Section 2: DBRS Reviews the Telecom/Cable Sector in Canada

Toronto CFA Society Credit Market Workshop: Telecom/Cable Sector

Insight beyond the rating.

Presented by:

Paul Holman
Managing Director

Chris Diceman, CFA
Senior Vice President

AUGUST 26, 2010

Agenda

- Introductions
- Fundamentals of Corporate Credit Analysis
- **DBRS Reviews the Telecom/Cable Sector in Canada**
- DBRS Case Studies, Part 1: Telecom
- DBRS Case Studies, Part 2: Cable
- Conclusion
- Questions & Answers

DBRS's Rating Scale

Ten long-term rating categories, with "high" and "low" subcategories

Long-Term Debt Rating Scale

Symbol	Credit Quality
AAA	Highest
AA	Superior
A	Satisfactory
BBB	Adequate
BB	Speculative
B	Highly Speculative
CCC	Very Highly Speculative
CC	Very Highly Speculative
C	Very Highly Speculative
D	Default

Investment Grade:
AAA to BBB (low)

Speculative Grade/High Yield:
BB (high) to D

Rating Process

Stage 1

Industry Business Risk Rating

Stage 2

Company Business Risk + Company Financial Risk = Final Company Rating

The **long-term rating** puts more emphasis on business risk than does the short-term rating.

The **short-term rating** stresses financial risk as well as business risk, but places more emphasis on financial risk and liquidity than does the long-term rating.

Stage 3

Rating on the Security

- Level of collateral and ranking of collateral and notching
- Holding Co. debt versus Operating Co. debt and notching principles

Stage 1: The Industry Business Risk Rating

Stage 1

Industry Business Risk Rating

Before we dive into the industries, who are the players?

DBRS Industry-Specific Factors

DBRS

Telecom Rating Methodology

General Business Risk Profile	– Macro and business environment	√
	– Quality of business and assets	√
General Financial Risk Profile	– Financial profile and performance	√
Industry-Specific Factors		
Predominant Factors	– Adaptation to changes in technology	
	– Regulatory environment	√
	– Competitive landscape	
Other Factors	– Size and scale	
	– Revenue mix	
	– Bundling	√
	– Networks, marketing and brand	
	– Defence of fixed-line services/subscribers	
	– Ability to manage costs	

DBRS Industry-Specific Factors

Wireless Rating Methodology

General Business Risk Profile	– Macro and business environment	√
	– Quality of business and assets	√
General Financial Risk Profile	– Financial profile and performance	√
Industry-Specific Factors		
<u>Predominant Factors</u>	– Competitive landscape – Network: coverage, quality, reputation – Licensing requirements, regulation	√
<u>Other Factors</u>	– Subscriber base: mix and quality – Market share – Size and scale – Pricing and trends, substitution impacts – Revenue profile – SAC, churn	√

DBRS Industry-Specific Factors

DBRS

Cable Rating Methodology

General Business Risk Profile	– Macro and business environment	√
	– Quality of business and assets	√
General Financial Risk Profile	– Financial profile and performance	√
Industry-Specific Factors		
Predominant Factors	– Technology – Size and scale – Capacity of network	√
Other Factors	– Capex – Basic subscribers/bundling – Regulatory – Penetration of homes/subscribers – Clustering – Churn	√

Telecom – A (low)/BBB (high) Industry Rating

A (low)/BBB (high) Industry Rating range supported by

Business

- Competitive duopoly for most services
- Subscription-based business models
- Stable EBITDA = Efficiencies + growth – access-line erosion
- EBITDA margins healthy, averaging 38.4%

Financial

- Reasonable balance sheets
- Strong free cash flow generation

Telecom – A (low)/BBB (high) Industry Rating

Industry Issues

- Competition ⟷ Deregulation
- Residential access-line erosion: cable telephony, technology substitution (i.e., wireless)
- Bundling: four-way play
- Telcos are enhancing networks with fibre, supporting enhanced data capability and video deployment
- Enterprise and SMB remain competitive and moving to IP-based platforms
- Integrated communications services
- Liberalization of current foreign ownership restrictions?

Telecom – A (low)/BBB (high) Industry Rating

Financial Risk

- Reasonable balance sheets, good liquidity, maturities
- Strong cash flow from operations supports
  - Sizable capex on fibre deployments, data, video
  - Meaningful dividends and share repurchases
- Healthy credit metrics:
  - % debt 41.8%; EBITDA int. coverage 9.12x; cash flow-to-debt 0.38x; net debt-to-EBITDA 1.83x

(CAD millions)	Wireline Only				Consolidated			
Major Canadian Operators	12 Months Ended	Total Revenue	EBITDA	EBITDA Margin	EBITDA Coverage	Cash Flow-to-Debt	% Debt in Cap. Stru.	Net Debt-to-EBITDA
BCE/Bell Canada BBB (high)/A (low)	June 2010	10,789	4,017	37.2%	11.09	0.42	40.2%	1.49
TELUS Corporation A (low)	June 2010	4,814	1,750	36.4%	7.38	0.36	48.1%	1.94
Bell Aliant Regional Comm. BBB (high)	June 2010	3,103	1,444	46.5%	8.89	0.37	33.4%	2.23
Manitoba Telecom Services Inc. BBB	June 2010	1,772	597	33.7%	9.10	0.38	45.5%	1.65

Major Canadian Operators	12 Months Ended	NAS (Thousands)	Long Dist. (Thousands)	Broadband (Thousands)	Wireless (Thousands)	Capex	Cash from Operations	Free Cash Flow
BCE/Bell Canada BBB (high)/A (low)	June 2010	6,632	3,979	2,064	6,987	2,653	5,150	771
TELUS Corporation A (low)	June 2010	3,845	2,692	1,134	6,699	1,780	2,622	286
Bell Aliant Regional Comm. BBB (high)	June 2010	2,864	2,148	830	126	456	1,142	22
Manitoba Telecom Services Inc. BBB	June 2010	1,195	285	185	470	323	407	(84)

Telecom – A (low)/BBB (high) Industry Rating

Summary

- General downward movement in rating over past decade
- Business risk has increased with advent of competition in all of its services
- Other changes: consolidation – a national telco?

Conclusion – Telecom

- Do the telcos in Canada ultimately end up at BBB (high)?
- Likely to be driven by increased business risk while financial risk expected to remain stable

Wireless – A (low)/BBB (high) Industry Rating

A (low)/BBB (high) Industry Rating range supported by

Business

- Highly competitive, albeit rational three-player market
- Subscription-based business models
- New entrants have deployed, more coming
- EBITDA margins currently healthy, averaging 41.9%

Financial

- Strong free cash flow generation
- Reasonable balance sheets of parents

Wireless – A (low)/BBB (high) Industry Rating

Industry Issues

- Competition increasing with new entrants
- Technology paths; 4G initiatives
- Wireless broadband: ingredients for significant growth
- Maturing industry, 68.8% penetration
- Voice ARPU pressure: can data ARPU growth offset this?
- Wireless substitution
- 700 MHz and 2.5/2.6 GHz spectrum auction in 2011/2012?
- Liberalization of current foreign ownership restrictions?

Wireless – A (low)/BBB (high) Industry Rating

Financial Risk

- Strong cash flow from operations
- Strong free cash flow, with capital intensity less than wireline
- Reasonable balance sheets of parents
- Healthy credit metrics:
  - % debt 52.5%; EBITDA int. coverage 8.45x; cash flow-to-debt 0.37x; net debt-to-EBITDA 1.81x

(CAD millions)	12 Months Ended	Total Revenue	EBITDA	EBITDA Margin	Interest Expense	EBITDA Coverage	Cash Flow-to-Debt	% Debt in Cap. Stru.	Net Debt-to-EBITDA
Major Canadian Carriers									
Rogers Wireless Inc.	June 2010	6,856	3,237	47.2%	677	6.89	0.33	69.1%	2.01
Bell Mobility Cellular Inc.	June 2010	4,739	1,779	37.5%	n/a	11.09	0.42	40.2%	1.49
TELUS Mobility	June 2010	4,853	1,980	40.8%	n/a	7.38	0.36	48.1%	1.94

	Three Months Ended	Subs. (Thousands)	Monthly Churn	Monthly ARPU	% Prepaid	Market Penetration	Total CPGA	Avg. Mins. Per User	3G Subs. (Thousands)
Major Canadian Carriers									
Rogers Wireless, Inc.	June 2010	8,626	1.4%	63.66	17%	27.8%	494	495	2,493
Bell Mobility Cellular Inc.	June 2010	6,987	1.8%	52.12	25%	21.6%	374	284	–
TELUS Mobility	June 2010	6,699	1.5%	57.47	20%	19.9%	342	373	–

Wireless – A (low)/BBB (high) Industry Rating

Summary

- New landscape in three to five years?
  - Likely fewer new entrants through consolidation, attrition
  - Could two incumbents join?
- Does this new competitive landscape pressure the business risk profiles of the incumbents?
- Does data growth (smart phones, devices) offset commoditization of voice services?

Conclusion – Wireless

- Trends currently Stable, Industry Rating could possibly move more to BBB (high) if business risk intensifies

Cable – BBB/BBB (high) Industry Rating

BBB/BBB (high) Industry Rating range supported by

Business

- Competitive duopoly for most services
- Subscription-based business models
- Healthy EBITDA margins, averaging 45.5%

Financial

- Strong cash flow from operations
- Reasonable balance sheets

Cable – BBB/BBB (high) Industry Rating

Industry Issues

- Technology continues to evolve
- Future of coax network; Internet advancement
- Competition: likely increased for video, stable for data
- Bundling: three-way/four-way play
- Wireless strategies
- Risk of disintermediation in video
- Liberalization of current foreign ownership restrictions?

Cable – BBB/BBB (high) Industry Rating

Financial Risk

- Strong cash flow from operations
- Sizable capex programs
- Reasonable balance sheets
- Good credit metrics:
  - % debt 62.9%; EBITDA interest coverage 7.34x; cash flow-to-debt 0.33x; net debt-to-EBITDA 2.02x

(CAD millions)	12 Months Ended	Total Revenue	EBITDA	EBITDA Margin	Interest Expense	EBITDA Coverage	Cash Flow-to-Debt	% Debt in Cap. Stru.	Net Debt-to-EBITDA
Major Canadian Carriers									
Rogers Wireless Inc.	June 2010	6,856	3,237	47.2%	677	6.89	0.33	69.1%	2.01
Bell Mobility Cellular Inc.	June 2010	4,739	1,779	37.5%	n/a	11.09	0.42	40.2%	1.49
TELUS Mobility	June 2010	4,853	1,980	40.8%	n/a	7.38	0.36	48.1%	1.94

	Three Months Ended	Subs. (Thousands)	Monthly Churn	Monthly ARPU	% Prepaid	Market Penetration	Total CPGA	Avg. Mins. Per User	3G Subs. (Thousands)
Major Canadian Carriers									
Rogers Wireless, Inc.	June 2010	8,626	1.4%	63.66	17%	27.8%	494	495	2,493
Bell Mobility Cellular Inc.	June 2010	6,987	1.8%	52.12	25%	21.6%	374	284	–
TELUS Mobility	June 2010	6,699	1.5%	57.47	20%	19.9%	342	373	–

Cable – BBB/BBB (high) Industry Rating

Summary

- General upward movement in ratings over past few years
- Shaw, Rogers Communications, Cogeco and Vidéotron upgraded
- Consolidation – a national cableco?

Conclusion – Cable

- Can cable in Canada move more to BBB (high)?
- Downgrade potential less likely with stronger balance sheets
- Would likely be leverage that causes rating pressure, and business risk is expected to remain fairly stable, although telcos are moving into video

DBRS's Ratings – Communications

Canadian ratings at or near specific Industry Rating ranges

Sector	Industry Rating Range	Canadian Ratings Range
Telecom	A (low)/BBB (high)	A (low) to BBB
Wireless	A (low)/BBB (high)	A (low) to BBB
Cable	BBB/BBB (high)	BBB to BB (high)
Media	BBB (high)/ BBB (low)	A (low) to BBB
Publishing	BBB/BBB (low)	BBB to BB (low)

Long-Term Debt Rating Scale

Symbol	Credit Quality
AAA	Highest
AA	Superior
A	Satisfactory
BBB	Adequate
BB	Speculative
B	Highly Speculative
CCC	Very Highly Speculative
CC	Very Highly Speculative
C	Very Highly Speculative
D	Default

DBRS's Telecom/Cable Universe

DBRS

Telecom/Wireless is converging with Cable

Canadian Company Ratings

Sectors	Industry Rating Range	*Business* EBITDA Margins	*Financial* Debt-to-Total Capital	Net Debt-to-EBITDA	EBITDA Interest Coverage	Cash Flow-to-Debt
		Business & Financial Risk Metrics – Group Averages				
Telecom						
Bell Canada A (low), TELUS A (low), Bell Aliant BBB (high), Manitoba Telecom BBB	A (low)/ BBB (high)	38.4%	41.8%	1.83x	9.12x	0.38x
Wireless						
Rogers Communications BBB, Bell Mobility (NR), TELUS Mobility (NR)	A (low)/ BBB (high)	41.9%	52.5%	1.81x	8.45x	0.37x
Cable						
Rogers Communications BBB, Shaw Communications BBB, Videotron BB (high), Cogeco Cable BBB (low)	BBB/ BBB (high)	45.5%	62.9%	2.02x	7.34x	0.33x

Note: Figures on an LTM basis to June 30, 2010; May 31, 2010, for Shaw and Cogeco Cable.

Telecom/Wireless/Cable – Summary

- Similar operating attributes around all three sectors
  - Size, scale, market position
  - Technology
  - Regulation/competition
- As telecom and cable sectors converge, expect that their Industry Ratings will converge as well
- Foreign ownership liberalization could lead to domestic consolidation and foreign investment/takeovers

Break

Brief Break

Contact Information

Paul Holman
+1 416 597 7534
pholman@dbrs.com

Chris Diceman, CFA
+1 416 597 7542
cdiceman@dbrs.com

www.dbrs.com