Methodology

Rating Companies in the Television Broadcasting Industry

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# Rating Companies in the Television Broadcasting Industry

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Introduction to DBRS Methodologies

- DBRS publishes rating methodologies to give issuers and investors insight into the rationale behind DBRS’s rating opinions.
- In general terms, DBRS ratings are opinions that reflect the creditworthiness of an issuer, a security or an obligation. DBRS ratings assess an issuer’s ability to make timely payments on outstanding obligations (whether principal, interest, preferred share dividends or distributions) with respect to the terms of an obligation. In some cases (e.g., non-investment grade corporate issuers), DBRS ratings may also address recovery prospects for a specific instrument given the assumption of an issuer default.
- DBRS rating methodologies include consideration of historical and expected business and financial risk factors as well as industry-specific issues, regional nuances and other subjective factors and intangible considerations. Our approach incorporates a combination of both quantitative and qualitative factors.
- The considerations outlined in DBRS methodologies are not exhaustive and the relative importance of any specific consideration can vary by issuer. In certain cases, a major strength can compensate for a weakness and, conversely, a single weakness can override major strengths of the issuer in other areas. DBRS may use, and appropriately weight, several methodologies when rating issuers that are involved in multiple business lines.
- DBRS operates with a stable rating philosophy; in other words, DBRS strives to factor the impact of a cyclical economic environment into its ratings wherever possible, which minimizes rating changes due to economic cycles. Rating revisions do occur, however, when more structural changes, either positive or negative, have occurred, or appear likely to occur in the near future.
- DBRS also publishes criteria which are an important part of the rating process. Criteria typically cover areas that apply to more than one industry. Both methodologies and criteria are publicly available on the DBRS website and many criteria are listed below under “Rating the Specific Instrument and Other Criteria.”
Overview of the DBRS Rating Process

• There are generally three components to the DBRS corporate rating process: (1) an industry risk rating (IRR); (2) an issuer rating; and (3) considerations for specific securities. The figure below outlines this process.

• An IRR is a relative ranking of most industries that have a DBRS methodology, typically using just three ranges of the DBRS long-term debt rating scale (i.e., “A,” BBB and BB), without making use of the “high” or “low” descriptors. The IRR is a general indication of credit risk in an industry and considers, among other things, an industry’s: (1) profitability and cash flow; (2) competitive landscape; (3) stability; (4) regulation; and (5) other factors. An “industry,” for the purposes of the IRR, is defined as those firms that are generally the larger, more established firms within the countries where the majority of DBRS’s rated issuers are based; this remains true for DBRS methodologies that are more global in nature. The industry risk rating helps DBRS set the BRR grid (see below) in that it positions, in an approximate way, an average firm in the industry onto the BRR grid. For firms in industries with low IRRs, the IRR can, in effect, act as a constraint or “cap” on the issuer’s rating.

• The issuer rating is DBRS’s assessment of the probability of default of a specific issuer. It is a function of: (1) the business risk rating (BRR), determined by assessing each of the primary and (where relevant) additional BRR factors in the BRR grid for a specific issuer; and (2) the financial risk rating (FRR), determined by assessing each of the primary and (where relevant) additional FRR metrics. The two components, BRR and FRR, are combined to determine the issuer rating; in most cases, the BRR will have greater weight than the FRR in determining the issuer rating. Throughout the BRR and FRR determination process, DBRS performs a consistency check of the issuer on these factors against the issuer’s peers in the same industry.

• The issuer rating is then used as a basis for specific instrument ratings. DBRS assigns, for example, a recovery rating and notches up or down from the issuer rating to determine a specific instrument rating for instruments of non-investment grade corporate issuers. (See “Rating the Specific Instrument and Other Criteria” below.)

DBRS Rating Analysis Process

* Depending on the instrument, “other criteria” may include the recovery methodology for non-investment grade issuers or the preferred share and hybrid criteria, for example. Please refer to the section below entitled “Rating the Specific Instrument and Other Criteria” for a list of these criteria, as well as other criteria that may be applicable at any stage of the rating process.
Television Broadcasting Industry

- The television broadcasting industry includes all free television broadcast companies (including network-owned companies, affiliates of networks and independently owned broadcasters), as well as subscription-based specialty television (i.e., cable television) companies. This methodology also includes firms that create content for television.
- Per the three-tier IRR system described on the previous page, the television broadcasting IRR is BB.
- The television broadcasting industry is characterized by: (1) relative stability in the subscription model and somewhat less stability in the free television model as revenues depend upon advertising expenditures, which are in turn sensitive to economic cycles; (2) competition from other television broadcasters, satellite-distributed specialty/cable stations, on-demand and over-the-top services associated with the Internet, as well as all other forms of mass media; (3) a reliance on either purchased or created content, which can be either expensive or risky, respectively; and (4) strong regulation that limits competition but increases costs, particularly if regulators set a minimum local content requirement (e.g., Canada).
- Revenues are generated from either wireline/satellite subscription fees or advertising. Spreading programming costs over a larger customer base maximizes operating leverage, so most companies have to serve more than one market and achieve number one or number two status in most markets to be cost competitive.
- Firms can own one or more main broadcast networks, one or more affiliates of a main broadcast network or independent broadcast networks. Larger networks have economies of scale, while independent broadcasters have a lower cost structure and greater flexibility than their broadcast and affiliate network counterparts.
- Content creation requires a somewhat risky investment in programming. Successful programming can be distributed through a number of platforms, including international channels, thereby spreading costs over a larger audience base.
- Regulation in the television broadcasting industry is intense, which can both help and hinder companies. Regulation does control the number of competitors and, by raising costs and bureaucracy, makes it more difficult and costly to enter the industry or a particular market. Regulators can also govern the content of television companies. For example, in Canada, regulators dictate Canadian content requirements. This can increase costs for the network and restrict programming.
Television Broadcasting Business Risk Rating

**PRIMARY BRR FACTORS**
- The BRR grid below shows the primary factors used by DBRS in determining the BRR. While these primary factors are shown in general order of importance, depending on a specific issuer’s business activities, this ranking can vary by issuer.

<table>
<thead>
<tr>
<th>Television Broadcasting — Primary BRR Factors</th>
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<tr>
<td><strong>Rating</strong></td>
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<td><strong>Size and Cost Patterns</strong></td>
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<td></td>
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<tr>
<td><strong>Programming</strong></td>
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<td></td>
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<tr>
<td><strong>Competition/Audience Fragmentation</strong></td>
</tr>
<tr>
<td></td>
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<tr>
<td><strong>Regulation</strong></td>
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<tr>
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</tbody>
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The following BRR risk factors are relevant to issuers in all industries (although the relevance of sovereign risk can vary considerably):

- **Sovereign Risk**
  The issuer rating may, in some cases, be constrained by the credit risk of the sovereign; in other words, the rating of the country in which the issuer operates generally sets a maximum rating for the issuer. If the issuer operates in multiple countries and a material amount of its business is conducted in a lower-rated country, DBRS may reflect this risk by downwardly adjusting its issuer rating.

- **Corporate Governance**
  Please refer to DBRS Criteria: Evaluating Corporate Governance for further information on how DBRS evaluates corporate governance and management.
ADDITIONAL BRR FACTORS

• The additional BRR factors discussed below may be very important for certain issuers, depending upon their activities, but they do not necessarily apply to all issuers in the industry.

Revenue Model

• Revenues can arise from either subscription-based services or advertising. The choice of revenue model can affect the magnitude and stability of margins and profitability.

Acquisition Focused

• As competition intensifies, many television broadcasters are focusing on growing through acquisitions in order to boost market reach, enhance programming and capitalize on cost synergies. Judging the cost-return benefit of these acquisitions is analyzed closely given the evolving competitive landscape.

Content Selection and Costs

• The ability to select appropriate content for its customer base at a fair price greatly impacts both a broadcaster’s revenue-generating capability and operating margins. The track record of content selection and the profitability of various programming in relation to competitors must be considered when judging management and a television broadcaster’s future prospects.

Content Creation

• In reviewing content creators and exhibitors that produce original programming, including sports programming, DBRS will review: (1) the issuer’s track record in creating highly sought-after content; (2) the ability to monetize this content through a number of distribution platforms, including international distribution; (3) the strength of the brand(s); and (4) potential interference from technologies and piracy.

Risks Associated with Vertical Integration

• Companies who create a significant portion of their content maintain a different risk profile than those who purchase the majority of their programming on set contractual terms. Given the degree of vertical integration, creating a series of products has the potential to heighten risks given their risk of failure and the associated sunk costs.

Geographic Mix

• The degree to which a broadcaster controls programming in various geographies is assessed. Subscribers within different regions and demographics are susceptible to different types of advertisements. Their programming preferences, spending levels and other demographic factors are also taken into account.
Television Broadcasting Financial Risk Rating

PRIMARY FRR METRICS

- The FRR grid below shows the primary FRR metrics used by DBRS to determine the FRR. While these primary FRR metrics are shown in general order of importance, depending upon an issuer’s activities, the ranking can vary by issuer.
- DBRS ratings are primarily based 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 not unusual for a company’s metrics to move in and out of the ranges noted in the grid below, particularly for cyclical industries. In the application of this matrix, DBRS looks beyond the point-in-time ratio.
- Financial metrics depend on accounting data whose governing principles vary by jurisdiction and, in some cases, industry. DBRS may adjust financial statements to permit comparisons with issuers using different accounting principles.
- Please refer to DBRS Criteria: Financial Ratios and Accounting Treatments – Non Financial Companies for definitions of, and common adjustments to, these ratios in the FRR grid below.
- Liquidity can be a material risk factor, especially for lower-rated non-investment grade issuers. DBRS will consider available sources of liquidity including cash on hand, cash flow, access to bank lines, etc., as well as uses of liquidity such as operations, capital expenditures, share buybacks and dividends for every issuer.
- DBRS considers an issuer’s financial policy including factors such its targeted financial leverage, its dividend policy and the likelihood of share buybacks or other management actions which may favour equity holders over bondholders.
- While market pricing information (such as market capitalization or credit spreads) may on occasion be of interest to DBRS, particularly where it suggests that an issuer may have difficulty in raising capital, this information does not usually play a material role in DBRS’s more fundamental approach to assessing credit risk.

Television Broadcasting — Primary FRR Metrics

<table>
<thead>
<tr>
<th>Primary Metric</th>
<th>A</th>
<th>BBB</th>
<th>BB</th>
<th>B</th>
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<tbody>
<tr>
<td>Debt-to-EBITDA</td>
<td>&lt; 2.0x</td>
<td>2.0x to 3.5x</td>
<td>3.5x to 5.0x</td>
<td>&gt; 5.0x</td>
</tr>
<tr>
<td>Cash flow-to-debt</td>
<td>&gt; 30%</td>
<td>20% to 30%</td>
<td>10% to 20%</td>
<td>&lt; 10%</td>
</tr>
<tr>
<td>EBITDA-to-interest</td>
<td>&gt; 7.0x</td>
<td>4.0x to 7.0x</td>
<td>2.0x to 4.0x</td>
<td>&lt; 2.0x</td>
</tr>
<tr>
<td>EBIT-to-interest</td>
<td>&gt; 5.0x</td>
<td>3.0x to 5.0x</td>
<td>1.5x to 3.0x</td>
<td>&lt; 1.5x</td>
</tr>
<tr>
<td>Debt-to-capital</td>
<td>&lt; 30%</td>
<td>30% to 45%</td>
<td>45% to 60%</td>
<td>&gt; 60%</td>
</tr>
</tbody>
</table>

ADDITIONAL FRR METRICS

- While the primary FRR metrics above will be the most important metrics that DBRS will use in determining the FRR of an issuer, other metrics may be used, depending upon an issuer’s activities, capital structure, pension liabilities and off-balance sheet obligations.
- Profitability, particularly in the medium term, can be an important differentiator of credit risk. DBRS may assess profitability through a variety of metrics, including return on capital.
- While free cash flow (i.e., net of changes in working capital, dividends and capital expenditures, etc.) can be volatile and, on occasion, negative, DBRS may use this and/or other cash flow metrics to assess a company’s ability to generate cash to repay debt.
Blending the BRR and FRR into an Issuer Rating

- The final issuer rating is a blend of the BRR and FRR. In most cases, the BRR will have greater weight than the FRR in determining the issuer rating.
- At the low end of the rating scale, however, particularly in the B range and below, the FRR and liquidity factors play a much larger role and the BRR would, therefore, typically receive a lower weighting than it would at higher rating levels.

Rating the Specific Instrument and Other Criteria

- For non-investment grade corporate issuers, DBRS assigns a recovery rating and reflects the seniority and the expected recovery of a specific instrument, under an assumed event of default scenario, by notching up or down from the issuer rating in accordance with the principles outlined in the criteria DBRS Recovery Ratings for Non-Investment Grade Corporate Issuers.
- Preferred share and hybrid considerations are discussed under Preferred Share and Hybrid Criteria for Corporate Issuers.
- The issuer rating (which is an indicator of the probability of default of an issuer’s debt) is the basis for rating specific instruments of an issuer, where applicable. 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 details on this subject, please refer to the general rating information contained in the DBRS rating policy Underlying Principles.
- For a discussion on the relationship between short- and long-term ratings and more details on liquidity factors, please refer to the DBRS policy Short-Term and Long-Term Rating Relationships and the criteria Commercial Paper Liquidity Support Criteria for Corporate Non-Bank Issuers.
- The existence of holding companies can have a meaningful impact on individual security ratings. For more details on this subject, please refer to the criteria Rating Holding Companies and Their Subsidiaries.
- Guarantees and other types of support are discussed in Guarantees and Other Forms of Explicit Support.
- For further information on how DBRS evaluates corporate governance, please refer to DBRS Criteria: Evaluating Corporate Governance.
- Please refer to DBRS Criteria: Financial Ratios and Accounting Treatments – Non Financial Companies for definitions of, and common adjustments to, these ratios.