescription drugs to unauthorized individuals, liabilities such as fines could hurt its performance in the long-term.		
Walmart Inc. (AA/Negative/A-1+)	**U.S.**	**Diya Iyer**
Walmart is heavily scrutinized in terms of its environmental, social, and governance risks, with particular attention on its labor and sourcing decisions, especially overseas. The company announced plans to raise minimum wages last year and remains focused on improving training and mobility for entry-level employees as well as emissions reduction. One notable governance risk in our view is the 2018 resignation of Binny Bansal, CEO of Walmart's Indian venture (Flipkart Group) following an internal probe into "serious personal misconduct." We will continue to watch expenses related to Walmart's Foreign Corrupt Practices Act ($30 million in 2019, down from $50 million-$60 million annually a few years ago). The company set aside nearly $300 million in 2017 for possible settlement, but no resolution has been reached. Walmart is also addressing significant social risks. In 2018, it said it would raise the minimum age to buy a firearm or ammunition to 21 from 18 and remove certain products resembling assault-style rifles from its inventory. It has prioritized produce in the U.S. and Mexico, seafood in Thailand, apparel in Bangladesh, and electronics in Malaysia and China as areas of focus for labor initiatives. It has also pledged to purchase approximately $250 billion in products that support the creation of American jobs between 2013 and 2023. We view these various efforts as credit positive.		

Ratings as of April 10, 2019.

Appendix: Components In The Sector ES Risk Atlas

Here is a list of examples of factors we consider in evaluating sector-specific environmental exposure. For example, we examine to what extent each sector is relatively exposed to:

Greenhouse gas emissions (GHG): actual or potential regulations such as carbon taxes, emissions trading schemes, and other direct or indirect costs. The GHG emissions under the Kyoto climate change agreement are carbon dioxide (CO_2), methane (CH_4), nitrous oxide (N_2O), hydrofluorocarbons (HFCs), perfluorocarbons (PFCs), and sulfur hexafluoride (SF_6).

Sensitivity to extreme weather events: incremental costs or the potential physical impact on assets associated with recurring (for example, hurricanes) or infrequent (droughts) severe weather events.

Sensitivity to water scarcity: potential costs related to the need for extracting or sourcing large quantities of water, or requiring on-site water treatment, in comparison to other water users of the same water basins or utilities.

Waste, pollution, and toxicity: potential fines or rising costs associated with prevention and treatment of waste and pollution, including hazardous waste and air pollution.

Land use and biodiversity: asset retirement obligations, developing natural land or potential operating constraints, or increased costs associated with protecting plant and animal life.

The following is a list of examples of factors we consider in evaluating sector-specific social exposure. For example, we analyze to what extent each sector is relatively exposed to:

Human capital management: a sector's capacity to develop a long-lasting productive workforce while reducing potential operational disruptions from workforce mismanagement; diversity and inclusion attributes; exposure to strikes and the sector's general exposure to dealing with emerging skills scarcity or surplus labor.

Changing consumer or user preferences: We recognize that changes in consumer behavior are often the result of complex dynamics, such as changes in technology or fashion or other disruptive business trends. Therefore, we treat a change in consumer preferences as a social factor related to sustainability, health, safety, the environment, privacy, financial mis-selling, or community and human rights, particularly when an entity has triggered the change.

Demographic changes: potential costs or opportunities related to population growth and composition, such as an aging population, urbanization, changing living standards, or a growing middle class.

Safety management: potential direct or indirect costs resulting from problems related to the safety of a sector's production processes and final customer products.

Social cohesion: potential or actual costs in direct operations or in the supply chain resulting from geopolitical or community-related events such as conflicts, community unrest, and terror attacks.

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