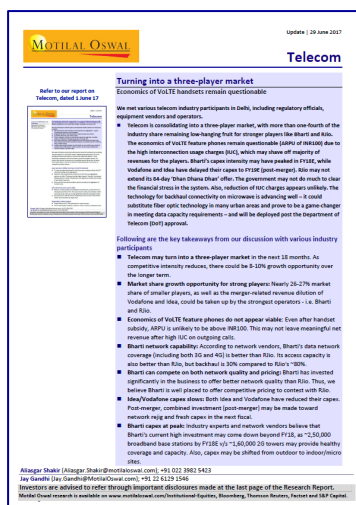


Kindly refer our earlier report published in June 2017



Freebies to taper off in near future

Low-priced VoLTE smartphones in focus; capex shifting toward backhaul

We conducted a series of channel checks with telecom channel partners and network vendors. Key takeaways:

- Incumbents are witnessing an increase in distributor/dealer churn (due to a fall in their revenues) post the service launch by RJio. Low commission is another reason – As we understand, the new operator is offering almost double commissions compared to the incumbents and is also aggressively ramping up front-end resources.
- The distribution network expects the freebies offered currently to taper off over the next 2-3 quarters, with commissions directly linked to recharge amounts.
- Supply of VoLTE feature phones is short, impacting offtake.
- Bigger handset players are less keen on producing VoLTE feature phones, given (a) the weak value proposition (low 4G data managing capability and user interface) and (b) the limited pricing price arbitrage compared to VoLTE smartphones. The focus is on reducing the VoLTE smartphone price to promote wider acceptance.
- To optimize their existing data network and increase traffic management capability, telcos are shifting their capex from cell sites to backhaul and network-optimizing products. This could significantly reduce capacity bottlenecks and increase capacity at a non-linear rate. Among incumbents, we understand that Bharti and Vodafone are investing aggressively.

Key points from our discussion with telecom channel partners

- **New operator offering nearly double distribution margin...:** RJio is paying ~6.5% retailer/dealer margin and ~2.5% distributor margin. This is much higher than the retailer margin of ~3.5% and the distributor margin of 1.75-2% offered by the incumbents.
- **...and aggressively ramping up marketing/sales functions:** We note that the new operator is aggressively increasing its in-house marketing team, with ~4-5x more company centers than incumbents to cater to distributors.
- **Incumbents' distributor churn rising:** Incumbents' distributor/dealer churn is increasing due to a 25-30% drop in distributor/retailer revenues since RJio's service launch.
- **Distribution network expects freebies to taper in 2-3 quarters:** The new operator's distributor/retailer recharge values are low currently due to the freebies (recharges with validity of 2-3 months). However, channel partners indicate that, over the next two quarters, freebies will be reduced, increasing distributor/retailer turnover.

Aliasgar Shakir – Research analyst (Aliasgar.Shakir@motilaloswal.com); +91 022 6129 1565

Hafeez Patel – Research analyst (Hafeez.Patel@MotilalOswal.com); +91 22 6129 1568

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- **TV viewing could increase on RJio:** Dealers are witnessing healthy inquiries for INR309/509 plans, which will allow 3-4 hours/6-7 hours of TV viewing via RJio connectivity.
- **VoLTE feature phone supply shortage:** VoLTE feature phone supply visibility is weak due to no update on delivery dates or new orders. Also, there is lack of clarity on delivery logistics – whether handset delivery and partial payment recovery will be done via company or retailer.

Key points from our discussion with a leading device manufacturer

- **Device manufacturers not keen on VoLTE feature phones:** VoLTE feature phones are priced at INR800-1,000 and VoLTE smartphones at INR5,000. Thus, according to the device manufacturer, instead of investing effort in producing VoLTE feature phones, the industry is working on reducing VoLTE smartphone prices to bridge the pricing gap.
- **Low-priced VoLTE smartphones in focus:** VoLTE smartphones priced in the INR5,000-7,000 bracket have the highest offtake in terms of shipment.
- **Low-ticket Lyf phones out of focus:** RJio's VoLTE smartphone (low-configuration) priced at ~INR3,000 were shipped far before the actual service launch, turning obsolete in a high configuration requirement. They have now been largely discontinued.
- **VoLTE feature phone a temporary make-shift arrangement:** VoLTE feature phones should witness limited offtake after the initial euphoria due to their weak configuration and limited data managing capability (processor and RAM, small-screen size).
- Increasing smartphone penetration had forced manufacturers to reduce device prices during 2010-11. A similar trend of price cuts is playing out now with rising demand for VoLTE smartphones.

Key points from our discussion with a network vendor

- **Investment shifting from front-end site addition to backhaul/network optimization platforms:** Investment is shifting from cell sites to optic fiber at the backhaul (transport level and expanding packet core, and self-organizing network or SON). SON optimizes network capacity based on data traffic and specific quality requirements. Telcos are aggressively investing in such products to optimize the existing data network capability and increase the traffic management capability.
- **Among incumbents, Bharti and Vodafone are taking the lead:** Bharti is aggressively investing in SON to improve traffic management (data) and also backhaul capacity with Cisco. Vodafone is also preparing actively – it remains the most agile and focused in terms of capacity expansion on the access and transport side.
- **VoLTE – a stable long-term technology:** VoLTE feature phones also have 2G RAN capability. Thus, it allows 2G voice and data usage. VoLTE calling is significantly superior, though. As VoLTE network service improves, it will start seeing consumer preference toward VoLTE calling.

- **Quick VoLTE launch is critical for growth:** For incumbents, the time period required to launch the VoLTE feature phone is critical, as it would also take some time to smoothen and streamline the network. The new operator's capacity investment is ahead of incumbents. Thus, aggressive investment here is critical.
- Vodafone and Idea have not accelerated cell site investment, despite the CCI and SEBI approvals. However, there are indications that they will soon start doing so.

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