



Did Rogers Overpay in the Spectrum Auction?

Description

It was only three months ago that **Rogers Communications Inc** ([TSX:RCI.B](#))([NYSE:RCI](#)) emerged as the winner of a bidding war for NHL broadcasting rights. Yesterday afternoon, Rogers again emerged as the winner of numerous spectrum licenses. And once again, the company's victory came at a price.

Rogers paid \$3.3 billion for the "A block" in every major market. The number is more than three times what analysts expected Rogers to spend, and also accounted for a majority of the \$5.3 billion that the Canadian government raised from the auction.

It should not be particularly surprising that Rogers is acting ambitiously. Its wireless and cable businesses have come under a lot of pressure recently, showing practically zero growth. Analysts and investors have been unimpressed with the company – its shares trade at a discount to its large rivals, **BCE Inc** ([TSX:BCE](#))([NYSE:BCE](#)) and **Telus Inc** ([TSX:T](#))([NYSE:TU](#)). But the question remains, was \$3.3 billion too much to pay in an effort to reignite the company?

The total operating profit of Rogers' wireless business was about \$3 billion in 2013, so this spectrum cost Rogers more than its entire wireless operating profit for all of last year. But if the new spectrum can increase Rogers's operating profit in that segment by 10-20%, then the company will earn an acceptable rate of return on its investment.

Even without that rationale, Rogers executives could argue that the purchase was necessary from a strategy point of view. The 700 MHz spectrum band is much more able to penetrate walls & buildings, making the signal stronger in places like elevators and parking garages. That frequency is used by American carriers **Verizon** and **AT&T** in their networks. So even if Rogers does not see that 10-20% uplift, the company did at least block its large rivals, and thus may have prevented a decline.

There have also been concerns about what this purchase will do to Rogers' balance sheet. The company already has net debt of nearly \$11 billion, over 2.3 times its shareholders equity. But Rogers is of course very profitable, and its subscription-based revenue model makes its earnings profile relatively smooth. Thus the company is perfectly capable of handling such a debt load, which only represents about 50% of its market capitalization. The spectrum purchase would bring that number up

to 65%.

Foolish bottom line

Most people seem unimpressed with the company's purchases. The shares opened trading the following morning down 3%. But with such a strong strategic rationale, and a manageable price tag, it's still too early to pass judgement.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:BCE (BCE Inc.)
2. NYSE:RCI (Rogers Communications Inc.)
3. NYSE:TU (TELUS)
4. TSX:BCE (BCE Inc.)
5. TSX:RCI.B (Rogers Communications Inc.)
6. TSX:T (TELUS)

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