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Virgin Mobile Aims Low

Carrier's Prepaid Plans Make Inroads Among Budget-Minded

BY ROGER CHENG

Virgin Mobile USA Inc. may benefit from an incoming wave of wireless customers looking to escape high monthly bills and annual contracts.

The company, which resells wireless service on a prepaid basis, has always gone after a younger, budget-conscious crowd. That should play well as more people try to save money—a change in consumers' spending attitudes that many believe represents a permanent shift.

"It's not just a retrenchment," Chief Executive Dan Schulman said in an interview. "We've had enough of a shock to the system that consumers are fundamentally rethinking how they spend and what they spend on."

Last month, Virgin Mobile, based in Warren, N.J., released preliminary fourth-quarter subscriber numbers that exceeded expectations, a nice first step toward recovery after it struggled through most of 2008.

Nonetheless, Virgin Mobile stock is still stuck below $1. Its shares rose four cents to 82 cents in New York Stock Exchange trading Monday.

"What Virgin Mobile has done well is target customers," said Rory Altman, a partner at telecom consultancy Altman Vilandrie & Co. "Now is a good time to be prepaid."

It won't be easy going for Virgin, though. With the vast majority of consumers already sporting a cellphone—or two—industry observers see a fierce battle at the low end for prepaid customers. **Sprint Nextel** Corp.'s Boost unit fired the first salvo last month—a $50 flat-rate plan with no contract—leaving other low-end competitors to react.

In addition, Virgin's model—having customers pay in advance for just the minutes they want to use—could take a hit if people shorten calls and cut back on text messages.Meanwhile, Virgin's recent acquisition of Helio LLC gives it a niche postpaid wireless service at a time when people are shying away from contracts. The company has introduced more traditional monthly plans that have helped prop up average revenue per user, and some believe Helio may ultimately be a useful tool to keep customers on Virgin's service.

Virgin is in a tough spot. Flat-rate prepaid services from MetroPCS Communications Inc., Leap Wireless International Inc. and Boost are pressuring it from the low end.

Analysts are looking for a price war to break out. But many believe Virgin is ill-equiped to handle a competition over cheaper rates because of its wholesale agreement with Sprint Nextel. Virgin buys and resells wireless minutes, so the company can't drop its rates below what it pays and still make money.

But Mr. Schulman notes that Virgin did a good job of renegotiating rates after the close of the Helio acquisition, and again at the end of the year. The expected network operating costs this year are down 10% from 2008, he said. If a price war does occur, Virgin is working from a lower cost base to begin with.

One positive byproduct of the lower prices will be an opportunity for the company to take market share from larger carriers. "There will be some postpaid customers moving to prepaid," said Charles Golvin, an analyst at Forrester Research.

Sprint and T-Mobile USA are seen as the most vulnerable. Sprint is already losing customers at a rapid clip, and T-Mobile, a unit of **Deutsche Telekom** AG, shares the same demographics.

Virgin also faces the prospect of lower revenue from customers that are paying for fewer minutes each month. But that hasn't come as a surprise to the company, which struggled with the problem all last year. The company is looking at "hybrid" plans that look more like monthly plans, but without a contract, as a source of stable revenue growth. These plans include a certain allotment of minutes and unlimited weekend and night calling.

"We've built into our expectations a decline in minutes per user in traditional prepaid services, which is more than offset" by the shift to hybrid plans, Mr. Schulman said. The plans have gained popularity, and they make up half of the most recent subscriber additions. As a result, the company expects continued improvement in average revenue per user.

Virgin bought fellow wireless reseller Helio in August for $38 million in stock. It was looking to take advantage of Helio's contract business model, 3G services and snazzy handset lineup to create a service that Virgin subscribers could "graduate" into if prepaid no longer suited them.

"Helio gives them the infrastructure for a postpaid plan," Mr. Altman said. "They have the ability to reposition the Helio product for subscribers as they mature."

But analysts believe the migration will be downward rather than up to higher-end services.

That leaves Virgin with a niche brand that didn't have many subscribers to begin with. Indeed, Mr. Schulman played down Helio's presence and ability to grow. "I don't see Helio as being a massive part of our gross adds going forward," he said.

Instead, Mr. Schulman focused on the balance sheet. Helio was a relatively cheap purchase, considering that **Virgin Group** Ltd. and **SK Telecom** Co. each invested an additional $25 million into the business, allowing Virgin Mobile to refinance its debt. SK Telecom owned Helio.

Critics last year were worried about Virgin Mobile's debt-covenant problems. That was partly why the company's shares took a tumble and have spent the last four months below the $1 mark. Mr. Schulman believes the deal quelled many of those fears. "Those issues have gone away," he said.