Industry Study

DBRS Corporate 2010 Year in Review and 2011 Outlook

JANUARY 2011

Insight beyond the rating.

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2010
A calmer year in credit . . . apart from a few noteworthy sovereign challenges

2011
Better-than-average credit experience expected

Executive Summary

Following two years of meaningful downgrade activity and record corporate default levels, 2010 was by most measures a much more positive year for credit. In essence, 2010 followed two years of significant rating actions on weaker credits and meaningful cost-cutting and/or reorganization and capital-preservation actions by companies. With the additional benefit of more stable economic conditions, the overall result was a reduction in both the volatility and negativity with respect to credit ratings.

Specifically, despite the fact that 2010 started with a significant number of entities either with a Negative trend or Under Review with Negative Implications (44 combined for U.S. and European financial institutions alone), the number of rating downgrades for the year fell to only 30 (from 97 and 74 for 2009 and 2008, respectively) and after a record 17 defaults during 2008 and 2009 combined, there were no defaults recorded in the DBRS credit universe during 2010.

The key metric of downgrades to upgrades fell from 5.4 times in 2009 to 1.6 times in 2010 (close to the DBRS historical average of 1.8 times), which modestly exceeded our expectations as we had predicted an overall downgrade-to-upgrade ratio of 2.0 times for 2010 in last year's review.

As projected last year, downgrade activity was led by banking in the United States and Europe, but at ten, the actual number of downgrades was far below the 56 rating cuts experienced by this group in 2009. No industry segment experienced as meaningful a level of downgrade activity in 2010, and for the first time in many years, the auto sector did not exhibit any negative ratings performance.

Despite that, all was not rosy in 2010. In last year's report, DBRS noted concerns as to how governments would succeed in the balancing act of unwinding fiscal stimulus and managing their deficits as there was no such thing as a choice without consequences. We expected sovereign debt would come under increased scrutiny and possible pressure in 2010. That certainly was the case, although to date the pressure has been concentrated in a small number of euro zone sovereigns, highlighted by Greece and Ireland and their respective financial support programs from the International Monetary Fund (IMF) and European Union (EU).

Looking ahead to the challenges in 2011, the strength of recovery in the United States and several other countries remains to be seen and while most non-European DBRS credits are presently less directly exposed to sovereign issues, there are real ripple effects should the present sovereign challenges in Europe worsen or spread. The success of tough austerity budgets in several highly indebted countries remains to be seen, the EU will be conducting a new round of stress tests on European banks and banks outside of this region also have uncertainties to work through with respect to new regulatory frameworks. High debt at both the government and consumer levels remains our number one concern and will not be easily or quickly corrected, and while not a short-term concern, higher energy and commodity prices have the potential to raise inflation, interest rates and base costs in the future. In this respect, however, we note that prolonged periods of low interest rates do have a negative side as they can eventually lead to unsustainable consumer debt burdens and can increase concerns for pension funds and corporate credits that profit from returns on fixed income portfolios.

On the positive side, however, many companies in the DBRS credit universe have managed to maintain reasonable balance sheets and liquidity positions since the "great recession" and the number of credits with a Negative trend or Under Review with Negative Implications has declined over the past year. Apart from certain select sovereign-related challenges, the trend of fewer negative rating actions for U.S. and European banks should continue in 2011.

In summary, we expect that our credit universe is likely to experience a relatively stable and positive year in 2011, with the downgrade-to-upgrade ratio below the 1.8 times historical DBRS average and default levels also remaining low.

Historical Results

The table below provides a detailed overview of DBRS downgrades and upgrades from 1999 to 2010. The downgrade–to-upgrade ratio is expected to improve in 2011 given past actions and more stable economic conditions.

Historical Performance

	2010	2009	2008	2007	2006	2005	2004	2003	2002	2001	2000	1999
Number of upgrades	18	18	24	36	44	50	32	19	14	18	18	27
Number of downgrades	29	97	74	55	41	41	37	51	66	77	41	40
Downgrades-to-upgrades ratio	**1.61**	**5.39**	**3.08**	**1.53**	**0.93**	**0.82**	**1.16**	**2.68**	**4.71**	**4.28**	**2.28**	**1.48**

Note: Includes multiple rating actions to individual credits.

The downgrade-to-upgrade ratio decreased to 1.61 times in 2010, which is a dramatic improvement from 2009 levels. This improvement is reflective of a recovery in the economy as market conditions remained relatively healthy throughout the year. The 2010 results are in line with historical performance of the downgrade-to-upgrade ratio, which averaged 1.80 times from 1978 through 2010.

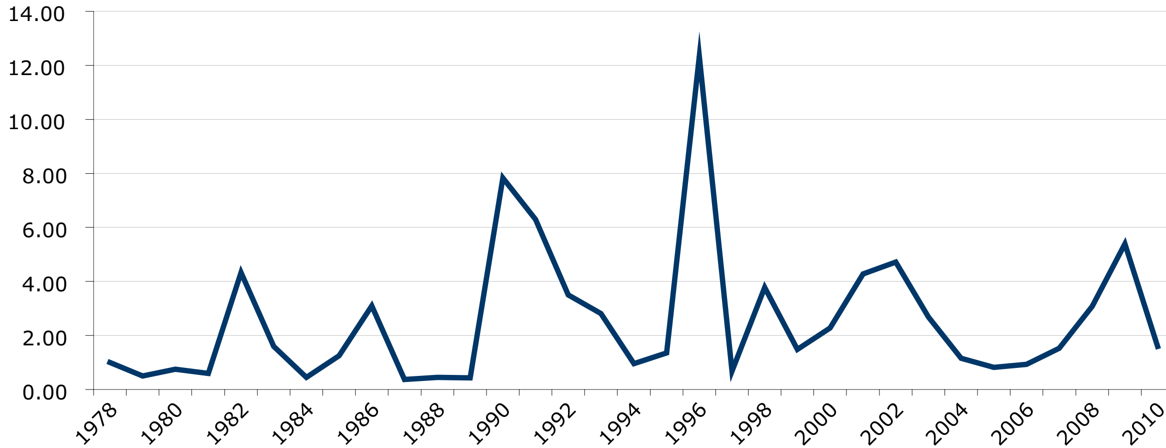
Rating activity in 2010 was evenly distributed among the AA, "A," BBB and non-investment-grade (i.e., high-yield) rating categories. Note the strong results in the high-yield and BBB universe, with upgrades outpacing downgrades by a 2:1 margin. Conversely, note the poor results in the AA category, with 12 downgrades and no upgrades, which was largely attributable to the banking segment.

Upgrades and Downgrades by Rating Category for 2010

	Upgrades	%	Downgrades	%	Total	%
AAA	0	0%	0	0%	0	0%
AA	0	0%	12	41%	12	26%
A	1	6%	9	31%	10	21%
BBB	8	44%	2	7%	10	21%
Non-investment grade	9	50%	6	21%	15	32%
Total	**18**	**100%**	**29**	**100%**	**47**	**100%**

Note: Includes multiple rating actions to individual credits. Upgrades and downgrades are based on DBRS sub-rating categories but are summarized into whole rating categories.

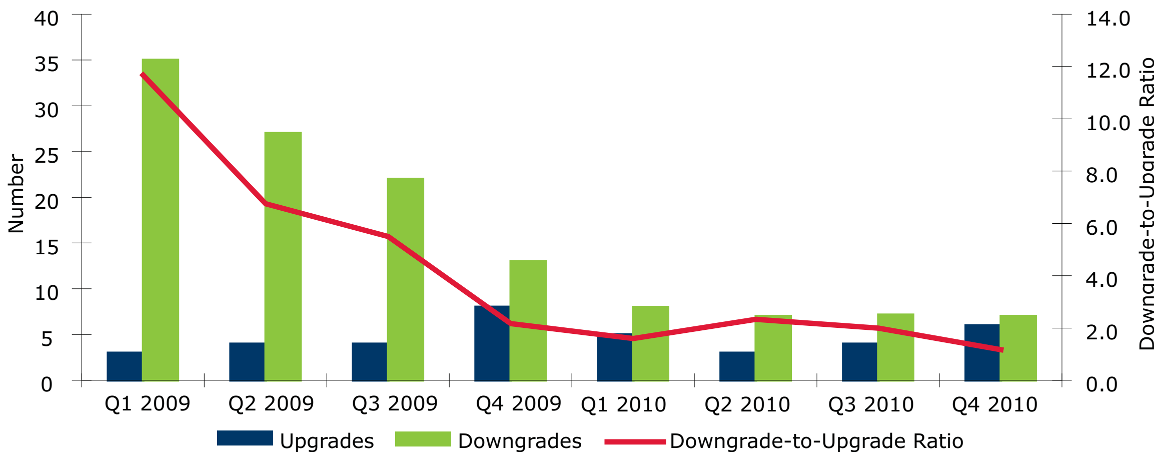
Historical Downgrade-to-Upgrade Ratio



Note: Includes multiple rating actions to individual credits post-2000.
Source: DBRS.

The graph above illustrates the rating volatility over the last 30 years. During economic downturns, downgrade activity often increases significantly, while upgrade activity decreases, which often results in a spike in the downgrade-to-upgrade ratio. Note the dramatic improvement in 2010 as the number of downgrades fell. This drop is largely attributable to a reduction in the number of downgrades in the U.S. and European financial institutions segments.

Quarter-by-Quarter Rating Activity, 2009 to 2010



Note: Includes multiple rating actions to individual credits.
Source: DBRS.

The graph above illustrates the decline in the number of downgrades on a quarterly basis from 2009 to 2010. In 2010, rating activity improved modestly in the second half as economic conditions became more favourable. DBRS expects 2011 results will mimic 2010 rating activity, with a fairly low level of rating changes.

In general, the rationale for a rating upgrade or downgrade can be broken into four types:

(1) **Operating Performance:** Performance above or below expectations could result in an upgrade or downgrade.

(2) **Structural Changes:** Structural changes primarily include significant long-term changes that affect the industry in which the issuer operates. In most cases, these structural changes are beyond the control of management.

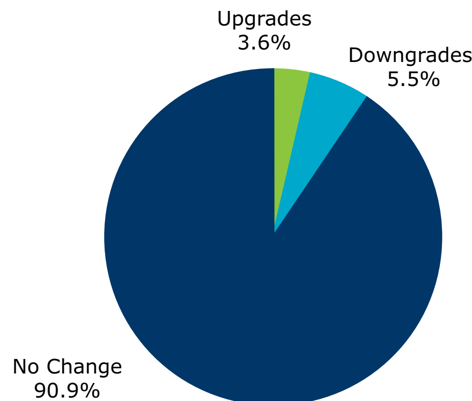
(3) **Leverage:** Changes in leverage within the capital structure could cause either negative or positive rating action.

(4) **Mergers and Acquisitions (M&As):** M&As have the potential of affecting both the business risk and financial risk profiles of an issuer, which can have a material effect on the rating.

2010 RATING CHANGES SUMMARY

In 2010, approximately 91% of the DBRS credit universe remained unchanged, while 6% was downgraded and only 4% was upgraded. In comparison, the 34-year average is 85% unchanged, 6% upgraded and 9% downgraded.

Rating Activity, 2010



Note: Excludes multiple rating actions to individual credits.
Source: DBRS.

Sector-by-Sector Analysis[1]

Overall, 2010 was a relatively strong year within DBRS's sample set, with zero defaults. More than 90% of the credits reviewed by DBRS were confirmed during the year, which is a clear indication of improvement in economic conditions within the global economy. Despite improvement, the financial institutions segment continued to struggle and accounted for the largest portion of the negative rating actions for the year. For 2011, DBRS expects downgrades will outpace upgrades by more normal margins. In addition, DBRS expects market conditions will continue to strengthen, which should result in below-average rating activity. Industries that are likely to stand out in 2011 include autos and utilities. This will be offset by expectations of weak performance for U.S. banks, European banks, forestry and sovereigns. The number of credits Under Review with Negative Implications or with a Negative trend is expected to decline.

2010 Rating Activity and Trends

		Rating Activity		Under Review		Trend	
	Sample	Upgrade	Downgrade	Negative	Positive	Negative	Positive
FINANCIAL INSTITUTIONS							
Australian	4	0	0	0	0	0	0
Canadian	39	2	2	0	1	1	0
European	36	1	2	1	0	8	0
Japanese	3	0	0	0	0	0	0
U.S.	62	3	8	3	3	13	1
Total Financial Institutions	**144**	**6**	**12**	**4**	**4**	**22**	**1**
ENERGY							
Oil & Gas	17	0	2	0	0	0	0
Utilities	78	4	1	1	0	1	0
Total Energy	**96**	**4**	**3**	**1**	**0**	**1**	**0**
NATURAL RESOURCES							
Forestry	10	1	2	0	0	4	0
Mining	20	1	0	1	0	0	1
Total Natural Resources	**30**	**2**	**2**	**1**	**0**	**4**	**1**
PUBLIC FINANCE							
Infrastructure and Other	35	0	0	0	0	1	0
Provinces & Municipalities	16	0	0	0	0	0	0
Sovereigns	15	1	2	1	0	4	1
Universities	13	0	2	0	1	2	0
Total Public Finance	**79**	**1**	**4**	**1**	**1**	**7**	**1**
OTHER							
Autos & Auto Suppliers	16	1	1	2	0	2	0
Consumers	33	0	2	0	0	0	0
Industrials and Transportation	24	1	1	0	0	0	1
Real Estate	28	2	1	0	0	0	0
Telecom/Media/Technology	21	0	0	0	0	0	0
Total Other	**122**	**4**	**5**	**2**	**0**	**2**	**1**
Total	**470**	**17**	**26**	**9**	**5**	**36**	**4**

Note: Excludes multiple rating actions to individual credits.

1. Note: The upgrade and downgrade figures quoted in this section exclude multiple rating actions to individual credits.

FINANCIAL INSTITUTIONS

Australian

Sample	Rating Activity		Under Review		Trend	
	Upgrade	Downgrade	Negative	Positive	Negative	Positive
4	0	0	0	0	0	0
Per Cent of Total	**0%**	**0%**	**0%**	**0%**	**0%**	**0%**

2010 Highlights – Neutral

Australian banks reported strong results in 2010. Major challenges included upward pressure on funding costs and continued reliance on offshore wholesale funding. The major risks to the sector are largely economic in nature, including housing affordability and the domestic economy's exposure to commodity prices and volumes.

2011 Outlook – Neutral

DBRS expects current trends to remain in place. Rating volatility is not expected in 2011 from this segment.

Canadian

Sample	Rating Activity		Under Review		Trend	
	Upgrade	Downgrade	Negative	Positive	Negative	Positive
39	2	2	0	1	1	0
Per Cent of Total	**5%**	**5%**	**0%**	**3%**	**3%**	**0**

2010 Highlights – Neutral

This sector was relatively stable as many Canadian financial institutions were able to weather the economic downturn and capital markets volatility. Rating changes were related to specific credit factors as opposed to any discernible industry trend. Despite lower earnings as a result of reduced capital markets revenue, most of the Canadian banking institutions' franchise businesses performed strongly, and loan loss provisions showed signs of improvement. Canadian financial institutions also raised capital to fortify reserves or pre-funded in anticipation of changes in contingent capital requirements. During the first half of 2010, insurance companies were quite active in accessing the capital markets, while banks raised debt and capital throughout the year. Once again, a prominent theme in 2010 was the stability of the Canadian financial system.

2011 Outlook – Neutral

The Canadian financial institutions sector is expected to remain stable in 2011. Similar to 2010, stability is expected to be the result of earnings derived from core franchises, strong capital levels and prudent risk management. Notwithstanding, DBRS is expecting more regulatory clarity on certain issues, including capital and liquidity.

European

Sample	Rating Activity		Under Review		Trend	
	Upgrade	Downgrade	Negative	Positive	Negative	Positive
36	1	2	1	0	8	0
Per Cent of Total	**3%**	**6%**	**3%**	**0%**	**22%**	**0%**

2010 Highlights – Negative

It was a year of improvement in 2010. Asset quality deterioration peaked, with improving trends becoming more evident over the year, especially in those economies where the recovery gained strength. After a good start to 2010, with the impact of legacy securities issues becoming more manageable, financial markets were disrupted by increasing concerns over risk in European sovereign credits in Q2 2010, particularly in the euro zone. Bank stress tests helped alleviate some of the fears about a widespread impact of potential sovereign debt declines on European banks. Elevated credit spreads and market nervousness kept pressure on weaker sovereigns and limited improvement in bank funding costs. Nevertheless, as the year progressed, more banks in more countries showed better earnings trends, with results bolstered by lower cost of credit, expense control and increased activity. While government programs were generally being scaled back, banks were increasingly able to tap the markets to add capital and get ahead of funding needs for 2010 and 2011. Even in the weaker countries, many banks continued to generate positive earnings despite their more challenging environments. As a result, rating changes were relatively limited in 2010, even with the stress.

2011 Outlook – Neutral

Many European banks are better positioned going into 2011 than going into 2010, despite the still difficult environment. That bodes well for rating stability. Positively, the economic recovery appears to be gaining momentum in more countries, which is good for bank revenues and continued declines in the cost of credit. Even for banks in stronger economies, however, extensive changes in the regulatory environment and stronger competition from recovering rivals will require effective strategies and successful execution. Banks that fail to adapt could see their franchises struggle, bringing pressure on ratings. Better alignment of funding mixes with business needs will be a key focus, given regulatory demands for increased liquidity and reduced reliance on wholesale funding. Many banks refocused their businesses on core activities in 2010; in 2011, they will have to demonstrate the earnings capacity of this core. Improving cost-to-income ratios is a critical factor. Banks that have retained their international franchises will need to deliver on the growth opportunities in those markets. Clouding this positive picture are the uncertainties surrounding the weaker sovereigns in Europe and the lack of a clear path to resolving their debt burdens. Ratings for banks in these stressed countries could come under pressure should conditions deteriorate rapidly. In the absence of any rapid economic improvement, financial markets are likely to remain exposed to bouts of stress.

Japanese

Sample	Rating Activity		Under Review		Trend	
	Upgrade	Downgrade	Negative	Positive	Negative	Positive
3	0	0	0	0	0	0
Per Cent of Total	**0%**	**0%**	**0%**	**0%**	**0%**	**0%**

2010 Highlights – Neutral

Material improvements were made in 2010 in this sector as capital was enhanced with large common equity issues and the banks modestly reduced their exposure to domestic equities. Earnings rebounded from crisis-induced lows, although, in some cases, the quality of earnings was not as strong as hoped for as a result of loan loss recoveries and trading gains in the bond portfolios. Asset quality generally strengthened. All ratings remained at the floor during the year, although the intrinsic assessment of Mizuho Corporate Bank, Ltd. (Mizuho) was lowed by one notch early in the year.

2011 Outlook – Neutral

Generally, further strengthening in credit quality is anticipated, particularly in terms of further improvements in the quantity and quality of capital, as well as further progress in reducing exposure to common equities. The earnings outlook is somewhat clouded by some unsustainable earnings in 2010 and the economic outlook.

U.S.

	Rating Activity		Under Review		Trend	
Sample	**Upgrade**	**Downgrade**	**Negative**	**Positive**	**Negative**	**Positive**
62	3	8	3	3	13	1
Per Cent of Total	**5%**	**13%**	**5%**	**5%**	**21%**	**2%**

2010 Highlights – Negative

U.S. banks that are primarily focused on regional retail and commercial banking struggled in 2010. Weaker performers, often with elevated real estate exposure, felt the brunt of the rating downgrades as their earnings remained negative. The cost of credit, including elevated non-interest expenses, continued to take its toll, especially in residential-related lending, even as asset quality trends showed improvement over the year. For banks with more activities in the capital markets and more transaction-based businesses, 2010 brought a modest rebound in earnings in these businesses. Improving financial markets also meant lower burdens from legacy “toxic” assets. Improving conditions during the year enabled banks to tap the markets to raise capital and get ahead of funding needs. Increasingly, stronger banks were able to repay government capital and replace government-guaranteed funding. Notable in 2010 was the passage of new legislation that introduced substantial changes and added to banks’ operational costs. With the economy showing increased strength toward the end of the year, bank earnings were on the upswing, but they were still not strong. Low interest rates remain a constraint on revenues, with little impetus for revenue improvement from still very anemic loan demand and still limited rebound in fees and transaction volumes.

2011 Outlook – Neutral

With housing markets still weak, house prices still flat to down, an uneven economic recovery and still low interest rates, 2011 is shaping up to be a challenging year for U.S. banks. For many, the year is likely to bring improving earnings as the economic recovery gains momentum and credit costs recede. Such performance is already reflected in the ratings. While negative rating actions are likely to diminish in a recovering economy, negative rating pressure is likely to be experienced by those banks that are struggling to sustain their franchises in the face of increasing competition and the burden of a rapidly changing regulatory environment. Many banks have refocused their business mix on their core strengths; in 2011, they will need to demonstrate that they can deliver the necessary earnings from this core to support increased capital requirements and more stringent regulatory demands. For most banks, enhanced capitalization, with more capital and lower risk profiles, is likely to offset any negative pressure on ratings from higher costs and business constraints due to regulatory changes. Improving cost-to-income ratios is a critical factor, with banks expected to generate resources to invest in their franchises and leverage technology to improve delivery to more demanding customers. For larger banks, effectively managing their more global businesses will require adapting to significant changes across multiple regulatory regimes, with increasing demands from local constituencies. Consolidation is inevitable as weaker banks struggle to adapt, although foreign bank acquisitions may contribute to increasing competition.

ENERGY

Oil & Gas

Sample	Rating Activity		Under Review		Trend	
	Upgrade	Downgrade	Negative	Positive	Negative	Positive
17	0	2	0	0	0	0
Per Cent of Total	**0%**	**12%**	**0%**	**0%**	**0%**	**0%**

2010 Highlights – Neutral

Despite the fact that there were two downgrades, the credit profiles of most oil and gas companies improved in 2010, with increased cash flow coverages, strengthened balance sheets and substantial liquidity, reflective of the economic recovery and the substantially higher commodity prices, especially for crude oil, although natural gas prices remained weak. Capital spending increased from 2009 at manageable levels, mostly within cash flows. Rating downgrades included BP p.l.c. and Anadarko Petroleum Corporation as a result of the substantial response costs and potential liabilities associated with the oil spill in the Gulf of Mexico in April 2010. On a positive note, the recently announced joint venture between Suncor Energy Inc. (Suncor) and Total Capital SA highlights the increased foreign investment in western Canada, particularly in the oil sands, apart from interests in the unconventional shale gas developments across North America.

2011 Outlook – Neutral

We expect a generally stable credit profile in 2011, particularly for oil-prone companies, despite a sluggish economy and still weak natural gas prices ($4 to $4.50 per thousand cubic feet (mcf)). A re-allocation of capital investments from natural gas to crude oil will continue, given favourable crude pricing expected in 2011 ($70 to $90 per barrel), which would render most projects economical. Resumption of mega oil sands projects will continue (e.g., Imperial Oil Limited, Husky Oil Ltd. and Suncor). Most gas-weighted operators rated by DBRS will continue to focus on unconventional shale gas and liquids-rich gas developments. Hedging arrangements, substantial liquidity and joint-venture arrangements also help mitigate the capex burden. Most industry participants plan to live within their means and continue to improve capital efficiency. There are generally no material debt maturities in 2011. Increased foreign investment in western Canada, primarily in the form of joint ventures, is expected to continue in 2011, mostly in activities related to the oil sands or shale gas developments. Overall, inflationary pressures, especially for oil sands projects, could resume, although, in the near term, they are not expected to be of the same magnitude as seen in 2005 to Q3 2008. The conversion of most oil and gas trusts into corporations by year-end 2010 could potentially result in more capital markets activities for these smaller players, apart from bank financing, resulting in potentially more high-yield bond issuance.

Utilities

Sample	Rating Activity		Under Review		Trend	
	Upgrade	Downgrade	Negative	Positive	Negative	Positive
78	4	1	1	0	1	0
Per Cent of Total	**5%**	**1%**	**1%**	**0%**	**1%**	**0%**

2010 Highlights – Positive

Rating activity in the utilities sector was positive in 2010, with upgrades outpacing downgrades by a margin of 4:1. Although under review and trend change rating actions were negative (i.e., from Stable to Negative), there was only one instance of each. Maintaining stable credit profiles through the sluggish economic conditions is a testament to the sector's largely regulated and/or contracted nature. These businesses typically remain well insulated from the direct impact of volatile commodity prices (crude oil,

natural gas and power), which were up to varying degrees in 2010 from depressed 2009 levels. Various regulatory bodies (Canada's National Energy Board (NEB), the Alberta Utilities Commission (AUC), the British Columbia Utilities Commission and the Ontario Energy Board (OEB)) continued to show a willingness to address the industry's low approved return on equity (ROE) and equity thickness levels. The changes to date are viewed as supportive of credit profiles but not material enough on their own to warrant any positive rating actions.

2011 Outlook – Neutral

We expect a generally stable credit profile in 2011 for the utilities sector, even in the event of sluggish economic conditions. While significant capital expenditures for growth and refurbishment are expected to continue, resulting in free cash flow deficits for some companies, the funding requirements are manageable within the context of strong credit profiles and liquidity positions. The deterioration of credit metrics during the construction period is expected to be temporary for companies with large capex programs. Ratings will continue to be supported by the underlying regulated and/or contracted business models, although certain of the companies have investments in segments with higher business risk (e.g., gas gathering and processing and merchant power). Issues of focus for 2011 include (1) progress on negotiated settlements for TransCanada Corporation's Canadian Mainline (likely to result in higher ROE than the current 8.5%) and Enbridge Inc.'s Mainline System, (2) project execution for large capex programs of various utility and pipeline companies and (3) the impact of production growth in northeast British Columbia and the Bakken region of Saskatchewan and North Dakota on pipeline developments.

NATURAL RESOURCES

Forestry

	Rating Activity		Under Review		Trend	
Sample	**Upgrade**	**Downgrade**	**Negative**	**Positive**	**Negative**	**Positive**
10	1	2	0	0	4	0
Per Cent of Total	**10%**	**20%**	**0%**	**0%**	**40%**	**0%**

2010 Highlights – Neutral

Conditions in the North America forest products sector improved slowly throughout the year in line with a modest recovery in the general economy. Although demand was still soft, producer discipline in managing supply supported prices at favourable levels. In the case of pulp and lumber, unexpected supply disruptions boosted prices sharply higher. Although lumber prices retreated in the second half of the year, they were still well above 2009 levels, supported by increasing exports to China. China's rising demand for lumber was an unexpected, pleasant surprise in 2010. Companies in the sector monitored by DBRS have generally performed slightly better than expected, particularly in the pulp and lumber sectors. There were a number of rating actions taken during the year: two downgrades (Catalyst Paper Corporation and Norbord Inc.), one upgrade (Domtar Corporation) and two trend changes from Negative to Stable (Cascades Inc. and West Fraser Timber Co. Ltd.).

2011 Outlook – Neutral to Slightly Positive

DBRS believes the forest products sector has stabilized, but a meaningful recovery is not likely until late 2011. Even though construction activities are expected to stay weak as a result of an ongoing depressed housing sector, increasing exports to China would support a modest growth in demand for lumber. Product prices are expected to remain near current levels through 2011. However, ongoing strength in the Canadian dollar would continue to pressure results at Canadian-based forest products companies. The rating outlook for companies in the forest products industry is neutral to slightly positive, with lumber producers most likely to have upside surprises.

Mining

	Rating Activity		Under Review		Trend	
Sample	**Upgrade**	**Downgrade**	**Negative**	**Positive**	**Negative**	**Positive**
20	1	0	1	0	0	1
Per Cent of Total	**5%**	**0%**	**5%**	**0%**	**0%**	**5%**

2010 Highlights – Neutral

In 2010, the mining sector showed recovery, with largely neutral rating actions. Base metal prices, on the strength of demand from China and other lesser developed countries, recovered from cycle lows beginning in Q2 2009, and as the peril of a double-dip recession in 2010 receded, there was a return to positive operating performance for most companies. Company-specific factors led to one upgrade during the year, although a number of companies were placed under review in response to M&A activity. Gold prices, which had retreated by about 25% early in the 2008–2009 recession, resumed a ten-year upward trend to record levels in late 2010. Robust commodity prices and much more receptive capital markets helped those companies that were overextended as a result of the 2008–2009 downturn repair their balance sheets, resolve liquidity issues and grow their capital bases. Improved earnings resulted in improving coverage metrics for much of the sector.

2011 Outlook – Neutral

Mining sector rating trends in 2011 are expected to be driven largely by company-specific factors as continued economic recovery in North America and Europe, offset by some slowing in Asian economic growth from a very strong pace in 2010, provides a positive environment for commodity prices. The watchword for many natural resources companies is "organic growth," and expansionary 2011 capital budgets are expected across the board. Acquisition activity will continue to be a wild card in 2011, raising the risk of the acquiring companies overextending their liquidity and leverage. The spectre of the 2008–2009 commodity price collapse will keep mining sector treasurers cautious, and most balance sheets are expected to remain healthy.

PUBLIC FINANCE

Infrastructure and Other

	Rating Activity		Under Review		Trend	
Sample	**Upgrade**	**Downgrade**	**Negative**	**Positive**	**Negative**	**Positive**
35	0	0	0	0	1	0
Per Cent of Total	**0%**	**0%**	**0%**	**0%**	**3%**	**0%**

CANADIAN PUBLIC PENSION FUNDS

2010 Highlights – Slightly Positive

Following the largest losses experienced in 2008 and early 2009, DBRS-rated public pension funds and asset managers posted a sharp rebound in investment performance in the second half of 2009, with the positive momentum continuing at a more moderate pace through 2010. This provided a strong boost to net assets and helped improve the funding status of pension plans. No rating action was taken in 2010 and all trends remained Stable as the credits were strongly supported by their very large asset bases and low-recourse debt levels, as well as sizable liquidity positions and generally strong sponsorship.

2011 Highlights – Neutral

With the recovery in the United States still fragile and European countries grappling with large deficits, DBRS expects global investment conditions to remain volatile, although returns should remain in positive territory given the scale, experience and diversification of the investment activities of DBRS-rated public pension funds and asset managers. However, the losses accumulated in the actuarial reserves will take a few years to get fully recognized, maintaining pressure on pension deficits. This situation will likely require most pension plans to increase contribution rates and/or reduce benefits when they file their next actuarial valuations to protect the soundness of the plans. Recourse debt is expected to increase moderately across the sector, although leverage will remain fairly low relative to net assets and well within the limits of the AAA ratings.

CANADIAN INFRASTRUCTURE PROVIDERS – AIRPORT AUTHORITIES AND OTHERS

2010 Highlights – Slightly Positive

For aviation-related credits, there was no upgrade or downgrade activity in 2010. Late in the year, DBRS stabilized the Negative trend of the Edmonton Regional Airports Authority as the implementation of its capital program showed progress and resulted in significant cost savings. After the fairly moderate decline in traffic experienced at Canadian airports in 2009, traffic has rebounded and all airport authorities rated by DBRS demonstrated low to mid-single-digit traffic growth for the first three quarters of 2010. Operating results trended upward as airport authorities continued to focus on cost controls and revenue diversification while relaxing temporary cost-cutting measures enacted in 2008 and 2009.

The availability-based public-private partnerships (PPPs) rated by DBRS performed as expected in 2010, and there was no upgrade or downgrade activity. Among the more mature, volume-based PPPs, traffic exhibited modest growth in 2010 after mixed results for 2009. There was no upgrade or downgrade activity, although Strait Crossing Development Inc. has a Negative trend as a result of weak coverage ratios and revenue growth outlook.

2011 Outlook – Neutral to Slightly Positive

For the aviation-related credits, rating activity is expected to be minimal in 2011 as DBRS expects that operating results will continue to demonstrate slow improvement, driven by modest traffic growth and sustained spending prudence. However, the weak financial position of certain airlines has the potential to affect passenger levels, which are also expected to remain constrained by the pace and depth of the economic recovery. For the PPP credits, rating stability is expected to be the norm. While there is potential for weak, volume-based credits to see rating actions in 2011, DBRS sees this as the exception rather than the rule for the sector.

Provinces & Municipalities

	Rating Activity		Under Review		Trend	
Sample	**Upgrade**	**Downgrade**	**Negative**	**Positive**	**Negative**	**Positive**
16	0	0	0	0	0	0
Per Cent of Total	**0%**	**0%**	**0%**	**0%**	**0%**	**0%**

CANADIAN PROVINCES

2010 Highlights – Neutral to Slightly Negative

Provincial economies began to emerge from the recession in 2010, with growth expected to average about 3.0%. However, the continuation of stimulus measures and rising program costs weighed heavily on fiscal results and debt as the combined federal and provincial debt-to-GDP ratio stood at 78% in 2009-10, up from a low of 61% two years prior. Nonetheless, ratings continued to show resilience as only one province was subject to a rating action during the year: the trends on Nova Scotia's long- and short-term ratings were changed to Stable from Positive following the decision to adopt a slower path to return to balance and greater erosion in the financial profile than originally expected.

2011 Outlook – Neutral to Slightly Negative

Provincial governments are expected to begin unwinding stimulus measures in an effort to rein in deficits, which speaks to fiscal discipline being generally maintained in the sector. However, the outlook for global economic growth has softened since the provincial plans to return to balance were introduced in the spring of 2010, which may require additional measures such as higher taxes or reducing spending to avoid stretching the string of deficits even further and ensure credit profiles remain intact. DBRS notes that five provinces go to the polls in the fall of 2011, creating the possibility that fiscal recovery plans could be altered notably over the course of the year.

CANADIAN MUNICIPALITIES

2010 Highlights – Neutral

DBRS-rated municipalities were little affected by the recession and generally maintained sound fiscal profiles, with no rating changes in 2010, highlighting the stability of their tax bases. However, heavy capital requirements added further to tax-supported debt, leading to reduced financial flexibility for some municipalities.

2011 Outlook – Neutral to Slightly Negative

Fiscal prudence is expected to continue to prevail in 2011, with balanced budgets generally maintained among DBRS-rated municipalities, although in many cases this will be achieved with the help of cost containment initiatives and still material tax increases. Large capital spending programs are expected to boost debt, which will continue to slowly erode the financial profiles of some municipalities. Nonetheless, Canadian municipalities benefit from a stable revenue base, reasonable fiscal discipline and modest debt levels that remain supportive of the current ratings.

Sovereigns

	Rating Activity		Under Review		Trend	
Sample	Upgrade	Downgrade	Negative	Positive	Negative	Positive
15	1	2	1	0	4	1
Per Cent of Total	**7%**	**13%**	**7%**	**0%**	**27%**	**7%**

2010 Highlights – Negative to Neutral

In 2010, DBRS-rated sovereigns remained under pressure as economic growth and employment stagnated, debt burdens increased and many sovereigns introduced fiscal austerity programs. Market volatility was high surrounding financial assistance packages for Greece and Ireland, which faced large competitiveness issues or rising financial liabilities. Some upward pressure on certain credits was evident, especially among fast-growing emerging markets, including India, Brazil, Peru, Argentina and Uruguay. However, for the most part, sovereigns, especially in Europe, remained under downward pressure.

2011 Outlook – Negative to Neutral

In 2011, DBRS expects that risks will remain on the downside as European credits, especially in the euro zone, face heavy refinancing needs amid low investor confidence. Investors are likely to continue to be concerned about the degree of financial assistance that Europe would provide member states; European policy with respect to collective action clauses on new bonds issued after June 2013; how effective fiscal adjustment would be in stabilizing debt ratios; and the pace of the economic recovery. These concerns may be somewhat offset by higher growth in the United States and Germany and resilience among emerging markets – possibly leading to upward rating pressure in certain credits – but by and large, DBRS expects that risks will remain to the downside.

Universities

	Rating Activity		Under Review		Trend	
Sample	**Upgrade**	**Downgrade**	**Negative**	**Positive**	**Negative**	**Positive**
13	0	2	0	1	2	0
Per Cent of Total	**0%**	**15%**	**0%**	**8%**	**15%**	**0%**

2010 Highlights – Slightly Negative

Several rating actions occurred for Canadian universities in 2010. Two institutions received rating downgrades as a result of significant debt needs for capital projects, sustained weakness in operating results and the likelihood of rising post-employment benefit costs, while the trend on the rating of another institution was changed to Negative from Stable, based on the expectation that debt-financed capital projects would weaken financial metrics. Conversely, only one university rating saw a positive change, having been placed Under Review with Positive Implications following the favourable restructuring of a large capital project and repayment of related debt. Results rebounded at most institutions during the 2009-10 fiscal year, helped by improving investment results, sound enrolment growth, continued tuition fee increases and cost-reduction initiatives implemented at many institutions. Debt was little changed at most DBRS-rated universities, although pension and post-employment benefit liabilities continued to rise steadily.

2011 Outlook – Slightly Negative

The operating environment is expected to remain challenging for Canadian universities over the coming years in light of the slow growth expected in senior government funding, continued limited tuition fee-setting autonomy and rising pension contributions. Enrollment growth will remain supportive of credit profiles but is unlikely to resolve all challenges, pointing to the need of further budget cuts at many universities and, for some, tightening operating flexibility.

OTHER

Autos & Auto Suppliers

	Rating Activity		Under Review		Trend	
Sample	**Upgrade**	**Downgrade**	**Negative**	**Positive**	**Negative**	**Positive**
16	1	1	2	0	2	0
Per Cent of Total	**6%**	**6%**	**13%**	**0%**	**13%**	**0%**

2010 Highlights – Neutral

The auto sector's performance was moderately positive in 2010. Global sales increased considerably year over year. DBRS notes that the global growth is significantly attributable to increases in emerging markets (particularly China) as well as in the United States. China reinforced its position as the world's largest automotive market and continued to exhibit very strong growth in 2010, although growth moderated somewhat in the latter half of the year. Conditions in major developed markets remained lacklustre, with the industry continuing to be materially adversely affected by ongoing economic headwinds. While the United States generated significant sales increases year over year, DBRS notes that this is relative to extremely weak levels, with 2010 volumes still substantially below historical norms. Sales in western Europe held relatively firm through the first six months of 2010, but they subsequently decreased materially amid the phasing out of vehicle scrappage incentives across the region.

Similarly, volumes in Japan (which had been progressively declining for several consecutive years) increased through the first eight months of 2010 but fell considerably with the expiry of government buying incentives in September. DBRS notes that the sector in general had substantial liquidity as the global financial crisis moderated, with several auto manufacturers beginning to pay down debt incurred

(to ensure liquidity) during the worst of the downturn. Rating activity was fairly muted, with Ford Motor Company (Ford) representing the only positive rating action of note, reflecting its much stronger earnings performance and improving financial profile amid significantly higher revenues given higher industry volumes, gains in market share and stronger pricing.

2011 Outlook – Positive

In 2011, industry levels are expected to continue exhibiting growth. As was the case in 2010, much of this growth will be further sourced from emerging markets. Regarding major developed markets, the industry should continue its recovery, although the recovery is likely to be gradual and protracted. Sales growth in the United States and western Europe could prove material in 2011; however, this could be undermined by persistent economic headwinds in both regions. Automakers will be further challenged by increasing global regulation regarding vehicle emissions, which will raise product development costs and, in turn, encourage consumers to purchase smaller, more fuel-efficient vehicles (typically with considerably lower per-unit margins). DBRS does not expect significant rating downgrades in 2011, with rating upgrades more likely, although upgrade activity may also be muted, reflecting the protracted recovery of the industry, particularly in mature markets.

Consumers

	Rating Activity		Under Review		Trend	
Sample	**Upgrade**	**Downgrade**	**Negative**	**Positive**	**Negative**	**Positive**
33	0	2	0	0	0	0
Per Cent of Total	**0%**	**6%**	**0%**	**0%**	**0%**	**0%**

2010 Highlights – Neutral

Except for two event-related actions, there were virtually no rating changes in this sector over the course of 2010. The Negative trends on two retailers at the end of 2009 were changed to Stable as economic recovery began to alleviate the pressure that mounted over the course of the recession. That said, companies remained focused on improving operational efficiencies and disciplined financial management as opposed to substantially increasing returns to shareholders and/or debt-financed acquisitions. Companies with strong market positions and/or brand names, large scales, geographic diversification and good liquidity proved to weather the economic downturn well. Food retailers in particular have remained relatively stable through the cycle. The two downgrades were on The Coca-Cola Company and PepsiCo, Inc. and resulted from each company's acquisition of its major respective bottler.

2011 Outlook – Neutral

DBRS believes growth in sales and operating income for the consumer products sector will be increasingly positive in 2011 as the economy continues to improve. Companies with strong market positions and good operating leverage should be well positioned to grow earnings. On the other hand, DBRS believes many consumer products and retail companies will begin to loosen up on previously applied capital-conserving tactics, particularly in a low interest rate environment, and contemplate increasing returns to shareholders and/or debt-financed investment and/or acquisitions. As such, DBRS's outlook for credit ratings in this sector is neutral, with limited rating activity expected.

Industrials and Transportation

Sample	Rating Activity		Under Review		Trend	
	Upgrade	Downgrade	Negative	Positive	Negative	Positive
24	1	1	0	0	0	1
Per Cent of Total	**4%**	**4%**	**0%**	**0%**	**0%**	**4%**

2010 Highlights – Neutral

Ratings were relatively stable across much of the industrial products sector. The relative stability followed a weak 2009, which led to several downgrades, mainly related to the sharper-than-expected deterioration in demand for highly cyclical products. The continued focus on liquidity through much of the year led to flat or lower capital expenditures and limited or no share repurchase activity in many instances. In addition, earnings growth, which was partly related to an improved macroeconomic environment (with continuing strength in Asia) from trough levels, contributed to stronger cash flow. As such, this enabled many companies to reduce debt from previously high levels and strengthen their credit profiles to levels more commensurate with their assigned ratings, but they were also able to engage in acquisition activity. With respect to transportation companies, a rebound in shipment volumes was the main driver of the rebound in operating results.

2011 Outlook – Neutral

Ratings are expected to remain relatively stable. Modest improvement in demand is expected, roughly in line with economic conditions. Most companies remain cautious with respect to capital investments given that weaker-than-expected macroeconomic fundamentals could lead to balance-sheet and liquidity deterioration. That said, a generally stable demand environment and favourable credit markets will likely result in continued acquisitions activity and/or renewed share repurchase programs. As such, financing activity will likely limit material improvement in credit profiles across the industrial products and transportation sectors. Refinancing risk remains, with a high amount of bank debt maturing in 2012, but it should be gradually addressed through the year.

Real Estate

Sample	Rating Activity		Under Review		Trend	
	Upgrade	Downgrade	Negative	Positive	Negative	Positive
28	2	1	0	0	0	0
Per Cent of Total	**7%**	**4%**	**0%**	**0%**	**0%**	**0%**

2010 Highlights – Neutral

The credit profile for the real estate sector was relatively stable during 2010. Operating fundamentals began displaying improvement as they typically lag general economic trends. Coverage ratios remained adequate as the sector continued to benefit from historically low interest rates. That said, improving economic prospects, combined with the low interest rate environment and good access to capital (liquidity), have led to renewed development and acquisition activity in the sector. Much of this interest was focused on the U.S. market, where capitalization rates and valuations were more attractive. The two DBRS upgrades were based on improved company-specific fundamentals. The one downgrade reflected the change in business mix at MI Developments Inc.

2011 Outlook – Neutral

DBRS expects real estate fundamentals to improve with economic conditions over the course of 2011 as growth and job creation translate into greater demand for space. Combined with the low interest rate environment, this should further propel property acquisition and development activity. More attractive valuations and a strong Canadian dollar should provide particular incentive for Canadian real estate

companies to invest outside the country. In this environment, DBRS would expect companies to restore their coverage and leverage ratios to stronger levels within their rating categories. However, DBRS's outlook could be negatively affected by high levels of debt-financed investment activity in the sector and/or a rapid rise in interest rates that is beyond our expectations.

Telecom/Media/Technology

	Rating Activity		Under Review		Trend	
Sample	**Upgrade**	**Downgrade**	**Negative**	**Positive**	**Negative**	**Positive**
21	0	0	0	0	0	0
Per Cent of Total	**0%**	**0%**	**0%**	**0%**	**0%**	**0%**

2010 Highlights – Communications, Neutral; Media, Stabilized

In 2010, ratings were steady in the communications and media industries in Canada given the relatively non-discretionary nature of most communications services, combined with relatively stable competitive, regulatory and technology operating environments; media companies experienced stability with their subscription-based businesses, while their advertising-supported operations benefitted from a stabilized economic environment and meaningful restructuring initiatives.

Communications companies with telecom, wireless and cable operations continued to increasingly compete with each other (horizontal integration), with the telcos advancing their video strategies and cable companies deploying wireless services. From a media perspective, subscription-based businesses such as specialty television saw continued revenue and EBITDA growth, while advertising-based businesses such as broadcast television, radio and newspapers saw revenues stabilize and, in some cases, return to growth. DBRS notes as part of the separate restructuring of Canwest Media Inc. and Canwest Limited Partnership (television and newspapers, respectively), these businesses were both recapitalized when Canwest Media Inc. was purchased by Shaw Communications Inc. (Shaw) and Canwest Limited Partnership was purchased by a group of unsecured creditors (Postmedia Network Canada Corp.). The Shaw transaction was followed by Bell Canada announcing its purchase of CTVglobemedia Inc.'s TV assets. The ratings of both Shaw and Bell Canada were confirmed with these acquisitions.

2011 Outlook – Communications, Neutral (with Some Possible Upside); Media, Neutral

DBRS is not expecting significant rating changes in 2011 as communications and media companies continue to benefit from stable, subscription-based business models, while advertising-dependent businesses have benefitted from economic stabilization, cost efficiencies and restructuring efforts undertaken in recent years. In communications, cable operators could see some possible trend changes as horizontal integration continues and cable operators benefit from good operating leverage with their bundled strategies. Any improvement in the ratings of cable operators would further close the rating gap between the telcos and the cable companies. Beyond this, DBRS expects a steady competitive environment between the telcos and cable companies for fixed-line services, while the wireless landscape continues to evolve with new players, including Shaw's newly launched wireless service in its territory.

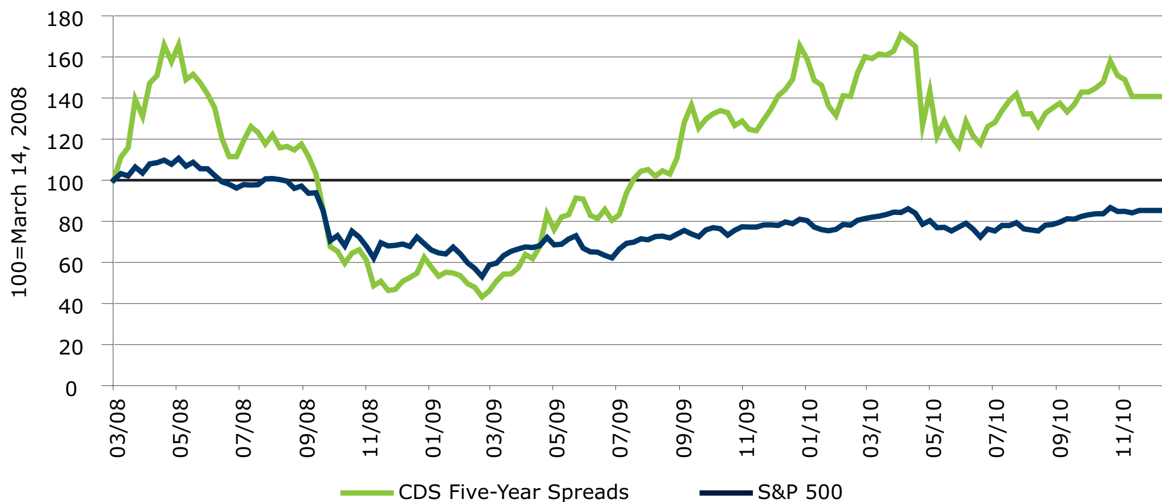
From a regulatory perspective, DBRS expects that Bell Canada's acquisition of CTVglobemedia Inc. will likely be approved and that the approach to regulating the vertically integrating communication and media industries in Canada will continue to evolve, along with regulations for new content distribution platforms such as wireless and the Internet. DBRS notes that important regulatory positions on foreign ownership in communications and spectrum rules for the 700 megahertz (MHz) wireless spectrum auction will be noteworthy developments in 2011 as they could affect the competitive landscape. Subscription growth at media companies is expected to remain relatively steady, while improvement in advertising revenue will remain tied to the economy.

Comments on Credit Spreads and Unemployment

To provide some additional background to future performance of the economy, the following views are presented on the important areas of credit spreads and unemployment.

CREDIT MARKETS OUTPERFORM EQUITY MARKETS IN A RECOVERY

Credit Default Swap (CDS) versus Equity Performance (as at December 31, 2010)



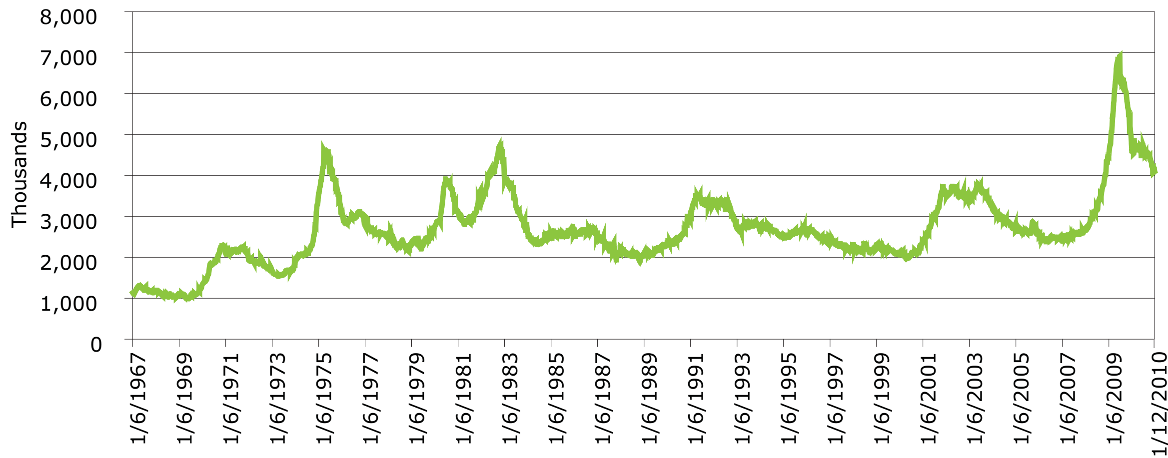
Source: Bloomberg.

The graph above illustrates the relative performance of both equity and credit markets since the collapse of Bear Stearns in March 2008. Equity markets are represented by the relative performance of the S&P 500, while the data for credit is represented by a 600-entity sample set of five-year credit default swap (CDS) performance.

Credit markets have significantly outperformed equity markets since the market bottom in March 2009. A variety of factors influenced this performance, including increased investor appetite for risk, rising spreads of government benchmarks and a return of the investor class. Clearly, in the recent recession, as illustrated above, the credit markets represented a leading indicator to the stock market and dramatically outperformed equity markets during this period. Volatility over the past three years was at unprecedented levels. The momentum from 2010 should continue throughout 2011, with the expectation of strong performance in the capital markets. The low interest rate environment should facilitate growth in the economy.

U.S. UNEMPLOYMENT CLAIMS BELLWETHER OF RECESSIONS

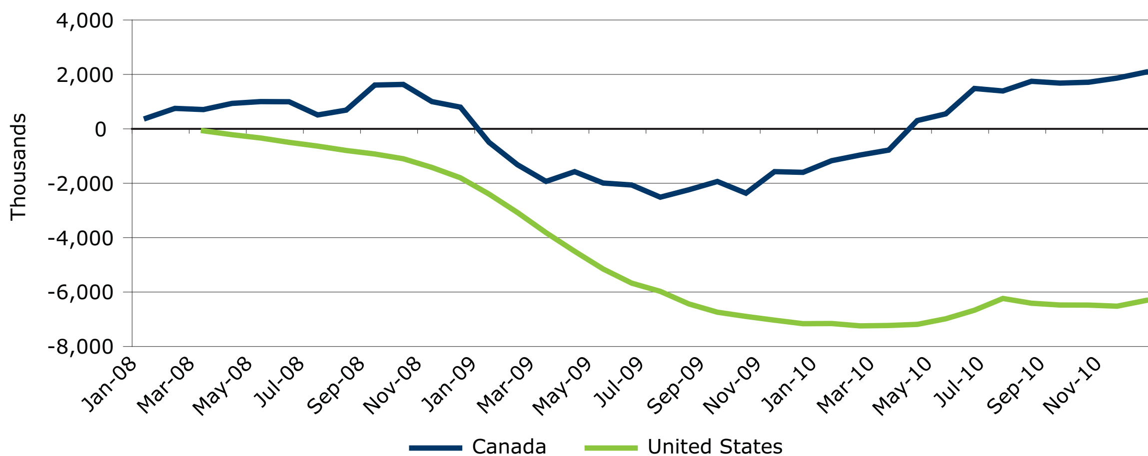
Continuing U.S. Unemployment Claims



Source: Bloomberg.

The graph above illustrates the movement of continuing U.S. jobless claims over the last 40 years. In each recessionary period, continuing jobless claims represent a leading indicator. The latest data show that the recovery in U.S. jobless claims is well underway, signaling an improving labour market. However, a full recovery in the United States to post-crisis levels is still several years away. Moreover, unemployment rates will likely stay well above historical norms for the foreseeable future. In contrast, as noted in the next graph, Canadian employment data is much healthier as employment levels are now above post-crisis levels.

Net Jobs in Canada versus the United States (January 2008 to December 2010)



Note: Canadian job numbers have been multiplied by ten to provide a better comparison with the United States.
Source: Bloomberg.

The graph above illustrates the rapid recovery in the employment numbers in Canada relative to the United States. Canada significantly outperformed the United States in recovery as the banking and real estate sectors were relatively unscathed during this recession. Note the acceleration of employment in Canada and the relative lack of direction in the U.S. employment picture. DBRS anticipates that it may take several years to close this gap.

Appendix

METHODOLOGY

The DBRS year in review is based on information obtained from DBRS's proprietary database and includes ratings from 1985 through December 31, 2010. The data set is limited to long-term corporate public and private ratings in all the sectors covered by DBRS except structured finance ratings. Upgrades and downgrades are tracked at the issuer level and, as such, where there are multiple long-term debt lines, only the issuer rating or the proxy for such (i.e., the senior unsecured debt rating) is used. Issuing subsidiaries and affiliates (together referred to as related entities) were removed from the data set in cases where there is a direct relationship to the rating of the parent. This can be the result of (1) a legal guarantee from the parent in support of the debt obligations of the related entity or (2) an essential business relationship between the parent and the related entity that exists such that the ratings of the related entity are predicated on the concept of implied support.

The objective of the aforementioned adjustment is to eliminate the impact of the migration of a series of ratings that are ultimately reliant on one entity. For all ratios related to upgrades and downgrades that include multiple ratings actions to individual credits, each rating change is treated as a separate event such that if the same entity is downgraded twice, this will be counted as two downgrades. When viewing industry-specific data, however, DBRS excludes multiple rating actions to individual credits; therefore, an entity experiencing multiple rating downgrades would only be counted once, providing a more accurate picture of the level of rating changes within an industry.

RATING CHANGES

Readers should note that, in general, downgrades outpace upgrades over the long term for three reasons:

(1) Many companies have a target credit rating that they believe provides optimal efficiency in balancing credit costs and credit availability with shareholder returns and there is often little incentive to achieve a higher rating. In other cases, credit ratings are limited by industry considerations, typically when the industry is highly cyclical, such that positive steps taken by an individual company may not be rewarded with a rating upgrade. These factors limit the overall upward migration of ratings in general.

(2) On the downside, corporate objectives may cause a company to take some risky actions that sometimes fail because of a variety of factors, including poor economies, planning or execution. When recessions occur, some credits suffer. In some cases, leveraged buyout actions dramatically add to the debt levels of an entity and cause rating downgrades. These factors create an inherent downward bias over the entire rating universe.

(3) It is not uncommon for an entity to experience multiple downgrades over a period of time as its credit profile weakens, but it is unusual for an entity to experience multiple upgrades over time, partly for the reasons noted in the first two points.

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