



Methodology
*Rating the Communications
Industry*

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Insight beyond the rating.

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Rating the Communications Industry

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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 company 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 company's general business risk profile, the company'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 a company 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 company-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 company 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.

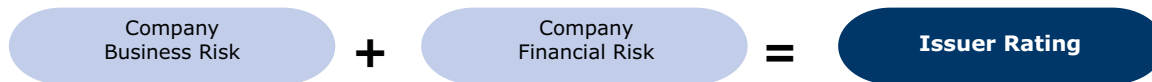


Stage 2: Issuer Rating

Consider the strength of the individual issuer:

- First assessing how the company’s BRR compares with the industry BRR.
- Then assessing the company’s financial risk.

Taken together, these factors will determine the company’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 the Communications Industry

DEFINITION OF THE INDUSTRY

- The communications industry is defined to include: (a) telecom operators that offer fixed line and wireless services to residential and enterprise customers, including local and long-distance voice services, high-speed Internet services and, increasingly, video services; (b) cable operators that offer video services (including direct-to-home satellite operators), high-speed Internet and, increasingly, voice services; and (c) wireless operators that are integrated as part of a telecom/cable operator or that operate on a stand-alone basis, which offer wireless voice and data services to residential and enterprise customers.

THE BUSINESS RISK RATING

- For the communications industry as a whole, DBRS views the BRR as being in the range of A (low) to BBB. While the lines between the previously distinct telecom, wireless and cable sectors have become blurred as these sectors that make up the communications industry have horizontally integrated (e.g., cable operators offering telecom services and vice versa), DBRS considers the business mix of a specific operator, noting that their business is likely a blend of these three main sectors – which may in turn have different degrees of these BRR critical factors.
- As such, DBRS views these sectors separately, at least for a frame of reference, with the telecom and cable sectors continuing to converge, albeit from different starting points, and wireless assessed at a slightly lower level than telecom given that it typically operates in a more competitive environment.
- Specifically, the telecom sector, which generally includes the fixed-line voice and data services of an incumbent, has a BRR that is A (low).
- Cable, which includes incumbent cable operators that distribute video content and provide voice and data services and direct-to-home satellite providers that typically focus on providing video services, is considered BBB (high)/BBB.
- The BRR for the wireless sector is BBB (high)/BBB. New entrants in these sectors typically have weaker business risk profiles and would likely garner a lower rating than these sector BRR ratings.
- Based on the five major categories used by DBRS in assessing industry BRRs, the rationale for this assessment is as follows.

INDUSTRY PROFITABILITY AND CASH FLOW

- Communications operators that are well established and operate in average competitive landscapes generate above-average levels of profitability while new entrants can take time to generate both cash flow and profitability, generally due to the capital and operating investment required to establish a communications business.
- The mix of business that an integrated communications operator has can also determine the level of profitability, with some services being more profitable than others. The combined factors of competitive landscape, technology and regulation are also important in determining the level of profitability and cash flow.

INDUSTRY COMPETITIVE LANDSCAPE

- The competitive landscape for fixed-line services is average, with typically two or three facilities-based operators competing for telephony, high-speed Internet and video services. Non-facilities-based operators who access networks on a wholesale basis can be large retail competitors in markets where regulators support non-facilities-based competition.
- The competitive landscape for wireless services is typically more competitive than that of fixed-line services as, depending on the individual market, there are typically three or more wireless service providers.

INDUSTRY STABILITY

- Fixed-line communications operators tend to be above-average in terms of stability as they are not generally subject to economic cycles given the non-discretionary nature of their services. Likewise, most markets of fixed-line telephony, video and high-speed Internet services are fairly mature. However, while small-to-medium and large enterprise voice and data services are typically provided under medium-term contracts, these services can be more economically sensitive as volumes tend to fluctuate with economic activity.
- Although wireless services are typically non-discretionary as well, there is a small portion of their results that are or could be correlated to the general economy in terms of subscriber loading, usage and roaming traffic.

INDUSTRY REGULATION

- Communications operators are subject to an average degree of regulation as most countries and regions have pursued some liberalization in their previously tightly-regulated regimes either to facilitate greater competition or as a result of competition.
- Regulations typically focus on the competitive nature of a market and have for the most part moved away from rate-based regulation (although some price regulation still exists in some markets). Competition has largely done away with the rate- and return-based regulation that existed in previous decades when telecom operators were more akin to utility companies.
- Regulation can come from a number of levels and different services are typically covered by different – and often more than one – statutes, laws and acts. Regulation and changes to existing regulatory guidelines can have an impact on both the operating and competitive environment of a communications operator.

OTHER INHERENT INDUSTRY CONSIDERATIONS

- Technological progress can represent something of a double-edged sword for the communications industry as the benefits of having the latest technology could be outweighed by the potential substitution threats that this very technology creates.
- The Internet is a perfect example of a technology deployed by communications operators that has created a new service while possibly facilitating substitution threats for other existing services (e.g., voice and video distribution).
- For communications operators, another consideration to bear in mind is their access to the sought-after content that they distribute to subscribers.
- Video and Internet services provide the best examples as, in terms of video distribution services, having or not having this content can have an indirect impact on the operator's subscriber base. This will remain a noteworthy factor in an environment where communications operators continue to acquire media companies as they pursue benefits from vertical integration.

Stage 2: Issuer Rating

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

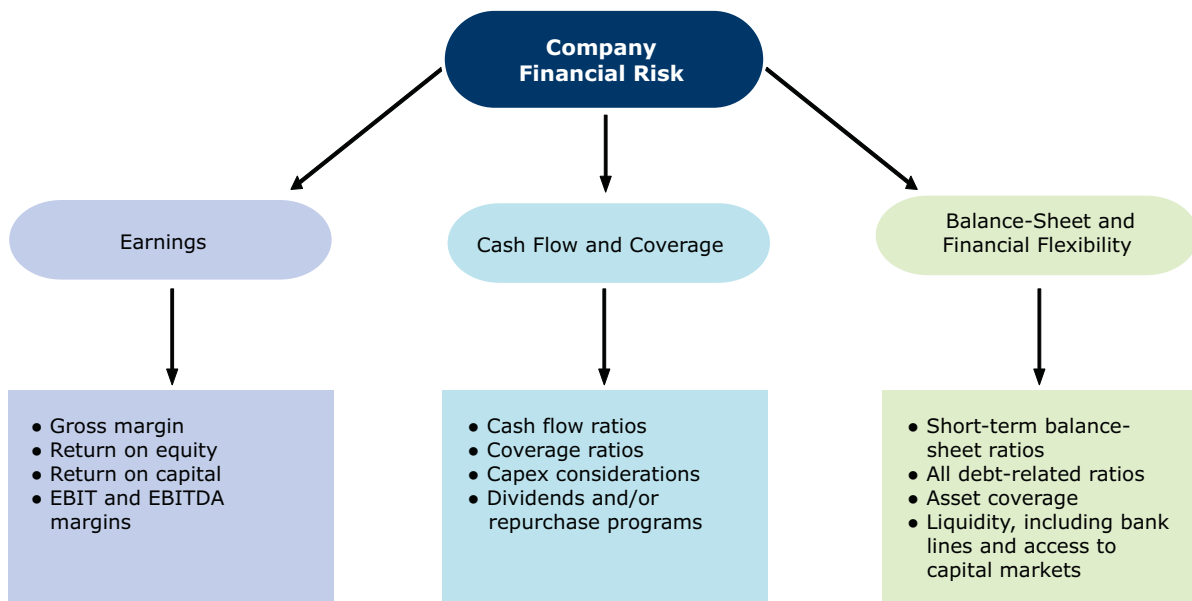
BUSINESS RISK PROFILE

- 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 Company-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





Company-Specific Business Risk Factors

- We now consider if an individual company in the communications 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 company 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 company within the BBB column.

Company-Specific Business Risks – Critical Factors

Rating Business Strength	AA Exceptional	A Superior	BBB Adequate	BB Weak	B Poor
Competitive Landscape	<ul style="list-style-type: none"> • Single incumbent fixed-line services operator with minimal or no competition and leading market position. • This situation is currently very rare. • Three national or large regional wireless operators or fewer, with fixed-line incumbent being a market leader. 	<ul style="list-style-type: none"> • Generally two or three fixed-line service operators competing for each individual service on a regional or national basis. • Three or four national or large regional wireless operators with some smaller regional players. • Modest competitive environment. • Market leaders would garner strongest consideration. 	<ul style="list-style-type: none"> • Three- to six-operator market for both fixed-line and wireless services. • Rational to modest competitive environment. • Market leaders would garner better consideration, while operators with smaller market positions less consideration. 	<ul style="list-style-type: none"> • Market with more than six operators for both fixed-line and wireless services. • Highly competitive market environment. • Market leaders would garner some consideration, while operators with smaller market positions modest consideration. 	<ul style="list-style-type: none"> • Extremely competitive and highly fragmented market environment. • Competitive equilibrium is in embryonic stage.
Technology	<ul style="list-style-type: none"> • Operator benefits from latest technologies, which provides a competitive advantage. • Barriers to entry remain high; low substitution threats to existing services. 	<ul style="list-style-type: none"> • Operator benefits from relatively new technologies, which provide a modest competitive advantage. • Barriers to entry and substitution threats are modest and manageable. 	<ul style="list-style-type: none"> • Operator benefits from somewhat new technologies • Barriers to entry and substitution threats are moderate and manageable. 	<ul style="list-style-type: none"> • Operator has not embraced latest technologies which puts it at a modest competitive disadvantage. • Barriers to entry are modest and substitution threats from other technologies are meaningful. 	<ul style="list-style-type: none"> • Operator has not embraced latest technologies, which puts it at a competitive disadvantage. • Barriers to entry are low and substitution threats from other technologies are high.



Company-Specific Business Risks – Critical Factors

Rating	AA	A	BBB	BB	B
Business Strength	Exceptional	Superior	Adequate	Weak	Poor
Regulation	<ul style="list-style-type: none"> Regulatory environment supportive of incumbent's market position, which creates a high barrier to entry and limited competition. 	<ul style="list-style-type: none"> Regulatory environment is relatively supportive of incumbents while moderately pursuing competition-enhancing framework and policies. 	<ul style="list-style-type: none"> Regulatory environment has a balance between regulation and competition-enhancing framework and policies. 	<ul style="list-style-type: none"> Regulatory environment supports enhancement to competitive environment, which reduces barriers to entry and fosters greater competition. 	<ul style="list-style-type: none"> Regulatory environment pursues competition at all costs in its framework and policies.
Networks	<ul style="list-style-type: none"> Highly advanced networks capable of providing full suite of fixed-line communications services and/ or wireless communications services. Networks provide a clear competitive advantage for all services. 	<ul style="list-style-type: none"> Advanced networks capable of providing multiple fixed-line communications services and/ or wireless communications services. Networks provide a competitive advantage for some services. 	<ul style="list-style-type: none"> Adequate networks capable of providing multiple fixed-line communications services and/ or wireless communications services. Networks provide a moderate competitive advantage for one or two services. 	<ul style="list-style-type: none"> Acceptable networks capable of providing one or two fixed-line communications services and/ or wireless communications services. Networks provide a modest competitive advantage for one or two services. 	<ul style="list-style-type: none"> Sufficient networks capable of providing one or two fixed-line communications services and/ or wireless communications services. Networks provide little or no competitive advantage for any services.
Product Diversification/ Ability to Bundle Services	<ul style="list-style-type: none"> Operator has ample ability to bundle all fixed-line and wireless services in all of its coverage territories. 	<ul style="list-style-type: none"> Operator has sufficient ability to bundle multiple fixed-line and wireless services in a majority of its coverage territories. 	<ul style="list-style-type: none"> Operator has adequate ability to bundle multiple services in a reasonable portion of its coverage territories. 	<ul style="list-style-type: none"> Operator has modest ability to bundle multiple services in a reasonable portion of its coverage territories. 	<ul style="list-style-type: none"> Operator has limited ability to bundle fixed-line and wireless services in any of its service territories.

PRIMARY FACTORS

Competitive Landscape

- The competitive environment in which a communications provider operates is assessed to determine the level of competitive intensity in the market. Generally, this is market-specific and can be highly correlated to the other critical factors listed below: technology, regulation, networks and ability to bundle services. Fixed-line services like telephony, high-speed Internet and video can have a different group of competitors than wireless services.
- Typically, the existence of fewer competitors indicates lower business risk and a strong competitive position for a market and specific operator, while an extremely competitive and highly fragmented market can warrant higher business risk.
- Other broad market characteristics like homes passed or population covered (POPs) metrics and 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.

Technology

- Communications providers can benefit from having the latest technology in terms of both creating and entrenching a competitive advantage and barriers to entry. However, technological advances can also make a provider's services susceptible to substitution threats.
- DBRS assesses communications providers' adoption and implementation of new fixed-line and wireless technologies, along with the competitive threat posed by these new technologies.
- While technological progress has generally benefited communications providers in terms of allowing for the development of new services such as high-speed Internet (for telecom and cable providers), telephony (for cable providers), terrestrial video (for telecom providers), and wireless data (for wireless providers), along with more efficient networks, some technologies have decreased the previous "last-mile" advantage that communications providers have enjoyed in servicing households and businesses.
- Furthermore, the type of technology platforms utilized, along with the chosen upgrade path, are important determinants in the competitive advantage held by a company, as well as in determining the capital and operating costs incurred in building and operating a communications network.
- The chosen technology can also have an impact on the availability of equipment and the types of services offered, thereby determining the level of competitive advantage in a market.

Regulation

- Although regulation affects every industry, in communications regulation can vary from country to country and from province to province and state to state (and even by local municipality in the case of the United States). Additionally, communications providers can be affected by regulation in several other industries, including media and information services.
- While communications regulation has generally been on a liberalizing trend in most markets for most services, regulators continue to set the framework, enforce rules, arbitrate and conduct discrete events such as the sale of wireless spectrum.
- Therefore, analysis is undertaken regarding the degree of regulation to which each communications provider is subject for its distinct or various business lines, as well as the stance of the regulator toward communications providers.
- Generally, regulatory stances include support of the incumbent and its investments, which creates a high barrier to entry and limited competition, or, at the other end of the spectrum, competition at all cost in favour of a highly competitive market and rapid innovation.

Networks

- The network capacity, functionality and scope of a communications provider's fixed-line and wireless networks are important considerations as they are the basis of an operator's ability to provide advanced communications services. As such, a communications provider's network, where highly advanced, can provide a competitive advantage, whereas an antiquated network would bring a competitive disadvantage.
- The contiguousness of a provider's networks is also considered as well-clustered networks and coverage areas tend to benefit from greater operating efficiencies.
- Network capacity and functionality are key considerations since they allow communications operators to offer new services, as well as enhancements to existing services. In addition, a network that offers high capacity vis-à-vis its peers using the latest technology can indicate lower operating costs, as well as only moderate capital expenditures required in the future.

Product Diversification – Ability to Bundle Services

- A communications operator's ability and success in bundling a number of services to its subscribers is assessed, as this can drive average revenue per user (ARPU) growth, unlock operating leverage benefits and reduce subscriber turnover (churn).
- Communications operators that can offer a full array of communications services, such as (1) video, (2) high-speed Internet, (3) telephony, and (4) wireless, are generally stronger in terms of their competitive position.
- An operator's success in bundling these services can also illustrate the level of success a provider has in terms of defending its core business and subscriber base or growing market share for new services. Alternatively, if an operator is missing key services in all or a portion of its territory, this could lead to a competitive disadvantage that may be difficult to remedy.

ADDITIONAL FACTORS

Size and Scale

- Size and scale can play an important role in assessing a communications operator. Generally, larger providers have the ability to spread costs over a wider customer base and can benefit in terms of greater purchasing power, marketing clout, branding and distribution opportunities.
- Larger operators can have the ability to drive procurement of new networks and services. Furthermore, larger communications operators tend to have greater ability to absorb any unforeseen shocks that may occur in the operating environment.
- Size and scale also allows operators to appeal to larger, national or international customers.
- For communications operators that distribute video services, size and scale can entail greater ability to negotiate with content providers for programming rights, which can lead to improved – or at least sustained – profit margins.
- Smaller operators tend not to have the same ability to negotiate programming or equipment agreements.

Subscriber Acquisition Costs or Customer Acquisition Costs

- The variable costs of adding subscribers for different services are examined as these can affect EBITDA, EBITDA margins and capex levels. Generally, this cost consists of three components: a sales commission, an equipment subsidy and marketing expenses.
- These costs can be relevant for most communications services including video, wireless, high-speed Internet and telephony.

Subscriber Turnover (Churn)

- Churn is examined as a measure of customer satisfaction. Typically, this is measured as a percentage of a provider's total subscriber base and on a monthly or annual basis. Low churn rates (typically expressed in a monthly percentage) indicate subscriber satisfaction with the service or services received from a communications operator.
- Conversely, high churn rates can be indicative of poor quality of services or meaningful competitive pressure from other communications operators. High churn rates or increases in churn generally indicate some pressure in a company's business risk profile.

Capex Levels/Capital Intensity

- The state of a communications network can be a determining factor for current and future network-related capital expenditure, while new subscribers can drive success-based capital expenditure. An analysis of this mix of capital expenditure is critical to understanding the state of the network and the portion that is related to revenue-linked growth.
- Capital intensity, relative to revenue and depreciation, is examined to determine the appropriateness of a provider's capital program.

Penetration Rates

- Market penetration rates can indicate growth potential and market coverage. This can include penetration rates for all services including telephony, high-speed Internet, video and wireless and can typically be measured on the basis of homes passed for fixed-line services and POPs for wireless services.
- Taking this further, multiple service penetration rates can be measured either in terms of the most mature service provided (e.g., basic cable) or homes passed/POPs covered to determine the success achieved in bundling multiple services.

Operating Efficiencies

- Given the evolving revenue mix, technological changes and competition that communications operators face, the ability to manage costs can be highly correlated to the level of EBITDA margins and cash flow from operations. This can also form the basis of a competitive advantage over other competitors.
- This ability can cover all facets of operations, including network costs, subscriber acquisition costs, marketing costs, and general and administration costs.

Brand

- The ability to maintain and grow a well-recognized brand and the associated accumulation of goodwill in an increasingly competitive market constitutes an important consideration when assessing a communications operator. An operator's brand, as well as the awareness, reputation and value of that brand, is taken into account to evaluate the resulting competitive advantage (or disadvantage) that the operator exhibits in the market relative to its competitors.
- An operator's brand can affect all levels of the supply chain, including the perception of the end-subscriber. As such, this is considered to be an asset that is not typically measured on the balance sheet.

Pension and Other Employee Benefits

- Pension and other employee benefit obligations are important factors as these can require both contributions and, in the case of defined benefits plans, solvency deficiency payments. Other post-retirement benefits, such as medical plans, are considered.
- Collectively, these factors can reduce an operator's free cash flow and liquidity should significant funding requirements arise.

Geographic Mix

- The degree to which a communications operator has geographically diversified 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 in turn increase operating risks.

Government Ownership

- The degree of government ownership and support is assessed as this may have direct or indirect implications on a communications operator's credit rating.
- While ownership and control have largely been liberalized in recent years, government ownership, control and support levels may still exist for some communications operators.

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 company 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 company 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 a company's ability to meet its financial obligations; 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.
- 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 a company, particularly when there are significant changes, challenges or major decisions facing the company. 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 company 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.

Company-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 communications industry. For example, a company 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 company 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.

Communications Industry Financial Metrics

Key Ratio	AA	A	BBB	BB	B
	Exceptional	Superior	Adequate	Weak	Poor
Percent debt in the capital structure	< 35%	35% to 45%	45% to 55%	55% to 65%	> 65%
Debt-to-EBITDA	< 1.5x	1.5x to 2.5x	2.5x to 4.0x	4.0x to 5.0x	> 5.0x
EBITDA interest coverage	> 12.0x	12.0x to 8.0x	8.0x to 6.0x	6.0x to 3.0x	< 3.0x
EBIT interest coverage	> 6.0x	6.0x to 4.0x	4.0x to 3.0x	3.0x to 1.5x	< 1.5x
Cash flow-to-debt	> 0.6x	0.60x to 0.35x	0.35x to 0.20x	0.20x to 0.10x	< 0.10x
Return on equity	> 14%	14% to 9%	9% to 7%	7% to 5%	< 5%

- 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 company. 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 a company'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 a company'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 company financial statements that are based on Canadian Generally Accepted Accounting Principles (GAAP) and U.S. GAAP, for the most part. When company 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 a company, 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 a Company'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 communications 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.

EARNINGS

- DBRS earnings analysis focuses on core earnings or earnings before non-recurring items 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., the 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 analysis. Notwithstanding the focus on core earnings, note that actual net earnings is also a consideration in our analysis given the direct impact that this has on the capital structure.

Typical Earnings Ratios

- EBITDA interest coverage.
- EBIT interest coverage.
- EBITDA margins.
- Fixed charges coverage.
- Return on capital.



CASH FLOW AND COVERAGE

- DBRS cash flow analysis focuses on the core ability of the company to generate cash flow to service current debt obligations and other cash requirements as well as on 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 relevant. As with earnings, the impact that non-core factors have on cash flow may also be an important reality.
- 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, future capital expenditures and dividend and/or stock repurchase programs, as applicable.

Typical Cash Flow Ratios

- Cash flow-to-debt.
- Capex-to-revenue.
- Capex-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 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 considerations such as 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, including capital expenditures and plans for maintenance or expansion, and the expected source of funding for these requirements, including bank lines and related covenants. Where the numbers are considered significant and the adjustments would meaningfully affect 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

- Percentage of debt in the capital structure.
- Gross debt-to-EBITDA.
- Net debt-to-EBITDA.

Stage 3: Rating the Security

With respect to Stage 3, the following comments describe how the issuer rating is used to determine ratings on individual securities:

- DBRS uses a hierarchy in rating long-term debt that affects issuers that have classes of debt that do not rank equally. In most cases, lower-ranking classes would receive a lower DBRS rating. For more detail on this subject, please refer to DBRS rating policy entitled "[Underlying Principles](#)."
- In some cases, issued debt is secured by collateral. This is more typical in the non-investment-grade spectrum. For more detail on this subject, please refer to [DBRS Rating Methodology for Leveraged Finance](#).
- The existence of holding companies can have a meaningful impact on individual security ratings. For more detail on this subject, please refer to the criteria [Rating Parent/Holding Companies and Their Subsidiaries](#).

Appendix 1

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 cyclical, 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 cyclical, 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 communications 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):** A company 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 a company 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.

SHORT-TERM AND LONG-TERM RATINGS

- For a discussion on the relationship between short- and long-term ratings and more detail on liquidity factors, please refer to the DBRS policy entitled "**Short-Term and Long-Term Rating Relationships**" and the criteria *DBRS Commercial Paper Liquidity Support Criteria for Corporate Non-Bank Issuers*.

Appendix 2: Glossary

Communications Industry Metrics and Technology Terms

INDUSTRY METRICS

ARPU	Average revenue per user – provides a measure of average monthly revenue on a per subscriber basis
Capex	Capital expenditures on an absolute and relative basis is a good measure between operators for comparability
Churn	An indicator of subscriber turnover measured as a percentage of an operator's average subscriber base over a specific period and stated on a monthly or annual basis
COA/CPGA	Cost of (subscriber) acquisition/cost per gross subscriber addition – provides an understanding of the average incremental cost to add a new subscriber
EBITDA margin	A measure of operational performance and business mix
Market share	A measure of the share of users, population or households that subscribe to a specific service. This can be viewed on both an absolute and incremental basis
MOU	Minutes of use – provides a measurement of average minutes of use per subscriber on a monthly basis.
Penetration rate	Typically measures subscribers as a percentage of population or homes passed
POPs	Population covered by a network

TECHNOLOGY TERMS

2G	Second-generation wireless standard
2.5G	Incremental step after 2G wireless standard and before 3G
3G	Third-generation wireless standard
3.5G	Incremental step after 3G wireless standard and before 4G
4G	Fourth-generation wireless standard
ADSL/ADSL2+	Asymmetric digital subscriber line
ATM	Asynchronous transfer mode
CDMA	Code division multiple access
CLEC	Competitive local exchange carrier
DOCSIS (1.0-3.0)	Data-over-cable service interface specification
DSL	Digital subscriber line
DTH	Direct-to-home satellite operator
DVR/PVR	Digital video recorder/personal video recorder
EV-DO	Evolution data only
FTTN	Fibre-to-the-node
GSM	Global system for mobile communications
HDTV	High-definition television
HSPA	High-speed packet access
ICT	Information communication technology
ILEC	Incumbent local exchange carrier
IP	Internet protocol
IPTV	Internet protocol television
LTE	Long-term evolution (a 4G wireless platform)
MVNO	Mobile virtual network operator
SMS	Short message service
UMTS	Universal mobile telecommunications system
VDSL/VDSL2+	Very high-speed digital subscriber line
VoIP	Voice over Internet protocol
VPN	Virtual private network

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