



Methodology
Rating Wireless

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Insight beyond the rating.

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Note: DBRS provides third-party, independent evaluations in four major areas: the corporate sector, financial institutions, public finance and structured finance. The corporate sector consists of a wide variety of industries.



I. Overview

DBRS ratings are opinions that reflect the creditworthiness of an issuer, a security or an obligation. They are opinions based on forward-looking measurements that assess a company's ability and willingness to make timely payments on outstanding obligations (whether principal, interest or dividend) with respect to the terms of an obligation. Ratings are not buy, hold or sell recommendations and they do not address the market price of a security.

DBRS rating methodologies include consideration of general business and financial risk factors applicable to most industries in the corporate sector, as well as industry-specific issues and more subjective factors, nuances and intangible considerations. Our approach is not based solely on statistical analysis but includes a combination of both quantitative and qualitative considerations. The considerations outlined in DBRS methodologies are not intended to be exhaustive. In certain cases, a major strength can compensate for a weakness that would be more critical for a peer company. Conversely, there are cases where one weakness is so critical that it overrides the fact that the company may be strong in most other areas.

DBRS rating methodology is underpinned by a stable rating philosophy, which means that in order to minimize the rating changes due primarily to global economic changes, DBRS generally factors the impact of a cyclical economic environment into its rating. Consequently, DBRS takes a longer-term "through the cycle" view of a company and, as such, rating changes are not based solely on normal economic cycles. Rating revisions do occur, however, when it is clear that a structural change, either positive or negative, has transpired or appears likely to transpire in the near future. An equally important aspect of DBRS analysis is its broad industry coverage, which it undertakes in order to understand the major differences and subtle nuances within a particular industry and to form an appropriate rating of a company relative to its competitors.

As a framework, DBRS rating methodologies consist of three components that together form the basis of the rating: an assessment of the company's general business risk profile based on cross-industry and macro business considerations; an assessment of the company's financial risk profile primarily based on quantitative ratio analysis; and consideration of industry-specific factors and measures particularly unique to the company. To some extent, the business risk and financial risk profiles are inter-related. The degree of financial risk considered acceptable for a company depends to a large measure on the business risks it faces.

Critical in the determination of a rating is the application of the analyst's experience and expertise in forming an initial rating opinion and recommendation for the rating committee and the role of the DBRS rating committee as the final decision maker. DBRS rating committees, which comprise experienced and knowledgeable DBRS personnel, strive to provide objective and independent rating decisions which are based upon all relevant information and factors, incorporate both global and local considerations, apply DBRS-approved methodologies and reflect the opinion of DBRS.

II. General Business Risk Profile

A fundamental component of DBRS analysis is the consideration of macro business factors that apply to most, if not all, industries within the corporate sector. The general business risk profile is largely a qualitative assessment of the environment a company is affected by and operates in. An assessment of the general business risk profile serves as a backdrop for the analysis of the company's financial risk profile as well as other qualitative and quantitative factors that are particularly unique to the company. Differing business risk profiles impact the assessment of a company's financial risk profile, and thus, it is important to understand the extraneous influences and business factors a company is or could be affected by despite its financial strength.

KEY CONSIDERATIONS IN EVALUATING A COMPANY'S BUSINESS RISK PROFILE

The following considerations, while not intended to be an exhaustive list, indicate the key areas DBRS considers in evaluating a company's business risk profile:

Economic Environment

The importance of the industry within the overall economy, in terms of either how it impacts or is impacted by the economy and shapes a company's viability. Also of importance is how the industry is influenced by current economic factors such as inflation or deflation, supply and demand, interest rates, currency swings and demographics.

Legislative and Regulatory Environment

Whether an industry is regulated or not is key, as the degree of regulation and legislative oversight can severely restrict or assist a company depending on its stage of growth, industry influence and regulatory relations. A regulated industry imposes a certain rigor and governance. It is also important to understand the frequency of change or stability in industry rules and whether regulations may require companies to make costly modifications to their infrastructure.

Competitive Environment

The nature of the market structure (e.g., monopoly versus oligopoly) determines the extent of competitiveness and the barriers to entry a company may face. Many industries are undergoing significant structural changes such as consolidation or deconsolidation, excess capacity, or competitive threats from new capacity in "low-cost" countries such as China, Brazil, and Russia in both domestic and international markets. Even small changes in the competitive environment can have a profound impact on a company.

Country Risk

Governments often intervene in their economies and occasionally make substantial changes in policy regarding competition, ownership, wage and price controls, restrictions on foreign currency, capital and imports/exports, among other things. Such policy changes can significantly affect a company, and therefore, considerations include the company's main location or country of operation, the extent of government intervention and support, and the degree of economic and political stability. The assessment of country risk is not limited to direct government actions to interfere with the private sector, but also encompasses the full range of financial and economic events that can spill across a country, causing widespread defaults in otherwise healthy corporate credits. As such, country risk can have considerable implications for corporate ratings. A country ceiling is assigned to corporate foreign currency ratings based on the country's susceptibility to systemic shocks and the private sector's ability to maintain its foreign currency debt payments when shocks occur.



Industry Cyclical

Cyclical is influenced by factors such as levels of consumer spending, consumer confidence and the strength of the economy. The degree of cyclical is influenced by the market segment in which a company specializes. Non-cyclical industries are better able to withstand dramatic economic changes, as are companies with more predictable cycles, than those with significant peaks and troughs. It is important to examine a company's strategies and performance over the longer term and understand them in cyclical highs and lows.

Management

The capability and strength of management is a pivotal factor in company success. An objective profile of management can be obtained by assessing the following: the appropriateness of core strategies; rigor of key policies, processes and practices; management's reaction to problem situations; its appetite for growth, either organically by adding new segments or through acquisition; its ability to smoothly integrate acquisitions without business disruption; and its track record in achieving financial results. Retention strategies and succession planning for senior roles are also critical considerations.

Corporate Governance

Effective corporate governance requires a healthy tension between management, the board of directors and the public. There is no one "right" approach for all companies. A good board can have a profound impact on growing companies, those in fragile financial states or those undergoing significant change. Beyond a review of management, assessment should focus on the appropriateness of board composition and structure (including the independence and expertise of the audit committee) to approve executive compensation and corporate strategy, and to oversee execution and opportunities for management self-interest. Other important areas include the extent of disclosure of financial and non-financial information (including aggressiveness of accounting practices and control weaknesses), share ownership (including director's) and shareholder rights.

III. General Financial Risk Profile

The financial risk profile is largely a quantitative assessment of the company's financial strength and an estimation of its future performance and financial profile. DBRS reviews three key areas: earnings, cash flow, and additional measures for balance sheet and financial flexibility. Within each area, DBRS focuses on key metrics and considerations which are assessed over time, noting that the trend in the ratios is also important to the rating. However, ratios alone cannot be used as an absolute test of financial strength. With a focus on future expectations, the primary goal of financial risk assessment is to understand the inter-relationship between the numbers, interpret what they mean and determine what they indicate about the company's ability to service and repay debt on a timely basis given the industry background.

KEY CONSIDERATIONS IN EVALUATING A COMPANY'S FINANCIAL RISK PROFILE

The following financial considerations and ratios tend to be analyzed for the majority of industries in the corporate sector. There may be additional quantitative factors and ratios that are considered on an industry-specific basis which are noted under Section IV – Industry-Specific Factors.

Also refer to the *Corporate Sector – Glossary of Ratio Definitions* at www.dbrs.com.



(A) Earnings

DBRS's earnings analysis focuses on core or normalized earnings and in doing so considers issues such as: the sources, mix and quality of revenue; the volatility or stability of revenue; the underlying cost base (e.g., company is a low-cost producer); optimal product pricing; and potential growth opportunities. Accordingly, earnings as presented in the financial statements are often adjusted for non-recurring items or items not considered part of ongoing operations. DBRS generally reviews company budgets and forecasts for future periods. Segmented breakdowns by division are also typically part of DBRS's analysis.

Typical earnings ratios include:

- Gross margin
- Return on common equity
- Return on capital
- EBIT margin and EBITDA margin

(B) Cash Flow/Coverage

DBRS's cash flow analysis focuses on the core cash flow generating ability of the company to service current debt obligations and other cash requirements, as well as the future direction of cash flow. From a credit analysis perspective, insufficient cash sources can create financial flexibility problems even though net income metrics may be favourable. DBRS evaluates the sustainability and quality of a company's core cash flow by focusing on cash flow from operations and free cash flow before and after working capital changes. Using core or normalized earnings as a base, DBRS adjusts cash flow from operations for as many non-recurring items as possible. In terms of outlook, DBRS focuses on the projected direction of free cash flow, the liquidity and coverage ratios and the company's ability to internally versus externally fund debt reduction and future capital expenditure and dividend/stock repurchase programs, as applicable.

Typical cash flow ratios include:

- EBIT interest coverage and EBITDA interest coverage
- EBIT fixed charges coverage
- Cash flow/total debt and cash flow/adjusted total debt
- Cash flow/capital expenditures
- Capital expenditures/depreciation
- Debt/EBITDA
- Dividend payout ratio

(C) Balance Sheet and Financial Flexibility Considerations

As part of determining the overall financial risk profile, DBRS evaluates various other factors to measure the strength and quality of the company's assets and its financial flexibility.

From a balance sheet perspective, DBRS focuses on the quality and composition of assets including goodwill and other intangibles, off-balance sheet risk and capital strength, including the quality of capital, appropriateness of leverage to asset quality and the ability to raise new capital. DBRS also reviews the company's strategies for growth, for example, capital expenditures, plans for maintenance or expansion and the expected source for funding these requirements. Where the numbers are considered significant and the adjustments would meaningfully impact the credit analysis, DBRS adjusts certain ratios for items such as operating leases, derivatives, securitizations, hybrid issues, off-balance sheet liabilities and various other accounting issues.

Typical balance sheet ratios include:

- Current ratio
- Turnover – Receivables and inventory
- Asset coverage (times)
- Per cent total debt to capital and per cent adjusted total debt to capital
- Per cent adjusted net debt to capital

The following factors focus on the company's liquidity:

- Maintaining sufficient bank-lines or cash balances
- Prudent use of cash balances for dividends or stock repurchases
- Terms and conditions of credit facilities, including unique terms and/or financial covenants
- Debt management approach, including dependence on short-term versus long-term debt, fixed versus variable rate debt and debt maturity schedule
- Interest rate and/or foreign exchange exposure
- Relationship and strength or weakness of a parent holding company or associated companies, if applicable

IV. Industry-Specific Factors

Each industry within the corporate sector has unique features that cannot be broadly applied across all industries. For example, capital spending is a key area in the utilities industry, reserves are particular to the mining industry, adequate R&D is critical for the pharmaceutical industry and seasonality significantly impacts merchandisers. Against the backdrop of the general business and financial risk profiles, a company's unique strengths, weaknesses and industry-specific issues need to be factored into the credit analysis to form an appropriate rating. These particular business and financial issues and measures also help to shape the company's status relative to its peers.

KEY CONSIDERATIONS IN EVALUATING A COMPANY WITHIN THE WIRELESS INDUSTRY

The following considerations more specifically characterize the Wireless industry and supplement the macro business and financial considerations, respectively, in Sections II and III of the DBRS methodology. All three sections, Sections II, III and IV, should be considered together.

(A) Predominant Factors

Competitive Landscape

The competitive landscape in which a carrier operates can have a significant influence on a company's business risk profile. An examination of the number of carriers in a market, for example, helps to gauge the level of competitiveness and most often the behaviour exhibited by carriers in a market. Other broad market characteristics, like current and potential penetration rates, are examined to determine a market's growth potential and degree of maturity. Finally, the demographics of the market are considered, along with the topography of the coverage area, to assess the revenue and EBITDA potential of the particular market and the network and capital required to service it.

Network: Coverage, Quality, Reliability and Reputation

The state of a carrier's network rollout and coverage are examined as they tend to impact call quality (both actual and perceived), reliability and, consequently, the reputation of a carrier's services. Furthermore, the number of voice and data networks that are operated in a market is considered as this can add additional complexity, cost and challenge in operating these networks in an efficient and seamless manner.

Licensing Requirements and Specific Regulatory Issues

Current regulatory policies on competition, pricing, handset subsidies, wireless licenses, spectrum distribution and ownership restrictions are examined for their influence, if any. Regulators typically stipulate certain requirements, including network coverage, as a condition of spectrum licenses. Additionally, the framework that the regulators create in terms of spectrum auctions is examined for the market, along with the resulting impact on the market.



(B) Other Factors

Subscriber Base: Subscriber Mix and Quality

The composition of a carrier's subscriber base is examined along with the market dynamics, since these factors can determine a wireless carrier's degree of profitability. Generally, carriers with larger post-paid subscriber bases tend to generate more average revenue per user, stronger EBITDA margins and exhibit greater stability in EBITDA – especially if subscribers are under multi-year contracts. Although prepaid subscriber bases can also be profitable, a carrier can often have to spend more on acquisition and retention efforts in order to retain that subscriber on a month-after-month basis. Furthermore, a carrier's proportion of business subscribers is examined as this segment tends to generate stronger profitability, given the typically strong demand for voice and data services from this subscriber segment.

Market Share

The market share and relative position of carriers within the industry is assessed to help gauge the competitive and operating strategies of the carriers in a market. A relationship with an incumbent telephone operator in a market can provide a carrier with additional opportunities and the ability to leverage off of an incumbent's customer base, brand, and marketing and distribution channels.

Geographic Revenue Mix

The degree to which a company has diversified its operations is assessed. This can occur both within a market (regional versus national) and geographically in other markets and can help to mitigate the risks of operating in a single market. It also allows carriers to leverage expertise and purchasing power in other markets. Alternatively, any negative diversification impacts – including risks – are examined, as management and operating resources must be dedicated to these markets, which can increase operating risks.

Size and Scale

The size of a carrier is examined, since larger wireless carriers can benefit from scale efficiencies, especially in terms of purchasing power, marketing, branding and distribution activities. This benefit can, in some cases, be further enhanced with a relationship with an incumbent fixed-line operator. Scale efficiencies can result in a carrier generating stronger EBITDA margins through incremental cost savings and the ability to spread fixed costs over a large subscriber base.

Pricing Trends, Substitution Impacts

Pricing trends on wireless voice and data services are examined to determine competitiveness and the price elasticity (or inelasticity) of demand for wireless services in a market. Additionally, the relative price of wireless to wireline services is considered to help to gauge the degree of wireless substitution that occurs in a market. In markets where fixed-to-wireless termination tariffs exist – where “the calling party pays” – the level of interdependence on the volume and price of fixed-to-wireless termination is considered. Finally, handsets and equipment pricing trends are taken into account to determine the degree of handset subsidy that exists in a wireless market.

Revenue Profile: Average Revenue Per User (ARPU)/Minutes of Use (MOU)

The level and trend in ARPU of a carrier is examined since ARPU is the largest determinant of a carrier's revenue. Average price per minute and MOU are both examined to determine the competitive environment, revenue gained from incremental subscribers, and data and advanced service revenue. MOU trends also help to quantify the level of adoption and the use of wireless services versus fixed-line services.



Subscriber Acquisition Costs: Cost Per Gross Addition (CPGA)/Subscriber Acquisition Costs (SAC)

Subscriber acquisition costs are considered a key determinant in assessing the costs associated with growing and/or maintaining a carrier's subscriber base. A carrier's CPGA is examined to determine trends and evaluate levels relative to peers. These costs ultimately support the level of EBITDA margins that a carrier generates. Typically, CPGA or SAC consists of three parts which are generally assessed both in aggregate and individually. These include sales and distribution costs; marketing and advertising costs; and the handset subsidy. These costs tend to be a function of a carrier's supply chain, its distribution channels and the price points of handsets. They are divided by gross subscriber additions to determine the incremental cost of adding new subscribers.

Customer Retention: Churn Rate

The level of churn can enhance or be a detriment to a carrier's EBITDA margins. This is especially the case when subscriber acquisition costs are high, as the carrier needs to replace these subscribers in order to increase its overall subscriber base to achieve growth and greater scale. The level and trend of churn rates are examined and help to highlight different subscriber mixes, satisfied or unsatisfied subscribers, and company-initiated versus subscriber-initiated subscriber turnover.

Technology Platforms

The type of technology platforms utilized, along with the chosen upgrade path, are important determinants in the capital and costs incurred in building and operating a wireless network in a market. The chosen technology can also have an impact on the availability of equipment and handsets and the types of services offered, thereby determining the degree of competitive advantage of certain carriers over their peers.

Quality of Assets – Fixed and Intangibles

The levels and the source of a carrier's fixed and intangible assets are considered to determine the quality of its asset base. While fixed assets are generally stable as networks continue to benefit from investment, the level of intangible assets is analyzed (including goodwill and intangible operating assets like wireless licensees and customer lists), as this can potentially be subject to write-downs.

Brand Recognition

A carrier's brand, as well as the awareness, reputation and value of that brand, is taken into consideration to assess the resulting competitive advantage (or disadvantage) that a carrier exhibits in a market relative to its peers. A carrier's brand can impact all levels of the supply chain, as well as the end consumer. As such, this is considered an asset that is not typically measured on the balance sheet.

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