

Section 1: DBRS Fundamentals of Corporate Credit Analysis

*Toronto CFA Society Credit Market Workshop:
Telecom/Cable Sector*



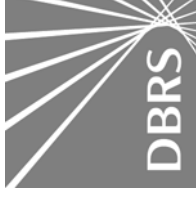
Presented by:

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Chief Credit Officer

AUGUST 26, 2010

Agenda

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



Agenda

- Introductions
- **DBRS Fundamentals of Corporate Credit Analysis**
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- DBRS Case Studies, Part 1: Telecom
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- Conclusion
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Why Is Credit Important?



- The credit market is actually larger (both in size and volume) than the equity market in Canada
- The building blocks we cover today are relevant for many areas of the credit market, including:
 - Buy side
 - Sell side
 - Lender
 - Issuer
 - Rating agency

Setting the Stage



- What is a rating?
 - “In general terms, ratings are opinions that reflect the creditworthiness of an issuer, a security or an obligation. They are opinions based on forward-looking measurements that assess an issuer’s ability and willingness to make timely payments on outstanding obligations . . . ”
- Brief overview today
 - Default risk versus loss recovery
 - How ratings reflect default risk and loss recovery
 - Two frameworks for corporate analysis

Elements of Credit Risk



- Two dimensions of credit risk:
 - Failure to perform *on time*
 - » Probability of default (PD)
 - » April 15, 2009: “The downgrade of Canwest Media’s Senior Subordinated Notes rating to D follows the company’s failure to make a US\$30.4 million interest payment on these notes on April 14, 2009.”
 - *Severity* of the failure to perform
 - » Loss given default or expected loss
 - » Quantifies the damage caused by the default
 - » Will not be the same for every creditor
 - » So following default, one lender may recover 90% of what is owed; another may lose everything

Elements of Credit Risk (Continued)

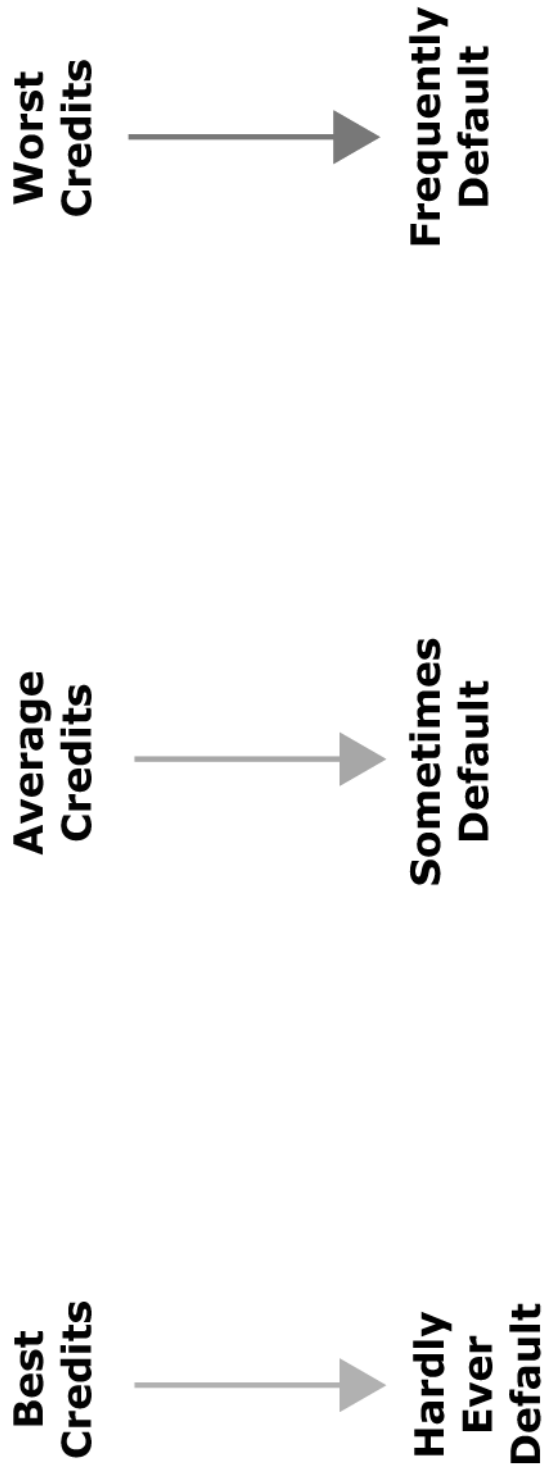


- At DBRS
 - Primary focus is on probability of default
 - But there is some accounting for expected loss in certain situations:
 - When rating different rankings of debt
 - » Royal Bank of Canada: Deposits rated AA
 - » Royal Bank of Canada: Subordinated Debt rated AA (low)
 - For non-investment-grade ratings
 - While DBRS has its own unique approach, no credit rating agency follows a pure form of either approach so differences are not as significant as one might expect

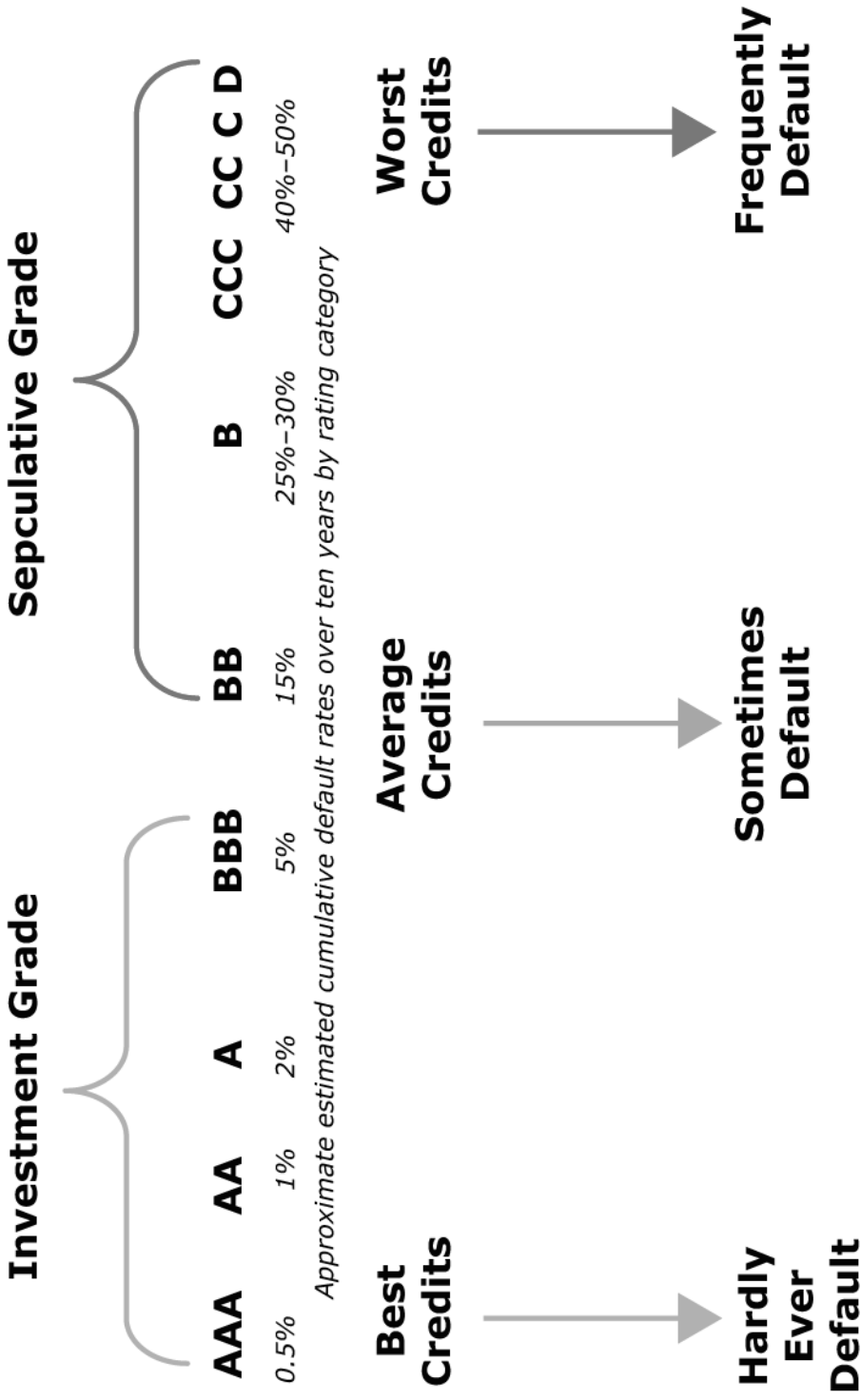
Credit Analysis – Simple Base



A fundamental goal of credit analysis is to assess an entity on this spectrum



Credit Analysis – Pulling It All Together



Example



Quebecor Media

BB (low)
RR1 (90%–100%)
BB (high)

Issuer Rating (PD)
Anticipated Recovery
Secured Debt Rating

20% (E)
10%
2%

Default Risk
Anticipated Loss
Final Loss

Better final loss if default

West Fraser Timber

BB (high)
RR3 (50%–70%)
BB (high)

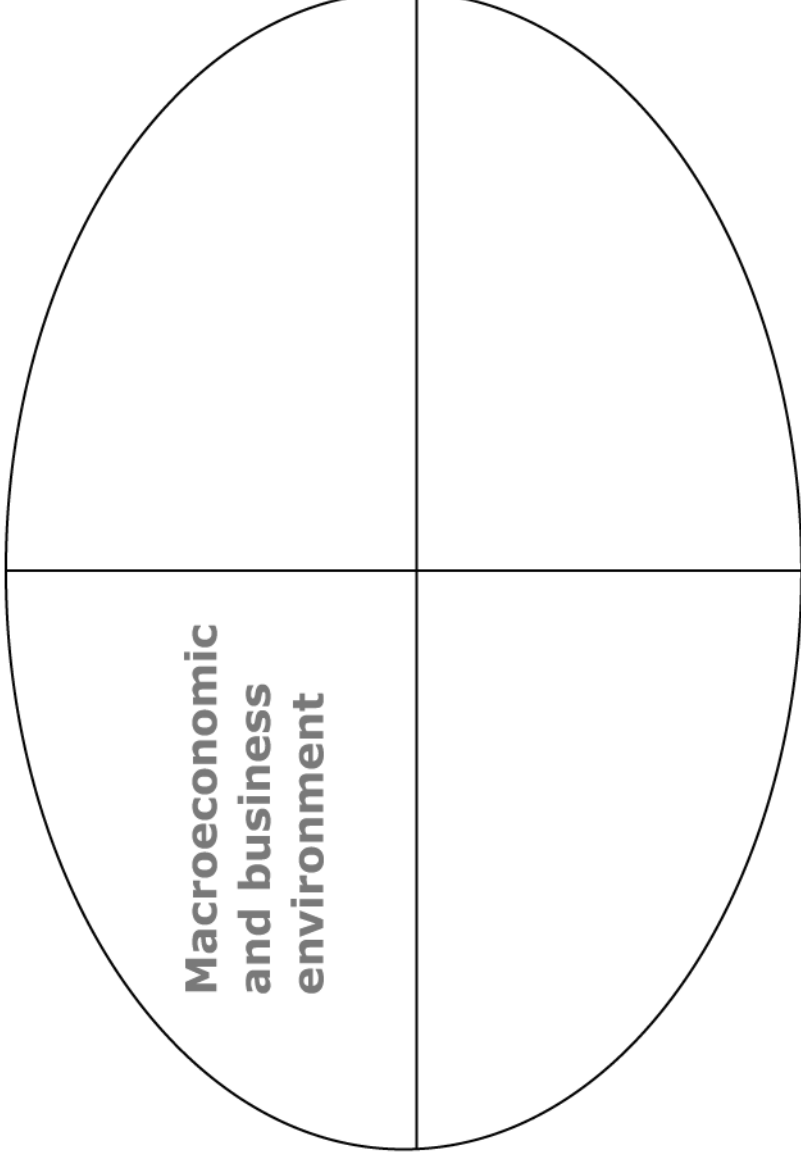
10% (E)
50%
5%

Better default risk

Framework #1: “Doing” Corporate Analysis



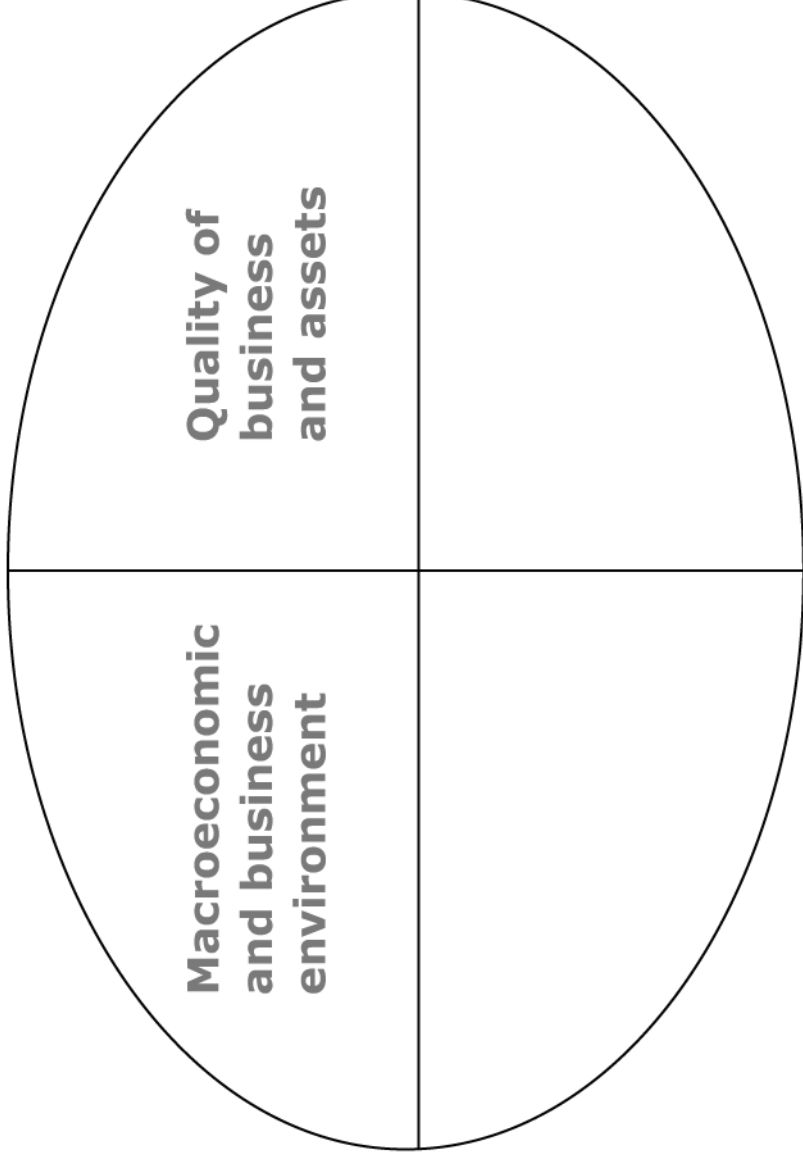
Four Key Analytical Elements



Framework #1: “Doing” Corporate Analysis



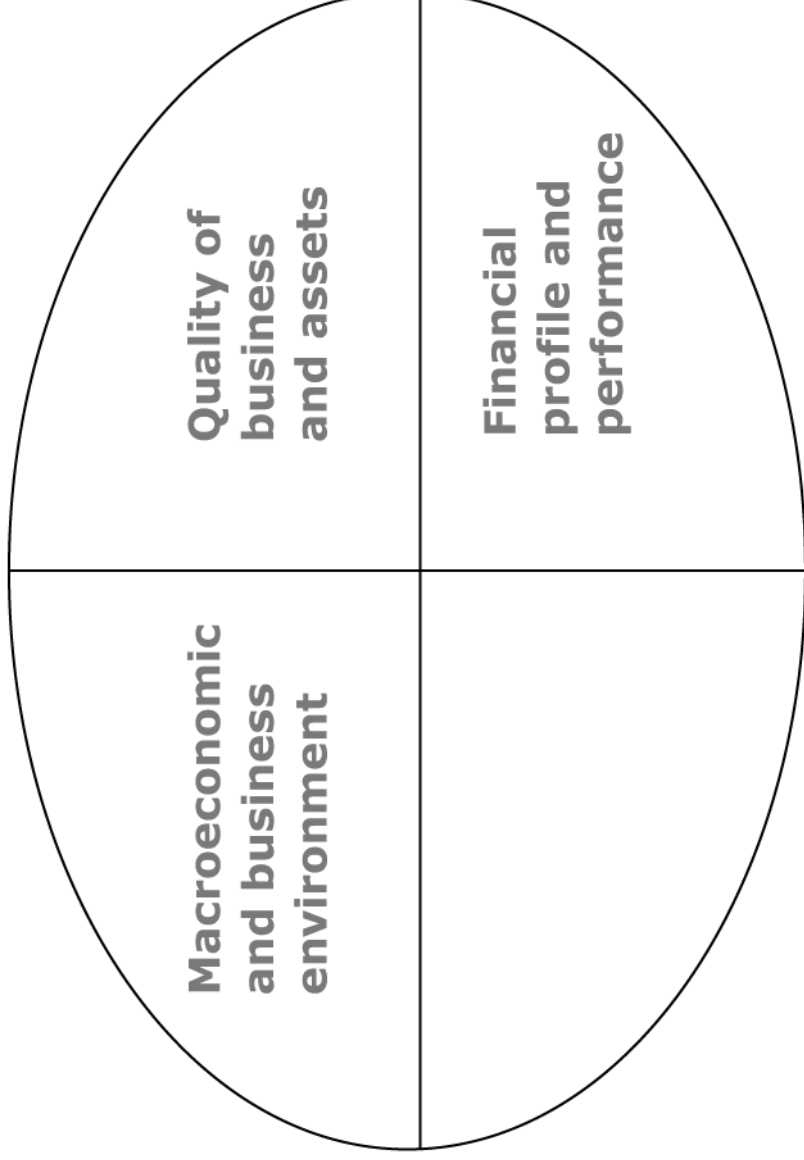
Four Key Analytical Elements



Framework #1: “Doing” Corporate Analysis



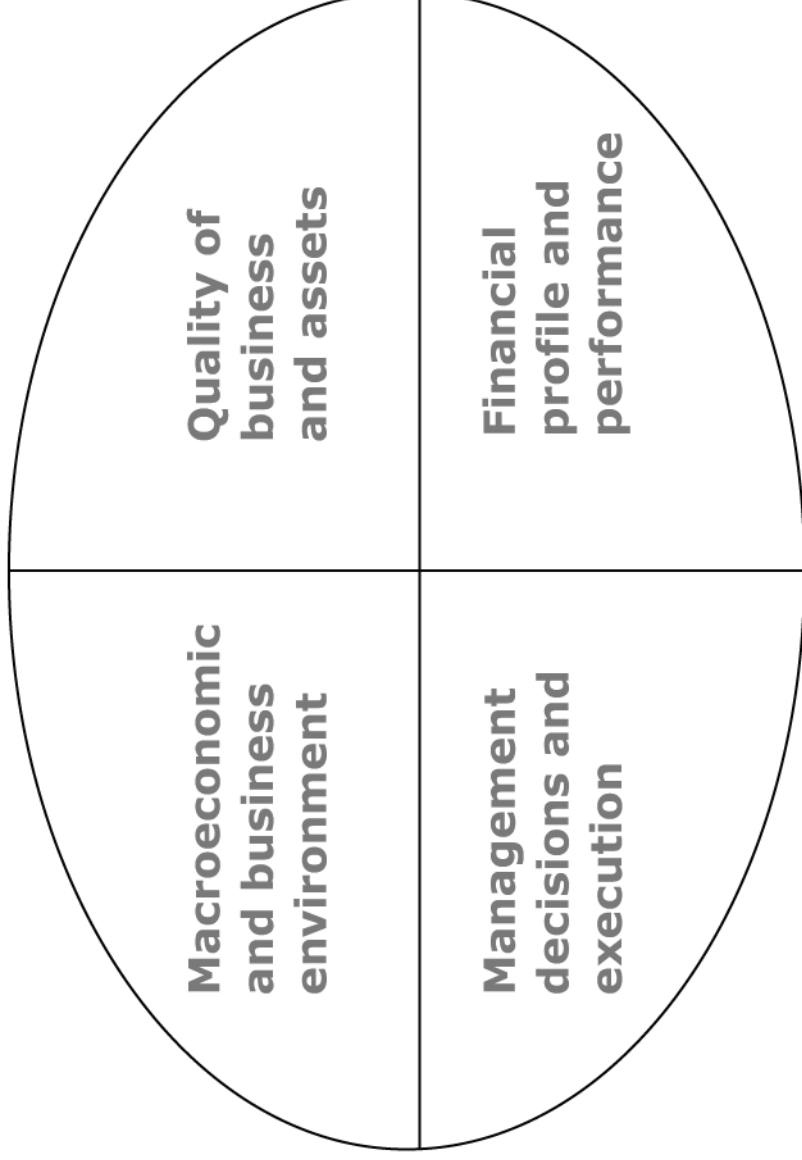
Four Key Analytical Elements



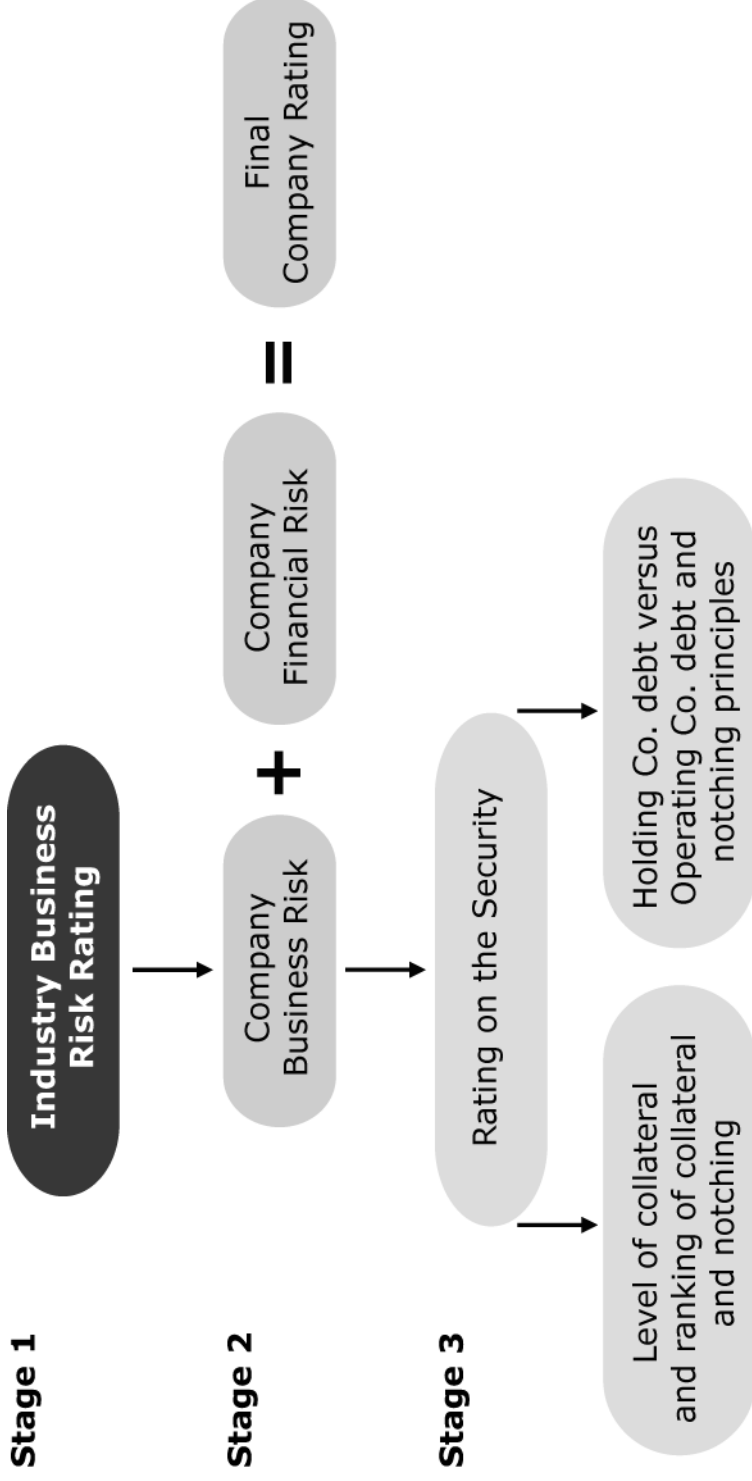
Framework #1: “Doing” Corporate Analysis



Four Key Analytical Elements



Framework #2: Business and Financial Risk



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

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

Business Risk

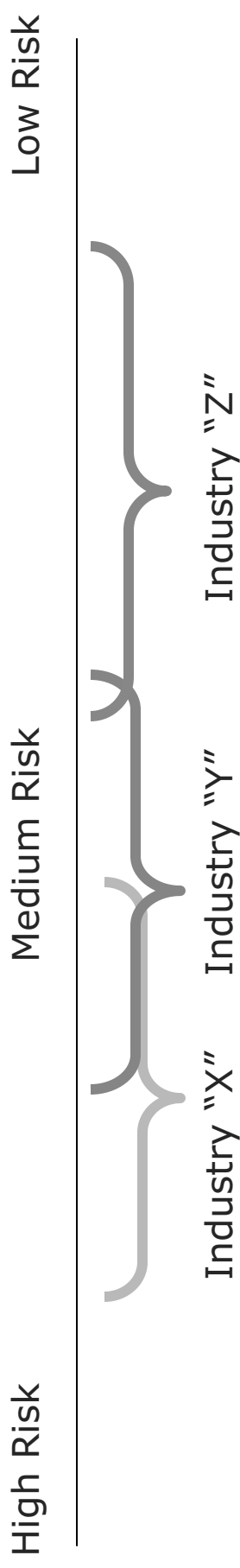


- Business risk is a combination of the industry and the individual choices made by companies.
- Key high-level considerations include the following:
 - Profitability
 - Competition
 - Stability
 - Regulation
 - Technology
 - Diversification
 - Other

Industry Risk



Every industry has its own uniquely inherent risks.



Industry Risk



Here is an “industry risk ranking” from a classic credit text. Do you agree with the authors’ industry risk assignments?

Industries Ranked by Inherent Risk

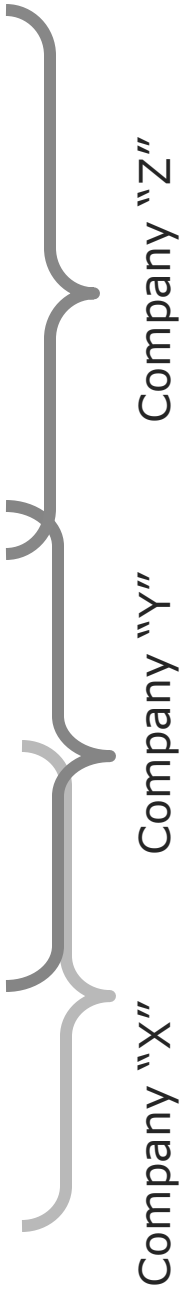
Highest Risk	Medium Risk	Lowest Risk
Automobiles and suppliers	Oil and natural gas	Branded consumer products
Metals, mining & steelmakers	Technology	Pharmaceuticals and medical devices
Airlines	Restaurants and retail	Regulated utilities
Homebuilders and building materials	Healthcare facilities	Publishing and broadcasting
Merchant electricity generators	Hotels and gaming	Military defense manufacturers
Paper and wood products	Railroads and trucking	Agriculture, meat and poultry companies

Company Business Risk

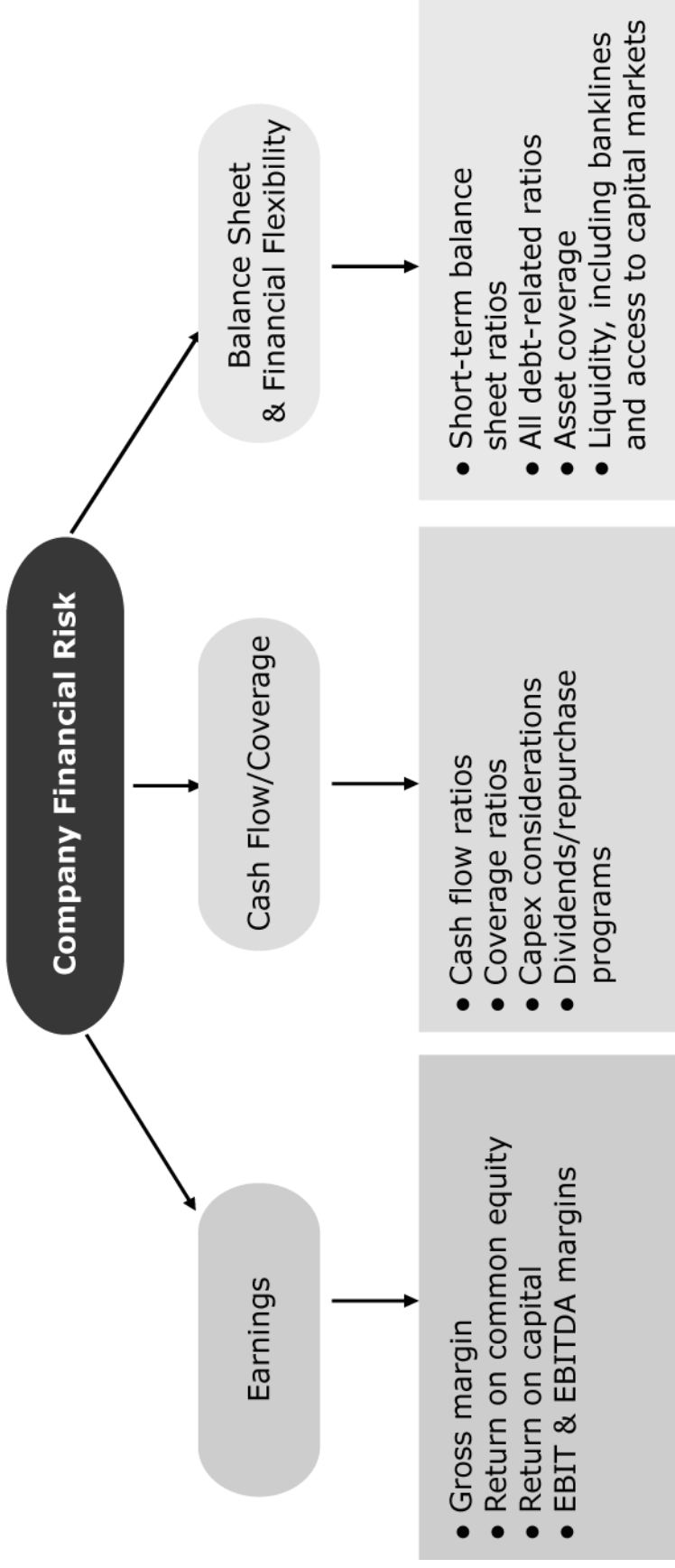


Every company has its own uniquely inherent risks

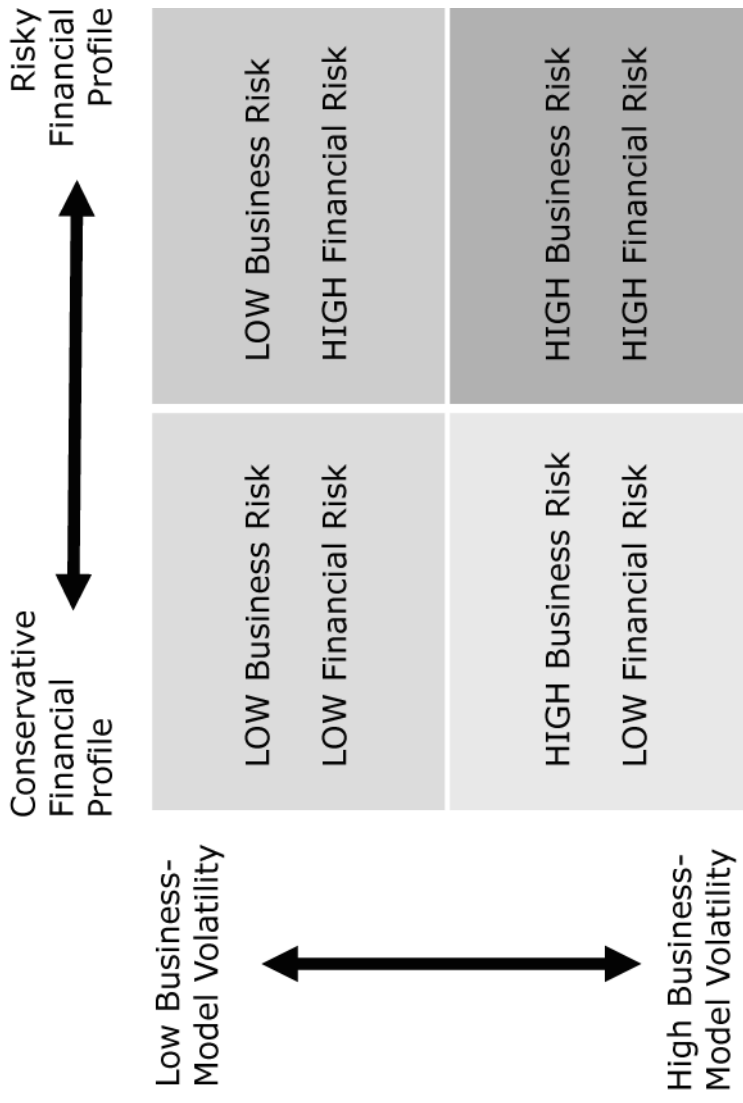
Industry "Y" (Medium Risk)



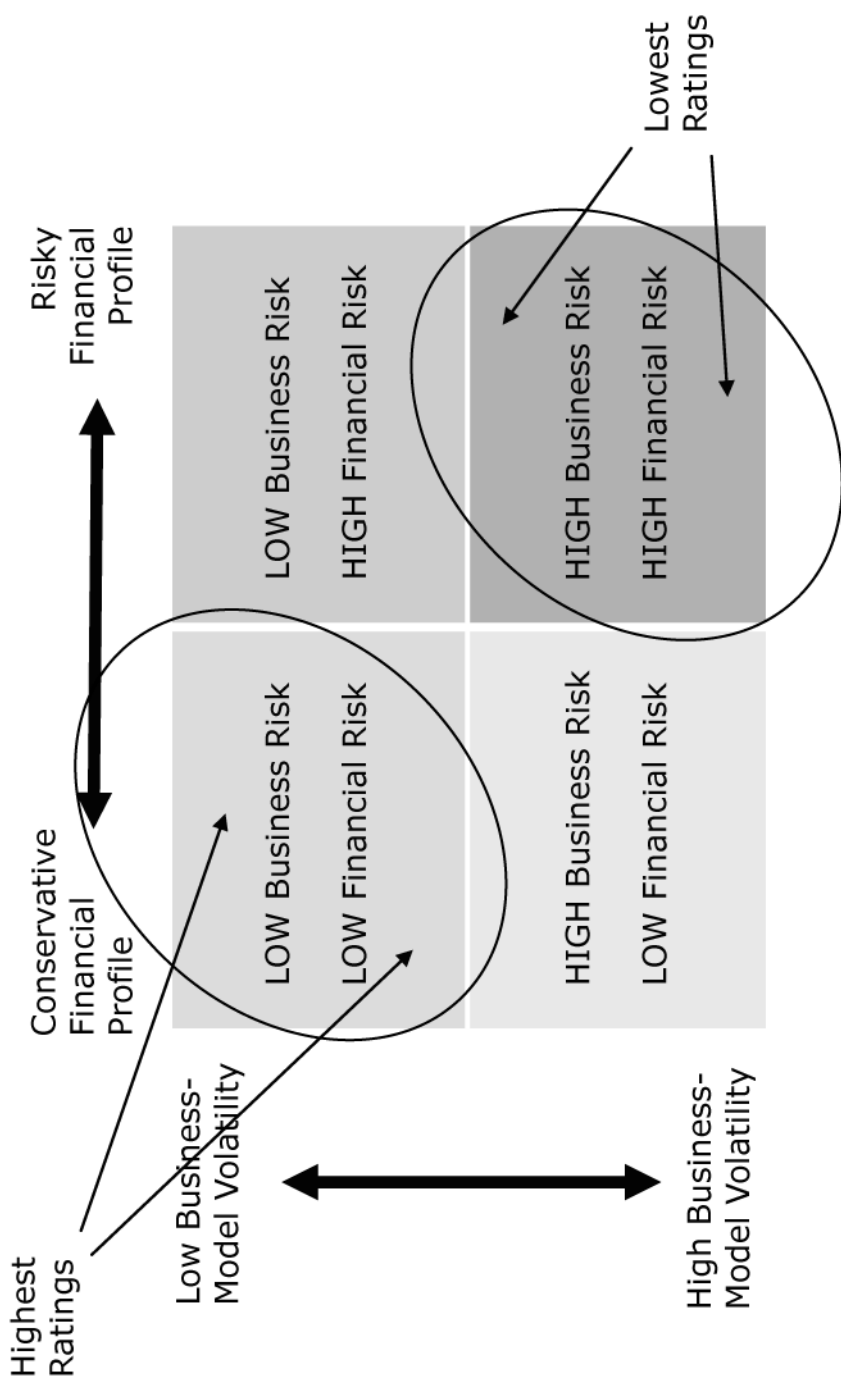
Financial Analysis



Outcome



Ratings



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