Who suffers most from Rakuten's launch? It's not who you'd think.

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Rakuten's launch as a 4th MNO in Japan is among the most widely anticipated near term events in global telcos. But the impact is not well understood in our view. Market dynamics are opaque, and as a result many investors are overemphasising the anticipated turmoil among the established incumbents in our view. In order to try to clarify the likely impact we carried out a proprietary survey of 1,000 Japanese mobile users. We conclude two things: disruption (at least initially) is probably not particularly substantial and the company most likely to be affected in our view is DOCOMO. Softbank looks well protected, and has multiple levers to pull to continue to grow profits and the dividend through the initial launch phase.

Whilst we published the results of our survey in 3 separate notes (HERE, HERE and HERE) in this short blog we wanted to draw our conclusions together from these pieces.

Key thoughts from the survey are:

1. The overall price & revenue threat is lower than many investors think as Japan's premium ARPU compared to other developed markets is predominantly a function of usage: based on our survey average usage in Japan is 7.4GB/pop/month, in line with other Asian countries such as Hong Kong and South Korea, but well ahead of most European or US markets. Price per GB is therefore in line with other developed markets and Japanese incomes. DOCOMO prices (even after the recent cuts) are still a premium to KDDI & SB. ARPUs are rising because the strategy of giving a lot more for a little more is working: most customers are still on low usage packages, but average usage is skewed by c. 15% on very high usage packages. However, the ARPU of these customers is only slightly above average. Nevertheless this means the operators are successfully monetising rising data demand. This explains why we are going into Rakuten's launch with improving growth trends, something we think bears on the market are ignoring. DOCOMO's pricing however, remains at a premium to KDDI and SB. While DOCOMO has clearly stickier and less price sensitive customers this represents a risk to the market leader we think.
2. A new entrant must have both seamless network quality and be truly radical on price. An offer of 15-20% cheaper service or a perception of weaker network quality is unlikely to garner many customers. Japanese consumers are not price sensitive and rate network quality highly. We already see this with the MVNOs who struggle to add customers despite ARPUs 50% below the incumbents, and perceived network quality that is similar (after all they are largely on DOCOMO;s network). As a result of the survey we think the MVNO business model is unsustainable. MVNO customers have a high opinion of Rakuten as a brand and we think this combination of factors means that these c. 10m customers will likely provide Rakuten with the core of their low end base. Most are currently with DOCOMO, so this represents a substantial risk to the price leader.
3. The overall ecosystem that Softbank has created with Yahoo! Japan puts them in a stronger position to defend against likely radical pricing from Rakuten than the other MNOs. We suspect that Rakuten's attempt to win customers at the top end will revolve around a "free" offer for customers spending more than ¥20,000 per month on their Ichiba e-commerce site. But our survey suggested only c. 6-7% of Softbank's revenue is generated by customers spending this much on a monthly basis with Ichiba, compared to roughly double that for DCM and KDDI. We expect this integration to rapidly accelerate in coming months once the deal to take control of YJ closes, suggesting that when Rakuten launches this gap may be wider. Furthermore, both KDDI and SB have managed to successfully segregate more price sensitive customers on to their sub-brands (UQ and Y!Mobile respectively). The lack of a sub-brand for DCM is a real weakness we think as price competition intensifies.

The set up in Japan is fascinating. Revenue growth is improving for sustainable reasons we think, as the operators are successfully monetising the move to near-unlimited offers. The market is anticipating revenues to come under substantial pressure when Rakuten launches, yet we see risk of delay and a limited geographic network initially. Japanese consumers are not price sensitive and those susceptible to radical offers at the high end or price sensitive towards the low end are not weighted towards the company investors are most bearish about: Softbank. It is possible the impact to Softbank in early 2020 is marginal at worst, while a working capital squeeze (HERE), gradually reducing capex (HERE), the iPhone air-pocket (HERE), limited price cutting (HERE), the potential for accretive acquisitions in a zero interest rate environment (HERE), and cost cutting (HERE), all suggest profits could be well ahead of expectations. This in turn suggests the potential for a meaningful share price squeeze we think. KDDI has the roaming deal which offsets the likely impact in the early years. This means DCM, with its MVNO base, lack of a sub-brand and premium pricing is most exposed to Rakuten risk. Nevertheless, we remain comfortable with our Buys on all the Japanese telcos plus Rakuten.
