

2G auction fails; Spectrum price could be lowered

The much awaited 2G spectrum auction in 1800MHz band ended in just two days (total 14 clock rounds), with DoT managing to sell only 102 out of 176 available blocks and garnering merely Rs94bn, as against the targeted amount of Rs400bn.

2G auction finds either no bidders or bids at base price only: Circles, like Mumbai, Delhi, Karnataka and Rajasthan, did not receive any bids at all. Combined reserve price of these 4 circles was Rs17.7bn per block, which is about 50% of the pan-India reserve price. In other circles, the winning bids were at base price, except for Bihar, where it was 9% higher than base price.

Idea buys spectrum in all 7 circles: Idea managed to buy spectrum in all the 7 circles where the Supreme Court had cancelled its licence for a consideration of Rs19.6bn. Idea also bought an additional spectrum block in the Bihar and West Bengal circles for Rs723mn, resulting in total outgo of Rs20.3bn.

Selective buying by Bharti & Vodafone and new entrants: Bharti bought only one block of spectrum for Rs87mn in Assam, whereas Vodafone bought extra spectrum in 14 circles (see Exhibit 1). Among new operators, Telenor and Videocon secured spectrum in six circles each for a total Rs40.2bn and Rs22.2bn.

DoT could approach TRAI for lowering base price: Media reports indicate that DoT is likely to approach TRAI for taking a relook, and possibly making a downward revision to the base reserve price for 2G spectrum. The failure of 2G auction has created various issues as there is now (1) no market determined price for GSM spectrum in four circles (2) no market determined price for CDMA spectrum in any of the circles (3) No demand at current base price, as not all available blocks were sold in any of the circles (except Bihar) and (4) no fair method to arrive at the price for re-farming in 900Mhz, excess spectrum, and spectrum "liberalisation".

Downward revision of 2G spectrum pricing to benefit industry: We believe any re-pricing of 2G spectrum will be positive for the industry, which is already suffering from stretched balance sheets, limited pricing flexibility and low payoffs from 3G/4G investments. Since pricing for the 2G auction was meant to act as a benchmark for deciding the pricing for all other spectrums (like re-farming of 900MHz band, penalty of excess spectrum beyond 6.2MHz, conversion of allotted spectrum to "liberalised" spectrum, and license renewal cost), any downward revision will have a positive cascading effect on all aspects of spectrum pricing.

Valuation: We believe the failure of 2G auction has resulted in current reserve price (Rs35bn per block pan-India) becoming a price ceiling for spectrum, rather than a price floor. Any lowering of 2G spectrum price will benefit Bharti and Idea, as the impact on their balance sheet will reduce, due to decline in future payoffs for license renewals, spectrum re-farming, and excess spectrum penalty. Bharti trades at 7x FY13 EV/EBITDA; maintain Add with a TP of Rs305. Idea trades at 6.6x FY13 EV/EBITDA, maintain Add with TP of Rs90.

Peer valuation

(Rs bn)

| Company | CMP (Rs) | Net sales | | | EBITDA | | | Net profit | | | EV/EBITDA (X) | | P/E (X) | | Rating |
|---------|-------------|-----------|-------|---------|--------|-------|-------|------------|-------|-------|---------------|-------|---------|-------|--------|
| | | FY13E | FY14E | FY15E | FY13E | FY14E | FY15E | FY13E | FY14E | FY15E | FY13E | FY14E | FY13E | FY14E | |
| Bharti | 283.0 | 804.4 | 902.0 | 1,006.7 | 252.3 | 299.2 | 348.1 | 37.3 | 65.6 | 85.0 | 7.1 | 6.0 | 28.8 | 16.4 | ADD |
| Idea | 92.2 | 219.3 | 251.5 | 283.5 | 58.6 | 70.5 | 80.2 | 9.7 | 13.9 | 17.0 | 7.4 | 6.2 | 31.5 | 22.3 | ADD |

Source: BRICS Research

Exhibit 1: 2G spectrum auction

(Rs mn)

| Circle | Reserve price/Block | Final winning price | Total Blocks sold | Winners | Remarks |
|-------------|---------------------|---------------------|-------------------|---|---|
| Bihar | 425 | 464 | 11 | Idea (1), Videocon (4), Vodafone (2), Telenor (4) | Winning price at 9.2% premium to base price |
| AP | 2,869 | 2,869 | 4 | Telenor (4) | Winner at base price only |
| Assam | 87 | 87 | 7 | Bharti (1), Idea (4), Vodafone (2) | Winner at base price only |
| Gujarat | 2,248 | 2,248 | 8 | Telenor (4), Videocon (4) | Winner at base price only |
| H.P. | 78 | 78 | 1 | Vodafone (1) | Winner at base price only |
| Haryana | 465 | 465 | 6 | Vodafone (2), Videocon (4) | Winner at base price only |
| J&K | 63 | 63 | 6 | Vodafone (2), Idea (4) | Winner at base price only |
| Kerala | 653 | 653 | 1 | Vodafone (1) | Winner at base price only |
| Kolkata | 1,137 | 1,137 | 4 | Idea (4) | Winner at base price only |
| M.P. | 540 | 540 | 6 | Vodafone (2), Videocon (4) | Winner at base price only |
| Maharashtra | 2,628 | 2,628 | 5 | Telenor (4), Vodafone (1) | Winner at base price only |
| North East | 88 | 88 | 6 | Idea (4), Vodafone (2) | Winner at base price only |
| Orissa | 203 | 203 | 6 | Idea (4), Vodafone (2) | Winner at base price only |
| Punjab | 673 | 673 | 1 | Vodafone (1) | Winner at base price only |
| Tamil Nadu | 3,061 | 3,061 | 4 | Idea (4) | Winner at base price only |
| UP-East | 762 | 762 | 9 | Videocon (4), Vodafone (1), Telenor (4) | Winner at base price only |
| UP-West | 1,074 | 1,074 | 10 | Videocon (4), Vodafone (2), Telenor (4) | Winner at base price only |
| West Bengal | 258 | 258 | 7 | Idea (5), Vodafone (2) | Winner at base price only |
| Delhi | 6,931 | | 0 | | No bidder |
| Mumbai | 6,785 | | 0 | | No bidder |
| Karnataka | 3,301 | | 0 | | No bidder |
| Rajasthan | 671 | | 0 | | No bidder |

Source: DoT, BRICS Research

BRICS RECOMMENDATION SCALE

| | |
|----------------|--|
| BUY: | More than 15% upside |
| ADD: | Upside up to 15% (between 0% and 15%) |
| REDUCE: | Downside up to 15% (between 0% and -15%) |
| SELL: | More than 15% downside |

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