



Methodology
Rating Canadian Airport Authorities

MARCH 2011



Insight beyond the rating.

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Introduction to DBRS Methodologies

- In general terms, DBRS ratings are opinions that reflect the creditworthiness of an issuer, a security or an obligation. They are opinions based on an analysis of historic trends and forward-looking measurements that assess an issuer's ability and willingness to make timely payments on outstanding obligations (whether principal, interest, dividend or distributions) with respect to the terms of an obligation.
- 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 and, conversely, there are cases where one weakness is so critical that it overrides the fact that the issuer may be strong in most other areas.
- DBRS rating methodologies are underpinned by a stable rating philosophy, which means that in order to minimize the rating changes due primarily to economic changes, DBRS strives to factor the impact of a cyclical economic environment into its rating as applicable. 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.
- As a framework, DBRS rating methodologies consist of several components that together form the basis of the ultimate ratings assigned to individual securities. Assessments typically include the industry's business risk profile, the issuer's general business risk profile, the entity's financial risk profile and considerations related to the specific security.
- To some extent, the business risk and financial risk profiles are interrelated. The financial risk for an issuer must be considered along with the business risks that it faces. In most cases, an entity's business risk will carry more weight in the final issuer rating than will its financial risk.

Business and Financial Risk Overview

- On a high-level macro basis, DBRS has a consistent approach to determining the issuer rating of an entity that is common across many industries. (See the appendix for the definition of "issuer rating.") Our high-level approach can be broken into three stages, as shown on the opposite page.
- Where applicable, DBRS uses the concept of business risk ratings (BRRs) as a tool in assessing the business strength of both industries and individual companies within many methodologies across the corporate finance area. DBRS typically assesses five areas to establish the overall BRR for an industry:
 - Profitability and cash flow.
 - Competitive landscape.
 - Stability.
 - Regulation.
 - Other inherent industry considerations.
- Although there is an overlap in some instances (to some degree, in the long term, all five factors tend to relate to profitability and stability), DBRS has found that considering these five measures in a separate fashion is a useful way of approaching this analysis.
- Using the same factors across different industries provides a common base with which to compare the business risks of various industries, even when they are distinctly different. In all cases, DBRS uses historic performance and our experience to determine an opinion on the future, which is the primary focus. For additional discussion on industry BRRs, please refer to the Industry Business Risk Ratings and Industry Business Risk Rating Definitions sections in the appendix.



- It is important to note that the ratings for issuer-specific business and financial risks as provided under Stage 2 of this document should not be taken as final issuer ratings. For example, an individual entity may fit into the “A” range with respect to the analysis of its business risk, but its financial metrics could be more in the BB category. It would be incorrect to believe that the final issuer rating in this case would be either “A” or BB. In determining the final issuer rating, both of these two major areas must be considered. For additional discussion on this topic, please refer to the Interrelationship between Business and Financial Risk section in the appendix.

Three Stages of DBRS Rating Analysis

Stage 1: Industry Business Risk Rating

Consider the overall business risk rating (BRR) for the industry.

Industry Business Risk Rating

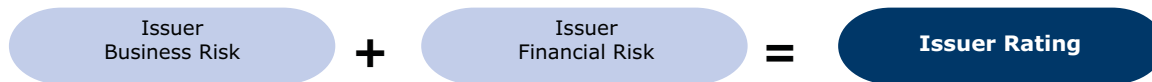


Stage 2: Issuer Rating

Consider the strength of the individual issuer:

- (a) First assessing how the issuer’s BRR compares with the industry BRR.
- (b) Then assessing the issuer’s financial risk.

Taken together, these factors will determine the entity’s issuer rating.



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



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

Stage 3: Rating the Security

Consider covenant and ranking issues that exist for specific securities, using the issuer rating to determine specific security ratings.





Stage 1: Industry Business Risk Rating for Canadian Airport Authorities

DBRS defines the Canadian airport authority sector as those authorities in charge of managing and operating the 26 airports that are part of the National Airports System (NAS). NAS airports include those in the national and provincial and territorial capitals as well as airports that handle at least 200,000 passengers each year. These airports handle more than 90% of air travelers in Canada and are considered by the federal government as comprising Canada's core network of airports. For the Canadian airport authority sector, DBRS views the BRR as being "A." Of the five major categories used by DBRS in assessing industry BRRs, three of them are markedly better than average in the case of the Canadian airport authority sector, as explained below.

INDUSTRY PROFITABILITY AND CASH FLOW

- Profitability in the Canadian airport authority industry is relatively low when compared with typical corporate credits. However, this is not the result of weak earning potential in the sector but rather the consequence of the cost-recovery mandate of Canadian airport authorities as opposed to profit maximization.
- Furthermore, this is not viewed as a rating impediment because airport authorities have considerable cash flow generating capabilities, if needed, given their unfettered fee-setting autonomy.

INDUSTRY COMPETITIVE LANDSCAPE

- The competitive landscape is considered to be very favourable for Canadian airport authorities.
- The capital intensity of airport activities, land constraints and the clause in an authority's ground lease with the federal government that prohibits the construction of another international airport within a certain radius all result in a quasi-monopoly for authorities in their service regions.

INDUSTRY STABILITY

- Air travel is a near-essential service in today's global economy, which translates into solid long-term growth fundamentals for the airline and airport industries. Nonetheless, the demand for air travel tends to exhibit a level of cyclicity that is moderately above average.
- Furthermore, the global nature of airline traffic and the reliance of Canadian airport authorities on one or, in some cases, two major airlines expose authorities to event risk.

INDUSTRY REGULATION

- There is currently no comprehensive legislation or policy framework guiding the activities of Canadian airport authorities. Certain constraints are imposed on the authorities through their ground leases with the federal government, but these are relatively minor, resulting in substantial operating flexibility.
- This is especially the case for fee-setting autonomy where there is no limit on rates and charges that can be levied on airport users in Canada and no need to obtain approval before raising fees, although authorities generally provide a 60-day notice prior to any fee change.

OTHER INHERENT INDUSTRY CONSIDERATIONS

- Another distinctive characteristic of the sector is the capital intensity of airport activities, which translates into the constant need to renew and expand infrastructure.
- Since airport authorities are unable to issue equity, this often leads to sizable debt burdens.

Stage 2: Issuer Rating

To move from the generic industry BRR toward the issuer rating for a specific issuer, two tasks must be performed. Specifically, we must determine the business risk and the financial risk for the individual entity.

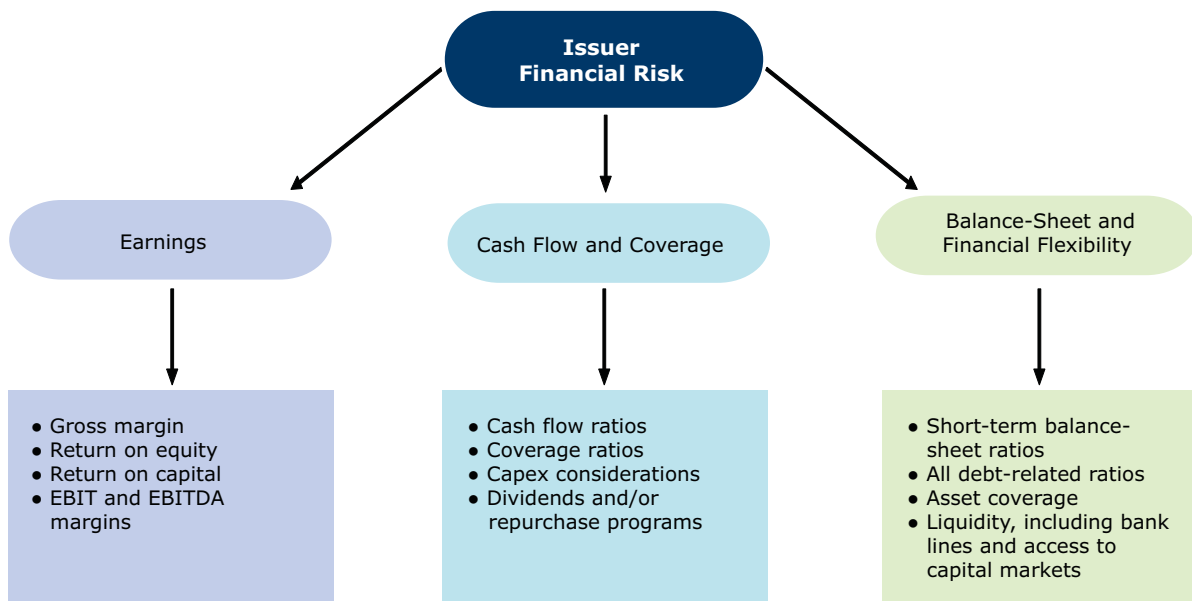
BUSINESS RISK PROFILE

- The business risk profile of the issuer may be better or worse than the industry average due to the presence of unique attributes or challenges that exist at the issuing entity. While not exhaustive, the list of critical factors outlined in the previous section could result in a specific issuer rating being different from the industry BRR.
- This methodology also provides some guidance on which factors are considered the most critical for the industry in question. Issuers may also have meaningful business lines in addition to the base business that extend beyond their most prominent industry, which could add significant attributes or challenges.

FINANCIAL RISK PROFILE

- The graphic below is a visual display of the key financial risk profile considerations that are discussed in the Issuer-Specific Financial Risk Factors section of this methodology, although even the detail provided there is not meant to be exhaustive.
- The discussion will note that DBRS often makes calculation adjustments in key ratios for risks related to a variety of areas. In some cases, a relationship with a parent or associated company will also be important.

Key Financial Risk Metrics



Issuer-Specific Business Risk Factors

- We now consider if an individual issuer in the Canadian airport authority industry would be better, worse or the same as the industry BRR. Our focus here is on the critical business risk factors that relate to this industry in particular. The five critical factors used to determine the industry BRR are applied by DBRS to compare numerous industries and are thus more general in nature.
- By analyzing these key drivers (which will vary on an industry-by-industry basis), the essential strengths and challenges of each industry are captured in an accurate fashion, and transparency is provided. The analysis below is connected to the industry BRR in that the industry BRR establishes where an average issuer would be considered to score on the matrix. For example, an industry with a BRR of BBB would mean that the following matrix describes the scoring of an average issuer within the BBB column.

Issuer-Specific Business Risks – Critical Factors

Rating	AA Exceptional	A Superior	BBB Adequate
Business Strength			
Economic Strength of Service Area	<ul style="list-style-type: none"> • The service area comprises one of Canada's largest and most diversified cities. • In addition, the service area has a strong business base and a good track record of economic and population growth and attracts considerable tourism, making the airport a preferred partner for international airlines and an essential component of Canada's airport network. 	<ul style="list-style-type: none"> • The service area comprises one of the province's largest and most diversified cities, with a reasonable track record of economic and population growth, making the airport an important component of Canada's airport network. 	<ul style="list-style-type: none"> • The service area is more regional in nature and comprises relatively small and less-diversified cities. • Regional economic indicators point to stagnant economic and population bases, resulting in limited traffic growth prospects.
Passenger and Airline Mix	<ul style="list-style-type: none"> • In addition to a strong and growing domestic passenger base, the airport benefits from significant international and transborder traffic flow. • The airport is also serviced by all major domestic airlines through a significant service offering and has a sizable number of international airline clients. 	<ul style="list-style-type: none"> • The passenger base is dominated by domestic traffic, but it also includes moderate contributions from the international and transborder segments. • The airline mix is reasonably well diversified. 	<ul style="list-style-type: none"> • The passenger base is mostly domestic, with notably below-average and/or exceedingly volatile growth exhibited historically. • Overreliance on connecting traffic may also be exhibited. • The mix of airlines serving the airport is very limited, with excessive dependence on one of Canada's two major airlines.
Adequacy of Infrastructure Base	<ul style="list-style-type: none"> • The airport authority's capital renewal program is mostly complete and the infrastructure base has been well maintained and is adequate to accommodate growth for the next ten years. 	<ul style="list-style-type: none"> • Considerable investments have been made to update infrastructure, but the authority still faces sizable investments to renew and/or expand programs to accommodate growth over the foreseeable future. • Although exposed to construction risk, the authority has a good track record of project delivery. 	<ul style="list-style-type: none"> • The infrastructure base is outdated or inadequate to meet current demand, resulting in congestion and potential safety issues. • Considerable investments are foreseen over the years to come, which will entail construction risk and potential cost overruns and/or disruption of airline services. • The authority has no track record of capital project delivery.

Issuer-Specific Business Risks – Critical Factors

Rating	AA Exceptional	A Superior	BBB Adequate
Business Strength			
Revenue Diversification	<ul style="list-style-type: none"> The revenue base is well diversified, with significant contributions from concessions, parking and other commercial activities. 	<ul style="list-style-type: none"> The revenue base is diversified, including significant inflows from concessions, parking and other commercial sources, contributing to competitive airline fees. 	<ul style="list-style-type: none"> Revenues almost exclusively originate from aeronautical fees, with only modest contribution from commercial activities.
Level of User Fees	<ul style="list-style-type: none"> Through prudent investment planning, expenditure management and/or alternative activities, the authority has been able to maintain aeronautical fees markedly below the industry average, leaving considerable room for upward adjustments, if needed. 	<ul style="list-style-type: none"> Aeronautical fees are comparable with the industry average, once adjusted for the wealth level of the region. 	<ul style="list-style-type: none"> Aeronautical fees are significantly above the industry average, even once adjusted for the wealth of the region, potentially impairing the ability of the authority to attract new airlines and/or suggesting that further increases may be met with considerable user resistance.

- Air travel demand can be volatile at times and tends to be especially sensitive to changing economic conditions and one-time shocks such as terrorism, airline bankruptcy, pandemics or geopolitical instability. As a result, the operating and financial performance of airport authorities can exhibit material swings from peak to trough. Nevertheless, DBRS endeavours to rate each issuer through the cycle and does not penalize a issuer at market troughs nor reward it at market peaks.
- Below is a summary of the key considerations and drivers of DBRS ratings that specifically characterize the Canadian airport authority industry.

PRIMARY INDUSTRY-SPECIFIC FACTORS

Economic Strength of the Service Area

- The economic fundamentals of a region are significant determinants of growth prospects for an airport given the generally strong correlation between economic activity and airline traffic. Airports serving regions with a large and buoyant economy will generally experience faster and more sustainable passenger and airline traffic growth as well as less volatility in demand as a result of changes in user fees than facilities located in sluggish economic regions.
- Key economic variables analyzed particularly closely by DBRS include the composition and diversification of the economic base, unemployment, income levels and population size and growth momentum.

Passenger and Airline Mix

- The composition of an airport's user base provides useful insight into the stability and growth potential of traffic and, ultimately, revenue.
- DBRS looks at the origination and destination (O&D) traffic in relation to connecting traffic, as well as at the breakdown of traffic in terms of domestic, international and transborder components, recognizing that a higher percentage of international traffic generally translates into higher growth potential, and high O&D traffic generally leads to a more stable traffic and revenue base. Airports with a strong O&D component are less sensitive than connecting hubs to the credit quality of a particular airline and to route reorganizations.
- Should a large airline fail, O&D traffic is more likely to be picked up by competitors than connecting traffic. Nonetheless, connecting traffic may in some cases allow for a more efficient use of the infrastructure in downtimes and provide a significant source of revenue diversification, with potential positive implications for the rating if the stability of such business can be demonstrated.



- The mix of airlines servicing the airport is also an important consideration in the analysis. A small pool of users or heavy reliance on a single airline may translate into more limited or volatile growth opportunities or higher risk of traffic disruption as a result of the generally weak financial profile of airlines and their exposure to labour actions.
- DBRS notes that the relatively low diversity of air carriers in Canada is a systemic risk because two carriers (i.e., Air Canada and its affiliates and WestJet) are responsible for the majority of passenger traffic at nearly all large Canadian airports.

Adequacy of Infrastructure Base

- The adequacy and state of good repair of an airport's infrastructure base provide valuable insight into the ability of the facilities to accommodate current and future traffic growth, maintenance requirements and future investment and borrowing needs.

Revenue Diversification

- Although all major revenue sources are ultimately linked to passenger traffic, the ability of an authority to leverage its user base and diversify its revenues away from traditional aeronautical fees, which are often determined on a residual basis, is viewed as a positive by DBRS because it reduces the burden imposed on airlines and contributes to some extent to reducing revenue volatility.

Level of User Fees

- Canadian airport authorities have an unregulated ability to raise fees and rates to remain commercially viable and to levy user fees, such as an airport improvement fee (AIF), for the funding of capital projects. Furthermore, collection powers are supported by statutory seizure rights, allowing authorities to seize aircraft owned or leased by airlines, provided a court order has been obtained.
- Emphasis is put on the current level of user fees, especially for aeronautical charges, and on the ability and willingness of management to further increase those user charges, if needed, to weather unexpected downturns or to fund upcoming capital investments.
- DBRS benchmarks key user charges against those of other major airports in order to establish the authority's competitiveness within the national network and gauge the possibility of user resistance to eventual increases.

ADDITIONAL FACTORS

Location and Competition

- Airports generally benefit from a quasi-monopoly in their service regions. Nonetheless, an airport's location may have important competitive and growth implications. For example, it can make an airport the most efficient option for certain connecting airline routes or dampen growth potential if a much larger airport is reasonably close.
- Competition among airports for new airline partners is more intense in the international segment. Airports may also compete with alternative modes of transportation, although the significant distances generally separating Canada's large urban centres often make air travel the most time-efficient means of transportation.

Relationship with Federal Government

- Despite the regulatory powers of the federal government in the aeronautical sector, there is currently no comprehensive legislation or policy framework guiding the activities of Canadian airport authorities.
- The operating framework of Canadian airport authorities is ultimately defined through their ground lease agreements with the government, which transfer the responsibility for managing and operating the country's major airports to airport authorities, which are non-share capital corporations. Nevertheless, the government has the capacity to significantly influence airport authorities' activities and financial performance by, for example, changing the ground rent payable by authorities or introducing legislation that could hinder the powers granted to authorities through the ground leases.
- DBRS notes that the government has so far been fairly supportive of the sector, with no material change ever imposed on the system, with the exception of the lighter and simpler airport rent regime introduced in 2005.

Labour Relations

- Frequent and prolonged labour disruptions can not only negatively affect cost structures but also erode an airport's image or perception as a reliable supplier. Important factors include the following: historical relationship between issuer and employees, degree of unionization, major labour contract details (e.g., expiry date of collective bargaining agreements, wage agreements and pension provisions), issuer or industry negotiation process and strike history.

Airport Security Requirements

- The security and screening requirements imposed on travelers at airports around the world have expanded significantly over the last decade. This has materially increased travel times, reduced the convenience of airline travel on shorter routes and added considerably to the complexity and cost of airport operations. While still manageable, the risk of continued tightening in security measures remains, which could eventually start dampening traffic growth.

COMMON BUSINESS CONSIDERATIONS

- There are two major considerations that were not included with the prior analysis but can have a meaningful impact on an individual issuer in any industry: country risk and corporate governance (which includes management). These areas tend to be regarded more as potential negative issues that could result in a lower rating than otherwise would be the case, although DBRS would certainly consider exceptional strength in corporate governance as a rating attribute.
- In most cases, our focus on the two areas is to ensure that the issuer in question does not have any meaningful challenges that are not readily identifiable when reviewing the other business risk considerations and financial metrics outlined in this methodology.

Country Risk

- Governments often intervene in their economies and occasionally make substantial changes that can significantly affect an entity's ability to meet its financial obligations; therefore, considerations include the issuer's main location or country of operation, the extent of government intervention and support and the degree of economic and political stability.
- As such, the sovereign rating itself may in some cases become a limiting factor in an entity's rating, particularly when the sovereign has a lower rating and the entity does not have meaningful diversification outside its domestic economy.

Corporate Governance

- Effective corporate governance requires a healthy tension between management, the board of directors and the public. There is no single approach that will be optimal for all companies.
- A good board will have a profound impact on an issuer, particularly when there are significant changes, challenges or major decisions facing the entity. DBRS will typically assess factors such as the appropriateness of board composition and structure, opportunities for management self-interest, the extent of financial and non-financial disclosure and the strength or weakness of control functions. For more detail on this subject, please refer to the DBRS criteria *Evaluating Corporate Governance*.
- With respect to the pivotal area of management, an objective profile can be obtained by assessing the following: the appropriateness of core strategies; the rigour of key policies, processes and practices; management's reaction to problem situations; the integrity of business and regulatory dealings; the entity's 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 can also be considerations.



Issuer-Specific Financial Risk Factors

KEY METRICS

- Recognizing that any analysis of financial metrics may be prone to misplaced precision, we have limited our key metrics to a small universe of critical ratios. For each of these ratios, DBRS provides a range within which the issuer's financial strength would be considered as supportive for the same level of business risk as the Canadian airport authority industry. For example, an issuer where the outlook for both business risk and financial risk metrics falls within the BBB category would, all else being equal, be expected to have an issuer rating in the BBB range.
- To be clear, the ratings in the matrix below should not be understood as the final rating for an entity with matching metrics. This would only be the case to the extent that the business risk of the issuer and a wide range of other financial metrics were also supportive. The final rating is a blend of both the business risk and financial risk considerations in their entirety.

Canadian Airport Authority Industry Financial Metrics

Key Ratio	AA	A	BBB
Debt-to-enplaned passenger	< \$125	\$125 to \$500	> \$500
Debt service coverage*	> 2.0x	1.25x to 2.0x	< 1.25x

* EBITDA-to-mandatory debt service requirements (principal and interest).

- While the data in the above table are recognized as key factors, they should not be expected to be fully adequate to provide a final financial risk rating for any issuer. The nature of credit analysis is such that it must incorporate a broad range of financial considerations, and this cannot be limited to a finite number of metrics, regardless of how critical these may be.
- DBRS ratings are based heavily on future performance expectations, so while past metrics are important, any final rating will incorporate DBRS's opinion on future metrics, a subjective but critical consideration.
- It is also not uncommon for an entity's key ratios to move in and out of the ranges noted in the ratio matrix above, particularly for cyclical industries. In the application of this matrix, however, DBRS is typically focusing on multi-year ratio averages.
- Notwithstanding these potential limitations, the key ratios are very useful in providing a good starting point in assessing an issuer's financial risk.
- It is important to note that actual financial ratios for an entity can and will be influenced by both accounting and accounting choices. In Canada, this will include the shift to International Financial Reporting Standards (IFRS). DBRS acknowledges that IFRS and other accounting choices will have an impact on the financial metrics of the companies that it covers. The financial risk factors include ratios based on data from the entity's financial statements that are based on Canadian Generally Accepted Accounting Principles (GAAP) and U.S. GAAP, for the most part. When the financial statements are based on GAAP in other countries, including IFRS, the ratios and ranges may need to be redefined.
- Recognizing that the metrics in the table above do not represent the entire universe of considerations that DBRS examines when evaluating the financial risk profile of an issuer, the following provides a general overview that encompasses a broader range of metrics and considerations that could be meaningful in some cases.

Overall Considerations in Evaluating an Issuer's Financial Risk Profile

In addition to the information already provided with respect to key financial metrics, the following financial considerations and ratios are typically part of the analysis for the Canadian airport authority industry. As it is not possible to completely separate business and financial risks, note that many of the following ratios will relate to both areas.

OPERATING RESULTS

- Because of the cost-recovery mandate of Canadian airport authorities (as opposed to profit maximization), DBRS's traditional earnings analysis used for corporate credits is not viewed as particularly relevant. Accrual losses and gains are tracked by DBRS, but they do not constitute a key rating determinant. It is fairly common for airport authorities and other large infrastructure providers to post repeated accrual shortfalls following the completion of major capital projects as they generally seek to recover their investments over the long term once use of the newly added capacity has ramped up.
- Instead, DBRS focuses on the core cash flow generating ability of the authority to service current debt obligations and fund future capital requirements. From a credit analysis perspective, insufficient cash sources can create financial flexibility problems, even though net income metrics may be favourable.
- In particular, DBRS analyzes the adequacy, sustainability and trend of EBITDA, cash flow from operations and free cash flow generation, as well as the key factors that have contributed to any notable deviation from budget in recent years, in order to develop a solid understanding of management quality and the likely trend of future results.
- Issues such as the sources, mix and quality of revenue; the volatility or stability of revenue; the predictability and manageability of the expenditure base; and potential cost pressure and growth opportunities are given particular attention. Considerable emphasis is also put on the authority's budget and longer-term forecasts, which provide insight into the projected direction of free cash flow, liquidity and coverage ratios. Results as presented in the financial statements are adjusted for non-recurring items or items not considered part of ongoing operations (if any).

Typical Operating Indicators Used

- EBITDA margin.
- Major revenue sources per enplaned passenger.
- Operating and maintenance (O&M) expenses per enplaned passenger.
- Interest charges as a per cent of expenses.
- EBITDA interest coverage.
- Capital expenditures-to-depreciation.

BALANCE-SHEET AND FINANCIAL FLEXIBILITY CONSIDERATIONS

- As part of determining the overall financial risk profile, DBRS evaluates various other factors to measure the current and projected strength and financial flexibility of a debt issuer. Because of their non-share capital structure, Canadian airport authorities must rely on internal cash flow and debt to finance capital needs. As such, DBRS closely analyses the composition and level of debt carried by an authority in relation to the resources expected to be available under prudent scenarios to fulfill its debt obligations and meet future infrastructure needs.
- This is the most forward-looking portion of the credit rating assessment, with DBRS endeavouring to establish a clear view of the direction likely to be taken by leverage over at least the next five years, based on a review of an authority's growth strategy, including capital expenditures and the expected source of funding for these requirements.



- DBRS notes that the capital-intensive nature of airport activities and the need to continually renew and expand infrastructure to accommodate growing traffic generally result in major Canadian airport authorities carrying sizable debt burdens.
- DBRS focuses on three key ratios when analyzing an authority's debt level: debt per enplaned passenger, debt-to-EBITDA and debt service coverage ratio (DSCR). The first ratio (debt per enplaned passenger) is viewed as a particularly valuable indicator of an authority's financial burden as it allows for easy comparisons among peers of different size and helps put in context debt affordability by incorporating traffic levels, which are viewed by DBRS as a good indicator of an authority's revenue-generating potential.
- The DSCR illustrates in a more dynamic fashion an entity's ability to service its debt. Defined by DBRS as the ratio of EBITDA-to-mandatory debt servicing, the DSCR ultimately highlights the cushion maintained in cash flows for debt-servicing obligations. While structured as non-share capital corporations and generally seeking to operate on a not-for-profit basis, Canadian airport authorities in the "A" range are expected by DBRS to maintain a DSCR in excess of 1.25 times under normal operating conditions.
- The composition of the debt burden warrants considerable attention. In the case of Canadian airport authorities, airport land is owned by the federal government; therefore, borrowing is usually done through revenue bonds, which grant security to bondholders primarily over revenue sources, rights under the ground lease and assets held in reserve funds.
- DBRS expects debt instruments to be denominated in Canadian dollars and predominantly bear fixed interest rates, ensuring stable debt-servicing requirements. If several debt series are outstanding, efforts should be made to smooth maturities in order to mitigate refinancing risk. Events of default are also examined carefully for their reasonableness, while covenants are assessed for their effectiveness in protecting bondholders.
- For Canadian airport authorities, covenants are fairly light and generally include a rate covenant, requiring the issuer to set user charges at levels sufficient to maintain a minimum DSCR (as defined under the trust indenture), and limitations on negative pledges, disposal of assets, non-core activities and additional borrowing.
- Because of the volatility of the air-travel sector, airport authorities are generally required under their trust indentures to maintain with the trustee liquid assets sufficient to cover six months of debt servicing (principal and interest). Authorities are also generally required under their trust indentures to establish an O&M contingency fund, with assets or an allocation of an undrawn committed credit facility sufficient to cover 25% of annual operating expenses.
- Given the long-term break-even objective generally pursued by Canadian airport authorities, other sources of liquidity carried on the balance sheet are often fairly limited or earmarked for future capital projects. These may include operating cash balances, AIF reserve or unspent bond proceeds. As such, authorities are expected to maintain credit facilities in excess of any allocation to the O&M reserve to ensure adequate levels of liquidity.
- In addition to including traditional debt in its analysis, DBRS may incorporate financial commitments such as capital leases and post-employment benefit obligations, which are allocated varying weightings depending on the certainty and timing of future disbursements.

Typical Balance-Sheet Ratios

- Current ratio.
- Debt per enplaned passenger.
- Debt service coverage ratio.
- Per cent of long-term debt maturing during the year.
- Uncommitted financial resources and reserves-to-O&M expenses.

Appendix

INDUSTRY BUSINESS RISK RATINGS

- DBRS uses the concept of business risk ratings (BRRs) as a tool in assessing the business strength of both industries and individual companies within many methodologies across the corporate finance area. (DBRS does not typically use this approach for most financial, government and public finance sectors, where the industry is more challenging to define and this approach is not as useful.)
- The BRR is assessed independently of financial risk, although in some cases there are subtle but important links. As an example, the very low business risk profile of many regulated utilities has historically allowed this sector to operate with debt levels that would not be acceptable for most other industry sectors. Given this reality, it is difficult to consider the utility industry's BRR without acknowledging to some degree that the industry operates with sizable debt levels. This type of relationship exists with many industries, although typically to a much lesser degree.
- When a BRR is applied to an industry, there is an acknowledgment that this is a general assessment and there may in fact be a wide disbursement in the business strength of individual entities within the industry. Nonetheless, this assessment is beneficial to enabling DBRS to clearly delineate our industry opinion and is a useful tool when comparing different industries. An industry BRR is defined as being representative of those entities that the market would consider as "established," meaning that the group of companies being considered would have at least reasonable critical mass and track records. As such, the BRR for an industry does not consider very small players, start-up operations or entities that have unusual strengths or weaknesses relative to the base industry.
- DBRS methodologies note whether they apply to global industries or more specific countries or regions. When analyzing individual credits, DBRS considers the degree to which regional considerations may differ from the geographic area applicable within the industry methodology. Many entities have business units that transcend industries and in these cases, more than one BRR would be considered, including the possible benefits or challenges that may exist when all businesses are analyzed as part of a combined group.
- The BRR is a tool that provides additional clarity regarding the business risk of the industry overall, but it should be viewed as just one aspect in the complex analysis of setting ratings and should by no means be seen as either a floor or ceiling for issuers within a given industry. Although DBRS does not anticipate volatility in an industry's BRR, changes are possible over time if there are meaningful structural developments in the industry. When such a change does occur, DBRS will make this clear and note any impact on related individual ratings within the industry as applicable.
- DBRS assesses five areas to establish the overall BRR for an industry. Although there is an overlap in some instances (to some degree, in the long term, all five factors tend to relate to profitability and stability), DBRS has found that considering these five measures in a separate fashion is a useful way of approaching its analysis. In all cases, DBRS uses historic performance and our experience to determine an opinion on the future, which is the primary focus.

Industry Profitability and Cash Flow

- When ratios such as return on equity, return on capital and a variety of cash flow metrics are considered, some industries are simply more profitable than others. While standard economics would suggest a reversion to the mean through new competitors, this often occurs at a very slow pace over a long time horizon and in some cases may not occur at all because of barriers to entry.
- The benefits from above-average profits and/or cash flow are substantial and include internal capital growth, easier access to external capital and an additional buffer to unexpected adversity from both liquidity and capital perspectives.
- Some industries and their participants have challenges or strengths in areas such as research and development (R&D), brand recognition, marketing, distribution, cost levels and a potentially wide variety of other tangibles and intangibles that affect their ability in the area of profitability.

Industry Competitive Landscape

- The competitive landscape provides information regarding future profitability for the industry and thus somewhat crosses over into the profitability and cash flow assessment, but competition is deemed worthy of separate consideration because of its critical nature.
- Participants in industries that lack discipline, produce commodity-like products or services, have low barriers to entry and exhibit ongoing pricing war strategies generally have difficulty attaining high profitability levels in the longer term. Certain industries benefit from a monopoly or oligopoly situation, which may relate to regulation.

Industry Stability

- This factor relates primarily to the degree of stability in cash flow and earnings, measuring the degree to which the industry and its participants are affected by economic or industry cycles. Stability is considered critical as industries with high peaks and troughs have to deal with higher risk at the bottom of a cycle. As such, to some degree, industries with lower but stable profitability are considered more highly than industries with higher average profitability that is more cyclical.
- Some of the key factors in considering stability include the nature of the cost structure (fixed or variable), diversification that provides counter-cyclical and the degree to which the industry interrelates with the overall economy. Depending on the industry, economic factors could include inflation or deflation, supply and demand, interest rates, currency swings and future demographics.

Industry Regulation

- Where applicable, regulation can provide support through stability and a barrier to entry, but it can also cause challenges and change the risk profile of an industry and its participants in a negative way, including the reality of additional costs and complications in enacting new strategies or other changes.
- As part of its analysis of regulation, DBRS also considers the likelihood of deregulation for a regulated industry, noting the many examples where this transition has proven to be a major challenge in the past.

Other Inherent Industry Considerations

- Each industry has its own set of unique potential risks that, even if managed well, cannot be totally eliminated. Specific risks, the ability to manage them and the range of potential outcomes vary industry by industry. Two of the most common risks are changing technology and operational risks.
- Some of the other more common risks are in the areas of legal, product tampering, weather, natural disasters, labour relations, currency, energy prices, emerging markets and pensions.



INDUSTRY BUSINESS RISK RATING DEFINITIONS

DBRS specifies the BRR for an industry in terms of our **Long-Term Obligations** rating scale. When discussing industry BRRs for an industry, DBRS typically provides either one specific rating or a limited range (such as BBB (high)/BBB). Using a range recognizes the fact that, by their nature, industry BRRs are less precise than a specific corporate or security rating as they represent an overall industry. In addition to relating to the industry level, these definitions also apply to the business risk of individual companies, which will fall more often in the very high and low categories (AA/AAA and B) than would be the case for an entire industry.

Industry Business Risk Ratings (BRRs)

Rating	Business Strength	Comment
AA/AAA	Exceptional	An industry BRR of AA/AAA is considered unusually strong, with no meaningful weakness in any individual area. It may include pure monopolies that are deemed essential (the primary case being regulated utilities, where the risk of deregulation is believed to be very low). Common attributes include product differentiation, high barriers to entry and meaningful cost advantages over other industries or entities. These and other strengths provide exceptional stability and high profitability. It would be quite rare for an industry to have a BRR in this category.
A	Superior	Industry BRRs at the "A" level are considered well above average in terms of stability and profitability and typically have some barriers to entry related to capital, technology or scale. Industries that have, by their nature, inherent challenges in terms of cyclicity, a high degree of competition and technology risks would be unlikely to attain this rating category.
BBB	Adequate	Industry BRRs at the BBB level include many cyclical industries where other positive considerations are somewhat offset by challenges related to areas such as commodity products, labour issues, low barriers to entry, high fixed costs and exposure to energy costs. This rating category is considered average and many industries fall within it, with key considerations such as overall profitability and stability typically considered as neither above or below average.
BB	Weak	An industry at the BB level has some meaningful challenges. In addition to high cyclicity, challenges could include the existence of high technology or other risks. Long-standing industries that may have lost their key strengths through factors such as new competition, obsolescence or the inability to meet changing purchaser demands may fit here. The culmination of such factors results in an industry that does not generally score well in terms of stability and profitability. For an entire industry, this is typically the lowest BRR level.
B	Poor	While not common, there are cases where an industry can have a BRR of B. Such industries would typically be characterized by below-average strength in all or virtually all major areas.



INTERRELATIONSHIP BETWEEN FINANCIAL AND BUSINESS RISK

Having in mind the prior discussion on the typical importance that DBRS places on certain financial metrics and business strengths for the Canadian airport authority industry, we provide some guiding principles pertaining to the application of DBRS methodologies, the first one being that, in most cases, an entity's business risk will carry more weight in the final rating than its financial risk.

Based on this underlying concept, we provide the additional guidance for individual companies with varying business risks:

- **For an Entity with a Business Risk of AA (Exceptional):** An issuer with a business risk of AA will almost always be able to obtain an investment-grade issuer rating. When financial metrics are in the BBB range, an entity with a business risk of AA would typically be able to attain an "A"-range issuer rating.
- **For an Entity with a Business Risk of "A" (Superior):** Unless financial strength fails to exceed the B range, superior business strength will typically allow the final issuer rating to be investment grade. Very conservative financial risk may in some cases allow the final issuer rating to be within the AA range, but this should not be considered the norm.
- **For an Entity with a Business Risk of BBB (Adequate):** At this average level of business risk, the level of financial risk typically has the ability to result in a final issuer rating from as high as "A" to as low as B.
- **For an Entity with a Business Risk of BB (Weak):** At this weak level of business risk, conservative financial risk can, in some cases, take the final issuer rating into the BBB investment-grade range.
- **For an Entity with a Business Risk of B (Poor):** It is not typically possible for an issuer with a business risk of B to achieve a final investment-grade issuer rating.

DEFINITION OF ISSUER RATING

- DBRS Corporate rating analysis begins with an evaluation of the fundamental creditworthiness of the issuer, which is reflected in an "issuer rating". Issuer ratings address the overall credit strength of the issuer. Unlike ratings on individual securities or classes of securities, issuer ratings are based on the entity itself and do not include consideration for security or ranking. Ratings that apply to actual securities (secured or unsecured) may be higher, lower or equal to the issuer rating for a given entity.
- Given the lack of impact from security or ranking considerations, issuer ratings generally provide an opinion of default risk for all industry sectors. As such, issuer ratings in the banking sector relate to the final credit opinion on a bank that incorporates both the intrinsic rating and support considerations, if any.
- DBRS typically assigns issuer ratings on a long-term basis using its **Long Term Obligations** Rating Scale; however, on occasion, DBRS may assign a "short-term issuer rating" using its **Commercial Paper and Short Term Debt** Rating Scale to reflect the issuer's overall creditworthiness over a short-term time horizon.

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