

Tonse Opinion

How NMS lost its way amidst Consolidation in VAS Infrastructure sector

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Disclaimer

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Indian VAS Market Background:

Invariably every reader of this story would have experienced Ring Back Tones or some form of mobile VAS services at some point. This article uncovers the unknown world of companies that lie deep in the belly of the telecom infrastructure world, enabling the hundred of mobile VAS applications such as RBT and how some of them struggle to get out of the intensely competitive world and fail. This is not about the Mobile VAS companies that typically develop the application software but the companies that build the underlying VAS enabling infrastructure.

As the Indian telecom market continues to build out impressively now adding about 10 million subscribers, with a large bulk of it being in the wireless sector, it continues to attract new investors, new operators, new licensees and new VAS developing companies wanting to enter Indian mobile market. The VAS have now become a staple revenue generator for mobile operators and are a lifestyle icon for many millions of subscribers while undeniably a productivity enhancing tool for many others. Most of these services are running on dedicated / VAS enabling infrastructure which has its beginnings in the CTI world {computer telephony integration} industry. A typical VAS suite that is deployed in a network at a high level may be represented as shown elsewhere in this article.

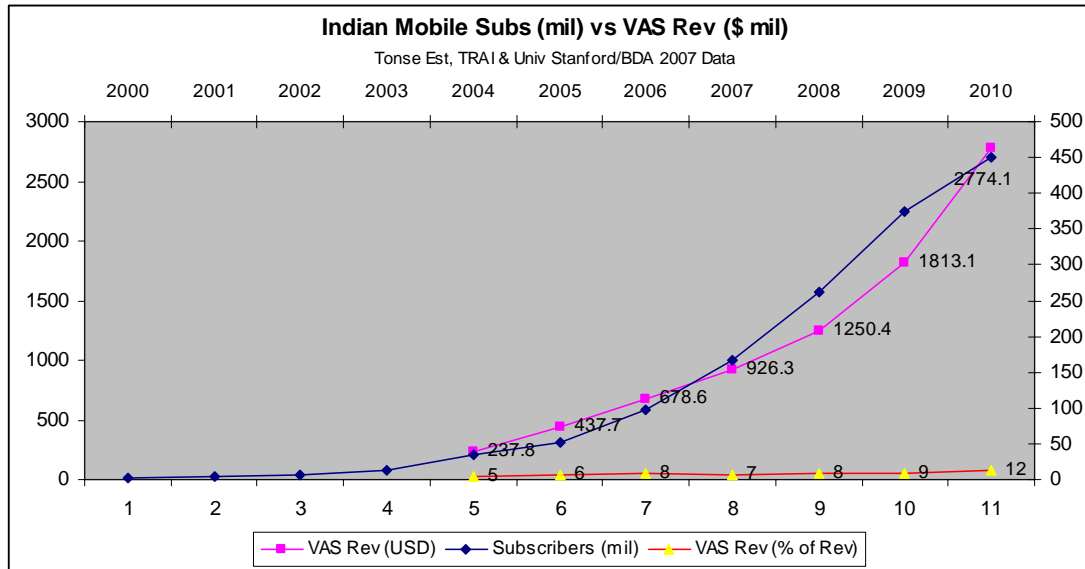


Fig 1: India Mobile Subscribers Vs. VAS Revenue graph

The graph included above is an indication of the current and expected growth of the Indian mobile market with respect to subscriber base by 2010. Tonse Telecom estimates that the Indian mobile subscriber base will be in the range of about 450 million by 2010 and the overall subscriber base (including Fixed line subscribers) will likely be around 500 million (not shown in the graph). The graph also depicts the current size of mobile VAS revenues as estimated in a study by University of Stanford together with BDA in Dec 2007 and is depicted to be about \$ 926 million (as of 2007). The VAS revenue as a percentage of the overall revenues for a typical Indian mobile operator is still perhaps low on a global plane compared to some of the large global mobile operators. However it is poised to increase further. As shown the mobile VAS revenue will become increasingly important to operators and ISVs. This is a widely discussed topic and will not be covered here.

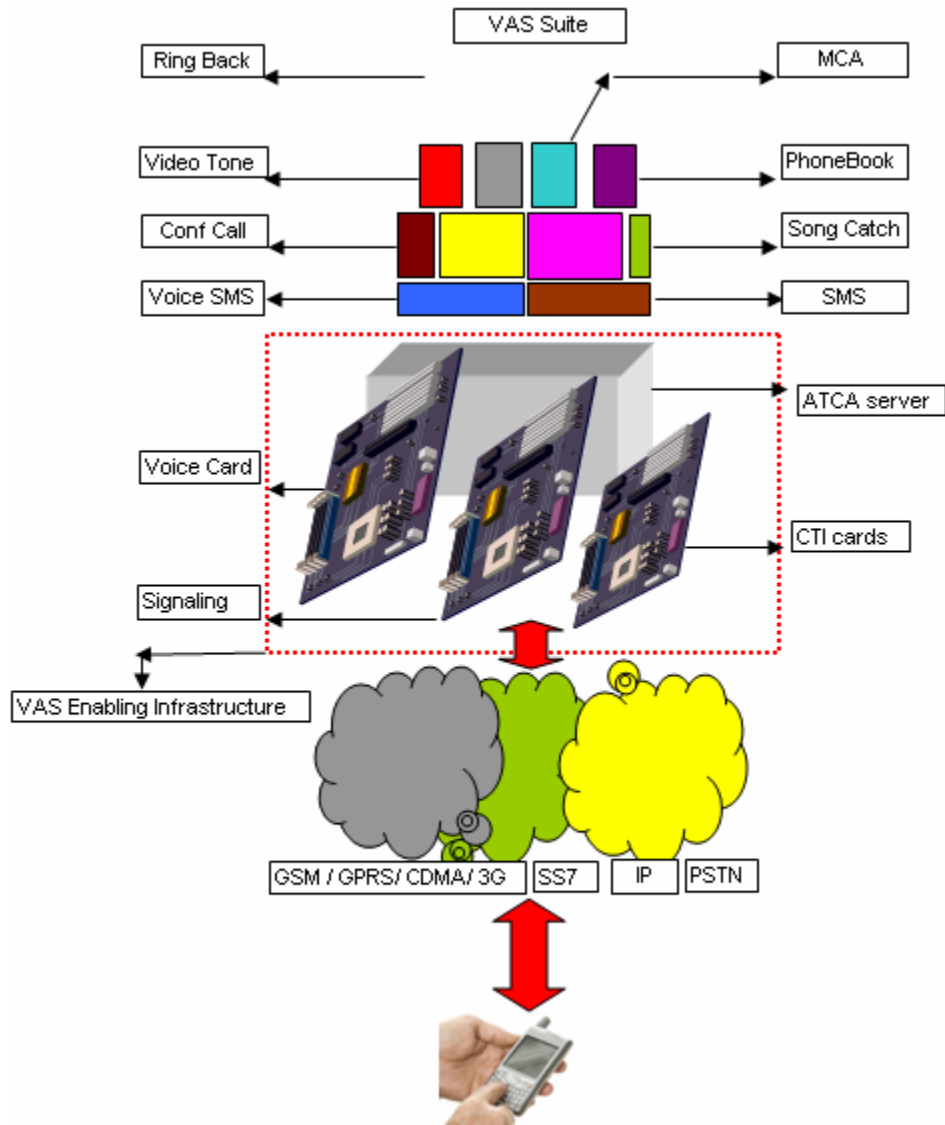


Fig 2: Network schematics showing VAS enabling infrastructure

The VAS Enabling Infrastructure Layer:

Along with the growth of VAS services business, the underlying VAS Enabling Infrastructure is also a rapidly growing business but is governed by a different set of drivers due to the nature of hardware business that it is. The most popular companies in this space that are dominating the landscape are NMS Communications, Dialogic, Audiocodes, Donjin, Aculab.

In the international market, these players are of course visible but are accompanied by an even larger array of card vendors such as Adax and even more important platform / solution vendors

such as Tietonator, IntelliNet Technologies, Roamware, HP via its Open Call platform, Ulticom and several other players with some variation in their solution offerings.

The segment called VAS Enabling Infrastructure is typically the domain of companies such as NMS, Dialogic and several others. The range of solutions include both hardware cards, software solutions, developer frameworks, programmable switches, and software APIs, signaling frameworks that are provided today reflect a phenomenal growth that has taken over this sector over the last ten plus years.

What's at the heart of the VAS enabling layer?

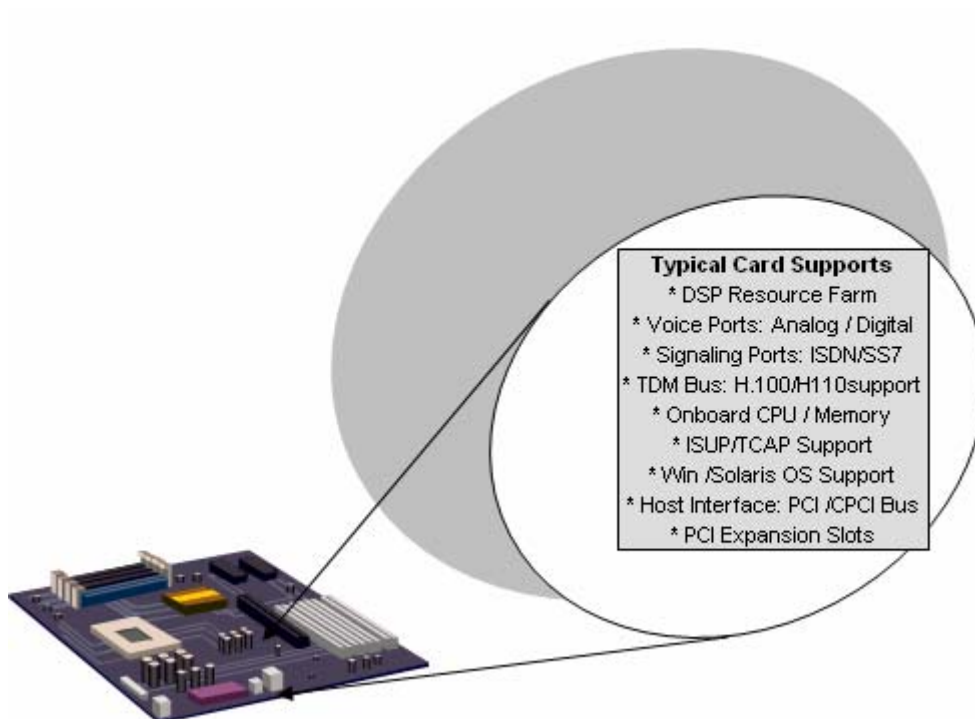


Fig 3: VAS enabling layer

VAS Enabler market in India

Generally speaking, the pure play CTI cards market is well past its prime and has matured in the large Western markets. Companies such as Dialogic, NMS Communications grew significantly during the 90s as they found their niches as Switch adjuncts in the Circuit switched world and as IVR solution / IN service environments for both wireless and wired networks. They also dominated the enterprise communications space significantly over the decade in the form of IP-PBX enablers, Enterprise IVR solutions, ACD and International IP call back solutions. As large Western markets matured, these companies found nascent Indian market a fantastic opportunity

to sell their wares. India, for example provided the most fertile high growth opportunity through the beginning of this decade as the cellular market had begun its hockey stick growth, enterprise communications was all set to kick-off and VAS market was just about to bloom.

By some estimates, card vendors' total market in India was just about a \$2 - \$3 million as early as 2002. It then started doubling annually as the Indian VAS market kicked off to a great start and was about \$10 million by 2005. By the following year, large deals kicked into the market as big VAS ISV s such as Bharti Telesoft, OnMobile, Cellebrum, One97 and others started bulk ordering of Cards / Chassis/ hardware spares for fast replacement / signaling software and Application frameworks for rapid VAS service creation.

In one specific case, a large VAS ISV placed a \$ 10 million hardware cards order in 2007 which was the single largest card deal in the VAS space. The fortunes of the card vendors changed rapidly as back at the Headquarters the parent companies of NMS / Dialogic and other such companies realized that while their native markets were suddenly less attractive than distant high growth Asian markets. By 2006 / 2007 most of these card vendors had significantly strengthened their India presence with robust channel partners who would scout deals from VAS ISVs / carriers and network operators to push card sales. By 2007 it was clear that India would be the next big market for these products.

Tonse estimates that the discreet CTI cards business in India (including analog / digital voice cards / signaling cards with relevant software) should be in the range of annual run rate of about \$30 - \$40 million. This is a phenomenal growth for a business that was only a couple of million dollars in value in 2002 but lost that it is in the hype of the mobile application space, this success story is hardly talked about. Thus the mobile VAS market has fuelled a great opportunity for the enabling layers.

Consolidation in the Mature VAS Enabling industry:

While the hardware cards business has been growing globally it is important to note that the sector has seen intense consolidation over the last 4 years or so. Falling margins, volume driven sales, mature market, negotiating leverage of the carriers and general health of application developer sector has resulted in buy-outs / acquisitions in a bid to strengthen market positions.

Some of the leaders in this space have constantly strived to differentiate themselves by attempting to deliver higher value proposition. Some companies such as NMS Communications

either continuously enhanced product offerings or acquired fine complementary technologies or both to deliver more.

Yet upon closer observation it appears that some of the large bets that companies made in acquiring firms or technologies and later sold with very little financial gains to show. In fact, there were several M&As in the period between 2003 and 2008 in the sector some of which are shown in the table below.

Transaction	Bought In / For \$	Sold In / For \$	Comments
Lucent bought	1999 Aug	2006 Aug	Sold for undisclosed sum
Excel Switching	\$1.7 Bil in Stock	In crisis situation - sold Excel to Pvt Equity firms for undisclosed sum	but believed to be at a low fraction of \$1.7B it was bought for
Intel bought Dialogic	1999 Jun	2006 Aug	Sold for undisclosed sum
	\$780 Mil	Sold to Eicon - Dialogic was about \$200mil Rev and about 600 people	but believed to be low
Brooktrout Technologies founded in 1984. Not profitable till 1990. Listed in 1992. Sales Rev of \$ 128 mil in 1999		2005 Aug Sold to Excel for \$173mil	At time of acquisition by Excel, Brooktrout had a Rev of \$80Mil with a Net loss of \$1.5 mil By Oct 2007, Dialogic acquired Excel, Brooktrout and Cantata via EAS, a PE holding company

Table 1: Examples of high value M&A in VAS infrastructure

NMS and Dialogic: Divergent paths over a decade

NMS and Dialogic took two different routes along this path. Dialogic got acquired and became a part of a large global corporate: Intel till it became free again as a part of Eicon in 2006. With Eicon, renaming itself Dialogic some semblance of independence showed up again at Dialogic. Then in one big sweep Dialogic acquired Cantata Technology, Brooktrout and Excel Switching to consolidate its position in the base CTI platform, media server, signaling solutions space.

NMS meanwhile continuously attempted to differentiate its solution offerings from pure play CTI cards suite to attempting to build more media streaming capabilities / message handling capability by acquiring small technology firms and integrating that technology into its offerings. There are several firsts to the credit of NMS as it built a phenomenal enabling engine and kept the focus on software driven innovations to move higher up the chain in the business. Looking at the nature of transactions from March 2006 onwards it is almost apparent that NMS was looking to move away from hardware business and find a new world of software enabled VAS as its new home. Its acquisition of Openera Technologies, a Bangalore based IMS Client developer for devices, was a harbinger of things to come. Toward end of the same year, NMS sold off its Access Gate solution to Verso for small amount of \$3.35 million.

In March 2008, Livewire, NMS' mobile personalization services business acquired Groove Mobile – a leading developer of managed mobile music solutions. This squarely placed NMS Communications as a company with two clear businesses: the traditional CTI cards space and a virgin, fast growing, mobile music and video solution targeting high degree of personalization of mobile music among mobile operators. The combination of Livewire with Groove was understandably like a young start-up with all the gear and the chutzpah to take on the global mobile music market by storm.

This pretty much separated the two broad business lines inside NMS. Understandably the company had driven a clear wedge separating the old world CTI cards business from the mobile music personalization world. This laid the foundation for the final clean up of NMS: to sell off the traditional Communications Platform division thereby eliminating the final trace of its legacy: the cards and platform division. Dialogic offered to buy the CP division* of NMS for a consideration of \$28 million in cash. In all of 2007, NMS had clocked \$82.5 million in revenue with a loss of \$9.3 million. [* at the time of writing this article, acquisition being subject to share holder approval]

Dialogic and NMS adopted two completely different paths for progress with NMS entirely exiting out of the legacy CTI player mode and leaving behind a next generation mobile music enabler: Livewire. Dialogic on the other hand further consolidated its position in the traditional VAS enabling technology play. The NMS communications platform business is a well known brand and has considerable standing globally. Still, the market has severely punished NMS for its strategy by progressively dropping its share price dangerously and in fact attracting a delisting notice from NASDAQ for quoting sub \$ share price for over 30 days in a row (week of Sep 12). It is in this same week that Dialogic made the acquisition announcement.

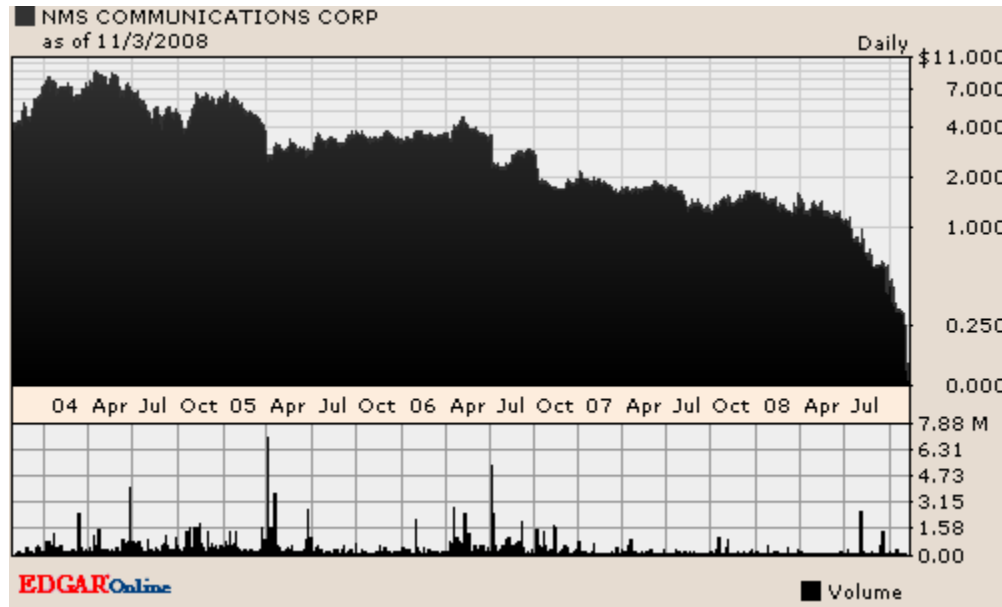


Fig 4: NMS Stock Performance

A very detailed time-line is presented toward the end of this report which talks about the overall consolidation in the space hi-lighting key transactions with dates and comments.

Moving Forward:

There appears to be still some level of disbelief with some industry folks saying that the Dialogic acquisition may not get shareholder approval. But in any case, the Dialogic strategy of building up clear leadership by acquiring competing brands seems to have given it much needed headway. Since Dialogic is privately held it is not known how profitable the operations are and how well the acquisitions have integrated so far. From a market perspective, it is believed that the customers will win with a broader range of solutions and complete support coming under one roof.

As far as Livewire is concerned, the proposition here is to provide music and video personalization services to global mobile operators in 'managed services' mode. So in effect the Livewire product platform will move into becoming an Application services business – a real transformation for what was originally a hardware company. A slew of content partnerships are already in place (Sony BMG, EMI, Warner Music, Universal) so also on the handset side (LG, Samsung, Nokia) and mobile operator partnerships with global biggies such as Vodafone, Sprint and Virgin Mobile.

Post-acquisition of the platforms business, Livewire will be the new name of the company and will focus exclusively on delivering managed music and video services business. The reorganized company is expected to generate about \$20 million in revenue by 2009 and become profitable,

generate positive cash flow by 2010. For now, it looks like Livewire has chartered a new path for itself leaving behind the familiar old world of CTI / platforms and signaling servers. Only time will tell, how high Livewire will fly!

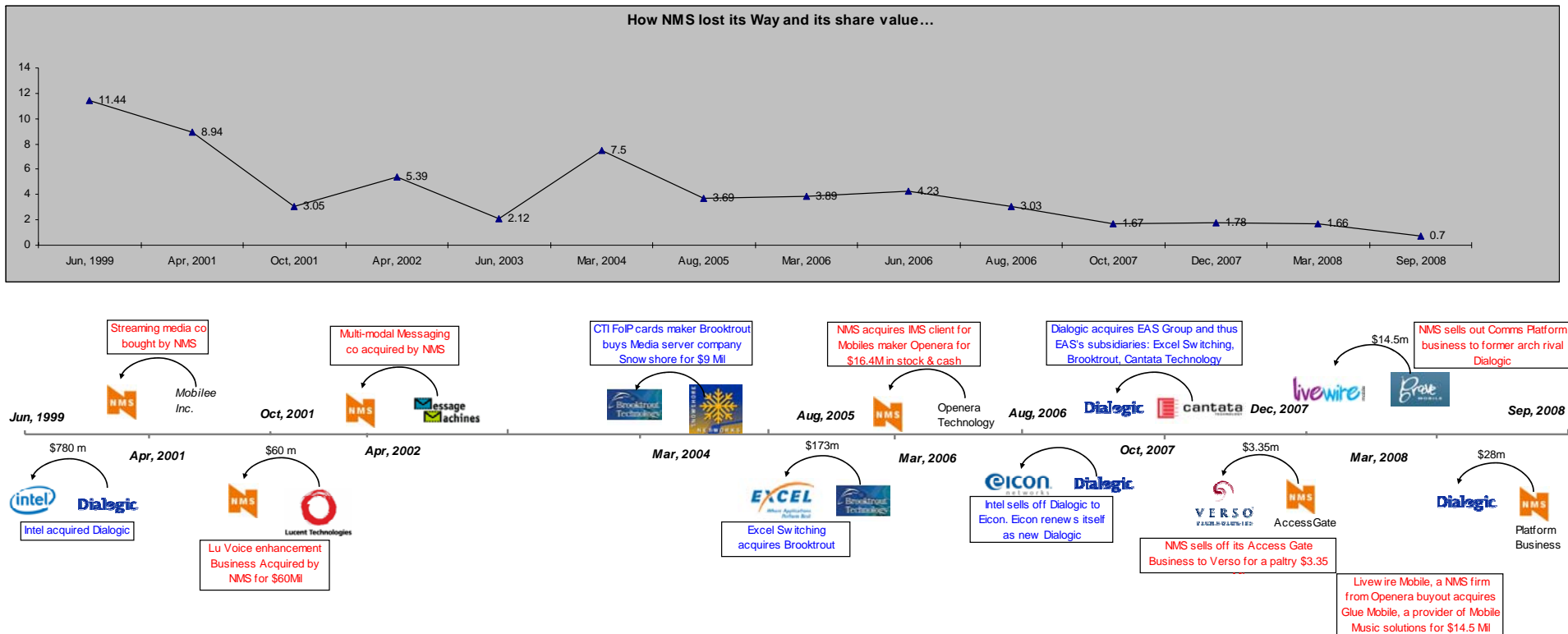


Fig 5: NMS Stock Performance Vs. Event timeline

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