

Reliance Communications Limited

Launches sub-US\$20 handsets; short term positive for net-adds but likely at the cost of margins - ALERT

- **RCOM introduces sub-US\$20 handsets.** RCOM has launched three new CDMA handset models under its own 'Classic' brand. However, unlike its other offers, these handsets do not come with any 'bundled' (on-net) minutes. We note that the cheapest 'Classic 202' model (Rs777 [US\$18.5], black & white) is priced 22% below the CDMA rival Tata Tele's (TTSL) Rs1075 'handset-only' offer, 40% below the cheapest GSM handset (Rs1300, Motorola) and 55% below the cheapest Nokia GSM handset (Rs1700) available in the market.
- **Net-adds to get a temporary boost but at the cost of margins.** The company has indicated (without specifying the quantity) that the stock of such handsets is limited. Given zero free minutes, sub growth under this offer will likely have a salutary impact on rate of ARPU decline. Nonetheless, 'cash' handset subsidy will probably increase to US\$15-20 levels from US\$5-6 currently; cost of the cheapest CDMA handset currently hovers around US\$35. We note RCOM reports its handset subsidy cost within the segment called 'Others' and not within the 'wireless' segment. We have forecasted ~1.2 mn monthly wireless net-adds (incl. GSM) for RCOM over FY2008-09.
- **TTSL could face some heat from RCOM's move.** Given basic product similarity (customers tend to get locked-in to the CDMA operators given lack of handset fungibility), we believe TTSL's net-adds and/or subsidy cost could get adversely impacted.
- **GSM growth driven by 'used handsets' could also get impacted.** For GSM operators, we believe the impact would be felt more on the incremental growth driven by 'used handsets'. Low-end used GSM handsets are available within the 'Classic price band' of Rs800-1200. Furthermore, RCOM is positioning its new handsets as an alternative to the 'used GSM/CDMA handsets'. Our channel checks indicate that Nokia is even more dominant in the used handset market. However of late, the supply of 'used' Nokia GSM handsets has been impacted because of the decline in Nokia's entry level handset pricing to Rs1700 (US\$40) from Rs2200 six months ago (prompted by Motofone pricing of sub-US\$35). GSM customers are yet unwilling to part with their Nokia handsets at the reduced price points of sub-Rs1000 led by the decline in prices of low-end Nokia handsets.

Neutral

Rs477.10

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Wireless Services

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RCOM: Classic range of handset models

Handset models	Rs	US\$
Classic 202	777	18.5
Classic 204	844	20.1
Classic 203	888	21.1

Source: Company website

Figure 1: RCOM: Classic 202 handset



Classic 202

Source: company website

Figure 2: RCOM: Classic range of handset models



Source: Company website.

Figure 3: Tata Indicom Handset (Motorola W 150i)



Source: Company website.

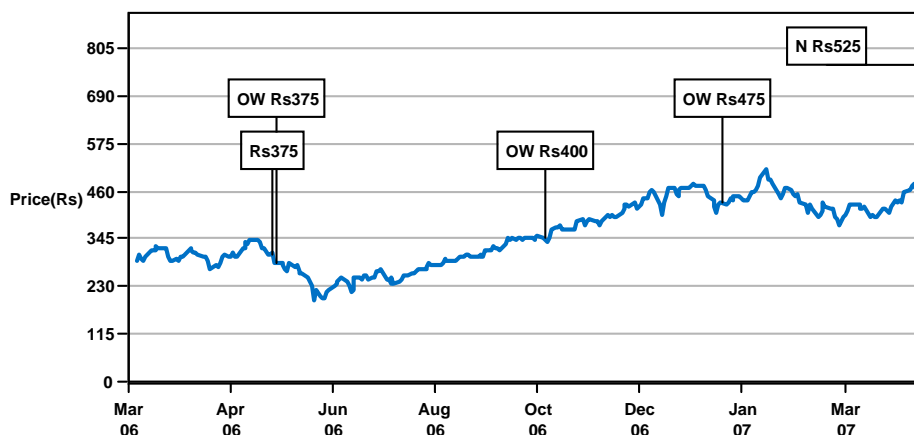
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Reliance Communications Limited (RLCM.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
19-May-06	OW	285.40	375.00
10-Oct-06	OW	347.50	400.00
13-Jan-07	OW	433.75	475.00
02-May-07	N	477.10	525.00

Source: Reuters and JPMorgan; price data adjusted for stock splits and dividends.
 Initiated coverage May 19, 2006. This chart shows JPMorgan’s continuing coverage of this stock; the current analyst may or may not have covered it over the entire period.
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