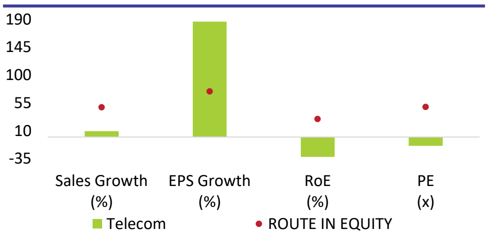
ROUTE MOBILE

INITIATING COVERAGE

KEY DATA

Rating	HOLD
Sector relative	Neutral
Price (INR)	1,159
12 month price target (INR)	1,280
Market cap (INR bn/USD bn)	66/0.9
Free float/Foreign ownership (%)	33.7/10.4

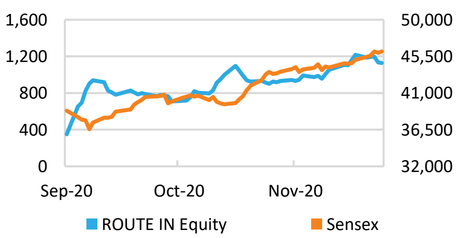
INVESTMENT METRICS



FINANCIALS (INR mn)

Year to March	FY20A	FY21E	FY22E	FY23E
Revenue	9,563	14,123	17,520	20,856
EBITDA	998	1,722	2,204	2,661
Adjusted profit	692	1,297	1,661	2,087
Diluted EPS (INR)	13.8	24.0	28.4	35.0
EPS growth (%)	23.6	73.6	18.5	23.1
RoAE (%)	28.7	29.0	23.7	24.1
P/E (x)	83.8	48.3	40.7	33.1
EV/EBITDA (x)	66.0	36.5	27.9	22.5
Dividend yield (%)	0.3	0.2	0.2	0.3

PRICE PERFORMANCE



Explore:

Financial model

Podcast

Corporate access

Video

Routing growth path

Route Mobile (Route) is one of the largest players in the Application to Person (A2P) messaging business and a formidable emerging player in the high-growth (33% CAGR over FY19-24E) CPaaS segment. Despite its global scale, the company's cloud-based architecture entails low capital requirement, driving high return ratios; this has spurred cash flow generation--a trend we expect to sustain.

We estimate 30%/44% revenue/EPS CAGR over FY20-23 as consolidation favours big players and its ability to mine large accounts. However, at 41x FY22E P/E, the market is already factoring in strong growth; hence, initiate with 'HOLD' and TP of INR1,280. Technological obsolescence and inefficient capital allocation are key risks.

A2P business: Strong moat; consolidation to drive market share gains

Route leverages its direct connect with 240+ mobile network operators (MNOs) to help enterprises offer SMS solutions (OTP, account information, etc.). The company has achieved significant economies of scale with its platform delivering over 30bn A2P messages annually. In the A2P business, scale creates entry barriers for new companies as MNOs do not connect with sub-scale aggregators. Economies of scale incentivise smaller players to consolidate with larger players, further improving unit economics of consolidators. With scale advantage and a marquee customer base, we expect Route to be the consolidator, clocking faster-than-industry growth.

CPaaS: Fast-growing industry; rapidly changing technology

Various industry reports estimate the CPaaS industry to clock 33-40% CAGR over FY19-24 led by a confluence of several factors--digital transformation of companies, consumers' smartphone adoption and emergence of API-based digital communication architecture. The covid pandemic has further accelerated the pace of digital communication adoption by enterprises. While emergence of new channels offers an opportunity to participate in enterprises' digital communication transformation journey, it's imperative for Route to develop the right products and processes in order to tap the same in the ever evolving competitive landscape.

Outlook and valuation: Strong growth priced in; initiate with 'HOLD'

We estimate Route to clock healthy 30% revenue CAGR, leading to 44% earnings CAGR over FY20-23 riding industry growth tailwinds and the company's strong positioning. Moreover, leveraging cloud-based infrastructure will minimise capital requirements, which will drive strong 29% ROCE.

At CMP, the stock is trading at 41x FY22E EPS, implying the market is already factoring in high growth rate. While global peers trade at much higher valuations, they do clock superior gross profit margins and have much broader product portfolios. Considering Route's lower gross margin, we peg our target multiple at 45x FY22E EPS to arrive at INR1,280 target price. We initiate coverage with **'HOLD'** recommendation and **'Sector Neutral'** rating. Faster-than-anticipated digital adoption driving faster revenue growth will be the key risk to our call.

Pranav Kshatriya
+91 (22) 4040 7495
Pranav.Kshatriya@edelweissfin.com

Sandip Agarwal
+91 (22) 6623 3474
Sandip.Agarwal@edelweissfin.com

Pulkit Chawla
Pulkit.Chawla@edelweissfin.com

Executive Summary

Scalable player in CPaaS space

Route is one of the largest players in the A2P messaging business and an emerging company in the Communication platform as a service (CPaaS) space. The company has direct relationships with over 240 MNOs with access to over 800 mobile networks, helping it offer services to global clients across multiple geographies. It has a wide range of enterprise communication services including A2P/P2A/2Way messaging, OTT business messaging, Rich Communication Services (RCS), voice, email and omni-channel communication. The company has a marquee customer base, including global tech giants such as Facebook, Google & Samsung and large Indian enterprises including SBI, ICICI Bank & Bank of Baroda. Diverse product offerings and large geographical presence have enabled Route scale up large enterprise customers, helping it clock 28% revenue CAGR over the past three years.

CPaaS industry growing at rapid pace

IDC forecasts the CPaaS industry to post 33% CAGR over FY19-24 driven by: 1) Rapid adoption of smartphones for commerce and communication by consumers. 2) Ease and scalability offered by CPaaS platforms to add communication channels. 3) Maturity of adjacent technologies such as chatbots, analytics, etc., helping companies effectively segment and target customers. 4) Digital transformation aiding companies better leverage multiple communication channels. API-driven architecture helps brands and companies seamlessly integrate new communication channels with the existing digital stack sans investments in the hardware and pay for it on volume basis. With strong presence in emerging markets in the CPaaS space, we expect Route to benefit from demand for its services.

Pandemic/lockdowns accelerating CPaaS growth

The covid-19 crisis has led to a dramatic uptick in the use of digital technologies to help reduce face-to-face interactions. Twilio's covid-19 digital engagement survey concluded that the pandemic has accelerated digital communication strategies of companies by six years. Covid-19 also broke down barriers to digital transformation such as getting executive approval, lack of clear strategy, reluctance to replace legacy software, insufficient budgets, etc. We believe covid-19 has exposed the fault-lines of traditional communication channels and business continuity planning has accelerated adoption of digital communication by brands and enterprises.

Industry consolidation spurring market share gains

Revenues of large players in the A2P industry have jumped 7-13x over the past six years due to industry consolidation despite much slower industry growth. For A2P service providers, economies of scale bring in synergies on the cost front, enhancing their ability to invest in the business. This phenomenon is driving M&A in the space, further enhancing scale of leaders in respective geographies. We expect industry leaders, including Route, to continue to grow at a much faster clip than the industry riding consolidation.

Strong revenue growth momentum to sustain

Over the past three years, Route has reported 27.9% revenue CAGR driven by strong growth in A2P volumes and a couple of tuck-in acquisitions; it clocked 21% transaction volume CAGR over the same period. While the industry was growing at a slower pace, Route could capture higher volume market share due to its direct reach to 240+ operators. We are now building in 18.6% volume CAGR over FY20-23 riding sustained consolidation in the A2P industry. On higher pricing in FY21, while we are building in 46.7% growth in FY21, we estimate FY20-23 revenue CAGR at 29.7%. We do expect revenue mix to change in favour of new CPaaS services from current A2P services as the former scale up.

Low capex to boost cash flow

Route has generated INR1.3bn FCF over FY18-20 on back of INR1.5bn OCF and meagre INR238mn capex. Low capex is a result of leveraging cloud technology solutions, which are readily scalable and work on the pay-as-you-go model. The company has invested FCF in acquiring business to further bolster its capabilities. We expect strong revenue and profit growth to continue to drive OCF, leading to sustained FCF generation. The company’s capex is expected to remain low due to adoption of cloud- based technologies.

Outlook and valuation: Growth priced in; initiate with ‘HOLD’

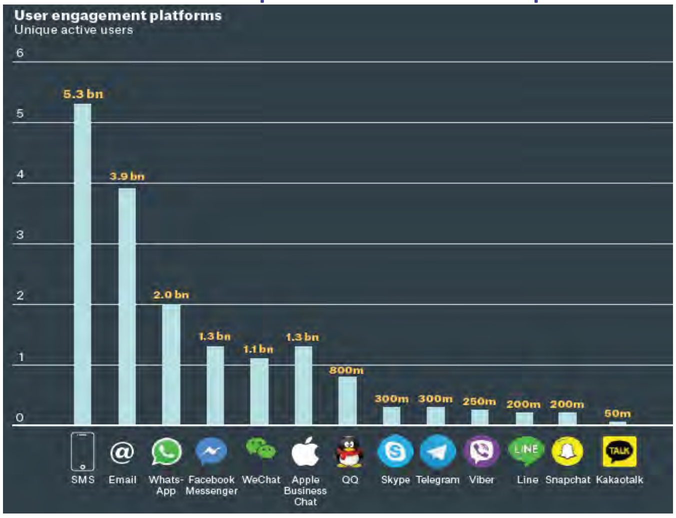
We initiate coverage on Route with **‘HOLD’** recommendation and **‘Sector Neutral’** rating. Our target price of INR1,280 is based on 45x FY22E EPS, which is at discount to global peers considering the company’s lower margin profile. We estimate Route to report 44% earnings CAGR over FY20–23 driven by strong revenue growth (30% CAGR) and high operating leverage. The stock is trading at 41x FY22E EPS--lower than global peers. While we are confident of Route’s robust growth, with 223% stock returns since the IPO, we believe the market is already factoring in high growth. While any value-accretive acquisitions will be the key upside risk to our hypothesis, disappointment in revenue growth and further margin compression are downside risks.

Key risks: Technological obsolescence, inefficient capital allocation

CPaaS as a space is rapidly evolving with the advent of new technologies and business models. Route has successfully scaled its business model in the A2P space, leveraging its direct connect with 240+ MNOs. As OTT and other new technologies are largely internet enabled, the company may not have the MNO direct connect advantage versus competition. While the company can still leverage its enterprise relationships, direct connect with MNOs will not help. It will have to invest in new product offerings to cater to the emerging landscape in which capital allocation decision will be crucial. We do see API architecture as the key growth driver of the CPaaS space and the company will need to create such solutions to capture growth. It is also looking at inorganic opportunities for scaling up in different geographies and products. Betting on correct geographies and products is crucial for sustaining high growth rate, profitably and return ratios.

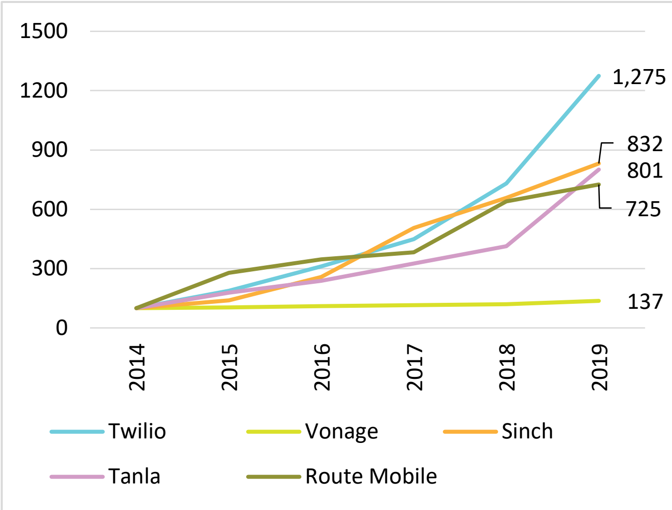
Story in Charts

Exhibit 1: SMS offer unparalleled reach to enterprises



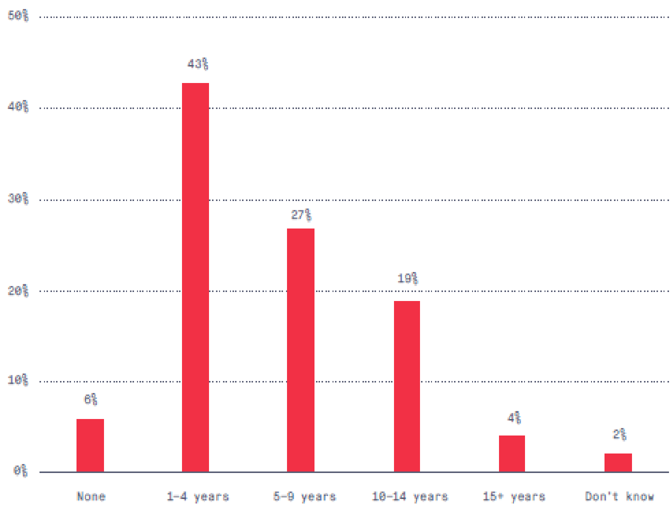
Source: Company

Exhibit 2: Industry consolidation accelerating growth



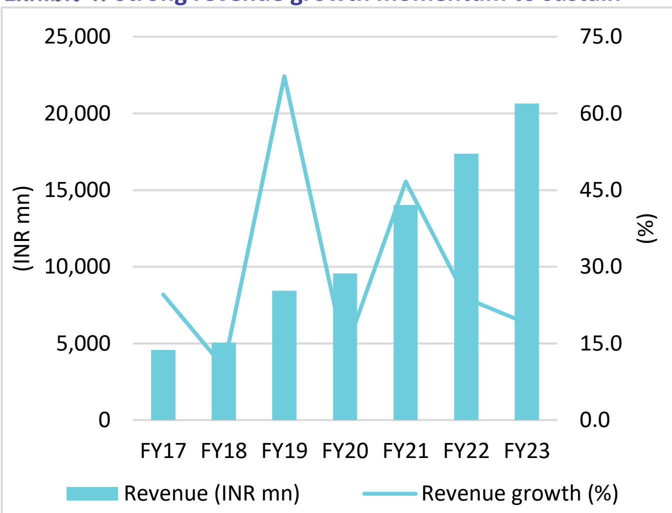
Source: Company, Edelweiss Research.

Exhibit 3: Covid-19 has accelerated digital adoption



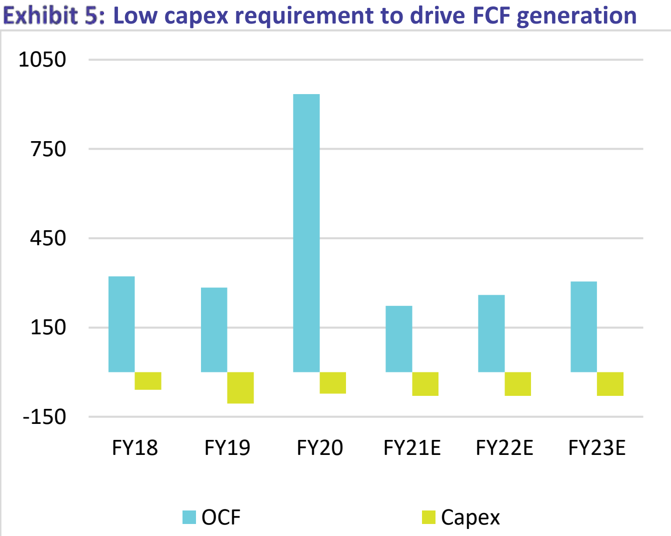
Source: Company

Exhibit 4: Strong revenue growth momentum to sustain



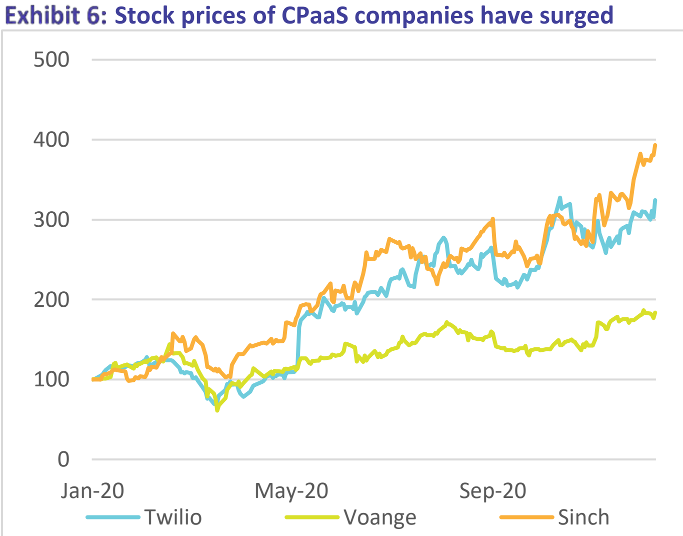
Source: Edelweiss Research

Exhibit 5: Low capex requirement to drive FCF generation



Source: Company, Edelweiss Research

Exhibit 6: Stock prices of CPaaS companies have surged



Source: Company, Edelweiss Research

Investment Rationale

Scale player in CPaaS space

- Route has direct relationships with over 240 MNOs with access to over 800 mobile networks. This helps it deliver services to global clients across multiple geographies.
- The company has a wide range of enterprise communication services including A2P/P2A/2Way Messaging, OTT business messaging, Rich Communication Services (RCS), voice, email, and omni-channel communication.
- The company boasts high quality customers including technology giants Google, Facebook & Samsung and large Indian enterprises like SBI, ICICI Bank, Bank of Baroda, among others.
- Low capital requirement drives superior returns and cash flows.

Route has direct relationships with over 240 MNOs (Super Network) and provides enterprise clients with access to over 800 mobile networks. The company partners with some of the key players across the globe. It also has seven strategically located data centres. Route's global presence enables it to offer clients the flexibility of multiple routes, better delivery speed and ability to optimise cost of delivery per message. The company is able to serve clients better as a result of its direct relationship with MNOs.

Technology giants Google, Facebook & Samsung and large enterprises like SBI, ICICI Bank, Bank of Baroda, amongst others, are Route's customers

Exhibit 7: Route- Omni-channel communication platform

Source: Company

Route, underpinned by its Super Network, is an attractive partner for enterprises enabling them to communicate cost-effectively across multiple geographies. The significant number of its direct relationships with a broad range of MNOs imparts it the ability to provide services at a competitive cost and ensures high quality of service for enterprise clients. The existing direct and indirect reach of mobile subscribers globally provides the company the ability to attract varied categories of enterprises that need to communicate with their clients. Route's established presence in all major geographies provides it the opportunity to leverage growth in the cloud-communications space.

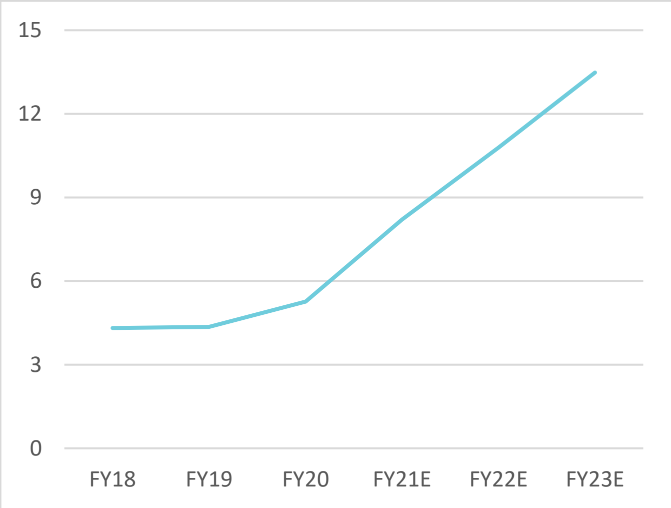
Route's product offerings are finding traction with customers, reflected in the robust growth in the company's top-15 enterprise customers. Importantly, the company counts tech giants like Google and Facebook as its clients, which signify the company's global reach, high quality offerings and robust value proposition. Route also counts large Indian enterprises such as SBI, ICICI Bank and Bank of Baroda as its clients.

Low capital requirement drives superior returns, cash flows

Despite 12% EBITDA margin, the company clocks 38% ROCE and 26% ROE

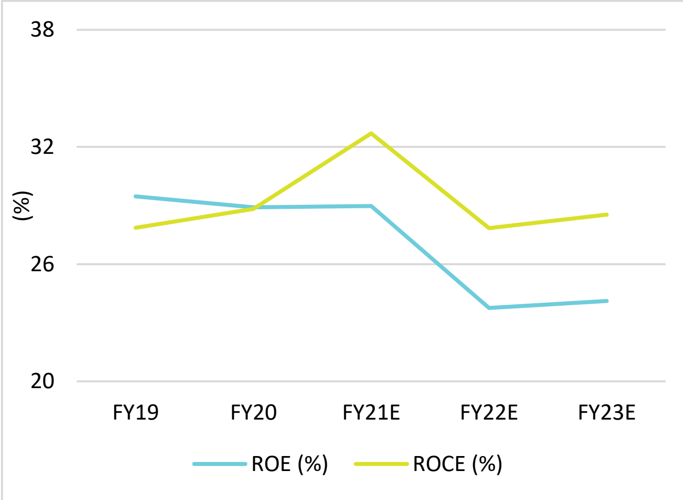
Route's business model requires minimal investments in fixed assets, which helps drive strong return ratios. Due to meagre 19.5% gross margin, the company operates at 12.3% EBITDA margin. However, despite lower EBITDA margin, the company clocks 38% ROCE and 26% ROE due to low capital requirement. Route posted H1FY21 annualised revenue of INR13.3b4n, which it achieved with meagre INR204mn net fixed assets and INR1.5bn other intangible assets. We do not perceive significant reinvestment requirements as the platform is cloud based, and hence has limited fixed asset requirements. The company may continue to acquire businesses to expand its product offerings and/or reach. However, such investments do not require faxed asset capacity augmentations. Hence, we believe Route will be able to sustainably grow sans dilution of return ratios.

Exhibit 8: Route--Fixed asset turnover



Source: Edelweiss Research

Exhibit 9: Route—ROE and ROCE



Source: Edelweiss Research

CPaaS industry growing at rapid pace

- IDC forecasts the CPaaS segment to post 33% CAGR over 2019-24.
- Key drivers: 1) Rapid adoption of smartphones for commerce and communication by consumers. 2) Ease and scalability offered by CPaaS platforms to add communication channels. 3) Maturity of adjacent technologies such as chatbots, analytics, etc., helping companies effectively segment and target customers. 4) Digital transformation helping companies better leverage multiple communication channels.
- API-driven architecture helps brands and companies seamlessly integrate new communication channels with existing digital stacks without investments in the hardware and pay for it on volume basis.

IDC forecasts the CPaaS segment to catapult to USD17.71bn in 2024 from USD4.26bn in 2019, implying a staggering 33% CAGR

Route operates in one of the fastest-growing industries–CPaaS platforms. IDC forecasts the CPaaS segment to grow from USD4.26bn in 2019 to USD17.71bn in 2024, implying a staggering 33% CAGR. Rising smartphone usage and shift to online commerce have forced brands and enterprises to focus on mobile communication and digital engagement channels. CPaaS leverages cloud technology to offer brands of all shapes and size the ability to develop and embed communication features without having to purchase purpose-built applications. Emerging API-driven architecture enables enterprises to integrate video, voice and messaging elements into their existing digital stack.

Key services that are considered part of the CPaaS platform (refer figure 11) are messaging technologies such as SMS, RCS (Rich Communication Services) and OTT messaging applications. Apart from this, push notifications, voice & video services and email are also key part of the platform. This field is evolving with introduction of new services and platforms.

CPaaS reflects the software value-add from products leveraging mobile messaging, voice or video

CPaaS solutions represent a significant departure from the way businesses of any size have become accustomed to purchasing and deploying communications. Their value proposition lies in providing a powerful toolset to make business communication applications richer and more tightly integrated within business workflows. CPaaS provides additional capabilities alongside existing communications infrastructure of businesses. For example, an organisation may decide that it wants to allow its customers to communicate with employees using SMS on business numbers. While its existing on-premises UC platform does not support SMS messaging, the business can leverage a CPaaS provider to enable text messaging as an integration or overlay of existing communications tools. In this example, the business maintains the existing relationship with its voice providers and its preferred UC vendor while leveraging a CPaaS provider to address a gap in customer interactions.

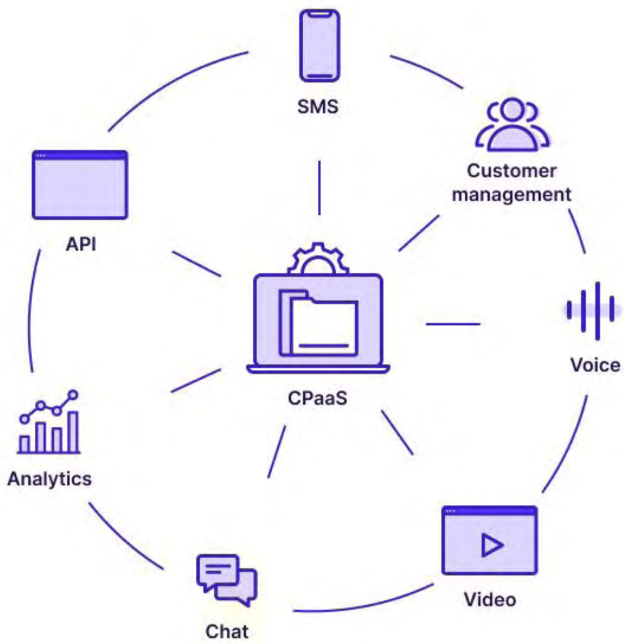
Like other cloud-based services, most CPaaS solutions offer businesses a compelling operating expense (opex) alternative to costly capital expenditures (capex) to deploy the appropriate communication and network infrastructure needed to securely support application programming interface (API)-driven voice, video and messaging services. Also, cloud-based CPaaS offerings are priced at published per-API call or per-minute rates, enabling businesses to pay for the exact amount of services they consume. This is a particularly compelling value proposition for organisations with varying levels of demand or seasonal spikes in business activity. The inherent scalability of cloud architectures also benefits CPaaS, enabling businesses to consume as much or as little of a provider’s API-directed services as needed by their application or work process.

With rising smartphone usage and commerce, mobile channels have become extremely important for brand and enterprise to drive communication and engagement. Considering fast-evolving technology trends in mobile channels, brands and enterprises are increasingly looking at external service providers who offer a comprehensive platform that enables management of this communication. These are CPaaS platforms.

Exhibit 10: CPaaS service-- Applications

Source: Juniper Research

Exhibit 11: CPaaS service-- Overview



Source: Vaximplant

Traditional tools of communicating with customers were limited. Companies relied on mass media, sales & distribution channels and call centres to reach out to customers. However, mass media was a one-way communication, limiting its impact; communication through sales and distribution channels required investments and was slower; and call centre communication was expensive and executives did not have contextual understanding of a customer's requirement, impacting customer experience.

With the evolution of technology, companies are leveraging email, SMS, automated calling and other such platforms to reach out to customers. This has enabled brands and enterprises more effective targeting. Digital transformation at the back end and CPaaS evolution have helped brands and enterprises offer unique customer experience.

Exhibit 12: Various CPaaS use cases

SMS alerts for easy order tracking	2 Factor Authentication (2FA) for an additional layer of security	AI powered chatbots to answer frequently asked customer questions	IVR system to route each call to the right call center agent	Click-to-call to enable customers to call you in a click
WhatsApp messages to send appointment reminders	Call analytics to make data-driven decisions and set future goals	Video calls to give a product demo	Call masking to protect stakeholder privacy	2-way messaging to engage customers

Source: Karix

API driven architecture; role of digital transformation

API architecture allows the flexibility to add a communication channel without worrying about back-end infrastructure

CPaaS is a cloud-based platform that enables seamless integration of voice, messaging, video, etc., into one software through APIs. Since everything is situated on the cloud, businesses can add these channels when required, without worrying about back-end infrastructure. By removing the need to invest in hardware, CPaaS is delivering an easier, faster and more economical way for businesses to build better customer experiences.

Technologies adjacent to CPaaS, such as analytics, chatbots, etc., are maturing. This enables brands and organisations to leverage communication channels basis consumer preference, cost structure and their effectiveness, thus optimising resources and enriching customer experience.

As businesses are investing in cloud-based platforms for digital transformation of their business, CPaaS allows extension of the same platform to the communication between various stakeholders. This provides: 1) better customer experience; 2) offers global reach; 3) enables easy addition of communication channels; and 4) saves cost. Consequently, CPaaS adoption is also a natural extension of digital transformation journey of brands and organisations.

Pandemic/lockdown accelerating CPaaS industry growth

- Covid-19 crisis led to dramatic uptick in the use of digital technologies to help reduce face-to-face interactions
- Twilio's covid-19 digital engagement survey concluded that the pandemic has accelerated OR advanced companies' digital communication strategy by six years.
- Covid-19 also broke down barriers to digital transformation such as getting executive approval, lack of clear strategy, reluctance to replace legacy software, insufficient budgets, among others.

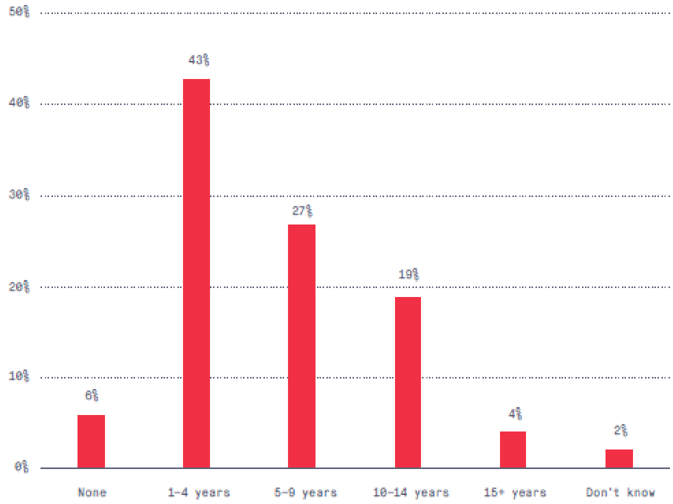
Covid-19 accelerating digital transformation

Covid-19 has had a significant impact on customers and businesses amidst the lock down, social distancing and other challenges. For businesses, one consequence of the crisis has been a dramatic uptick in the use of digital technologies that help reduce face-to-face interactions and safeguard customer and employee health and well-being. These digital technologies include consumer-facing applications such as grocery & food delivery services, business-to-business e-commerce applications and applications such as video conferencing that seem to have penetrated consumer, business and not-for-profit worlds.

Importantly, considering the short time in which this impact happened and its scale, organisations were compelled to respond with extraordinary speed and vigour. While digital transformation roadmaps could be anywhere from a year to 10 years, covid-19 forced businesses to figure out how to reach their customers overnight.

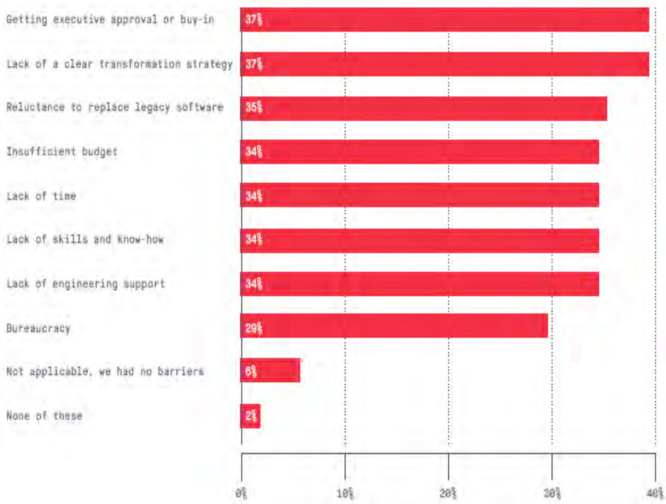
Twilio's covid-19 digital engagement survey concluded that the pandemic has accelerated companies' digital communication strategy by six years. One of the key reasons for acceleration in digital communication was that it was critical to address business challenges posed by the pandemic. Covid-19 also broke down barriers to digital transformation such as getting executive approval, lack of clear strategy, reluctance to replace legacy software, insufficient budgets, etc.

Exhibit 13: Covid-19 spurred digital acceleration



Source: Twilio

Exhibit 14: Covid-19 broken down barriers



Source: Twilio

The survey also highlighted that covid-19 propelled focus on omni-channel communication as almost all companies were looking for new ways to engage customers and stakeholders. One in three companies started using live chats and the IVR channel for the first time due to covid-19.

Industry consolidation helping large players gain market share

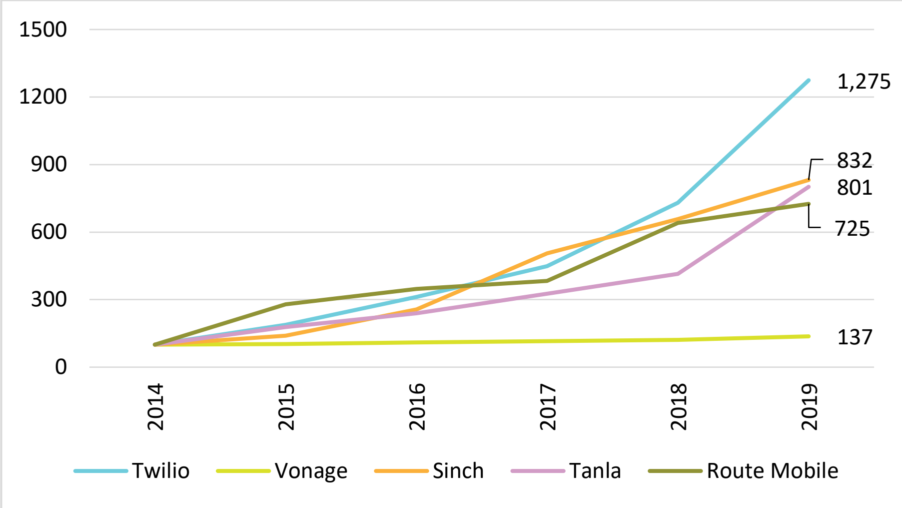
- Revenue of large players in the A2P industry has jumped 7-13x over the past six years due to industry consolidation, despite much slower industry growth.
- For A2P service providers, economies of scale bring in synergies on cost front, enhancing their ability to invest in the business, propelling M&A in this space.
- We expect industry leaders, including Route, to continue to grow at a much faster clip than the industry as a result of consolidation.

Over the past six years, revenues of Twilio, Sinch, Tanla Solutions and Route have jumped 13x, 8.3x, 8.0x and 7.3x, respectively

While digital transformation accelerating CPaaS growth, the A2P industry--a sub-set of CPaaS--is witnessing accelerated consolidation. Although the A2P industry is growing at a slower pace than the overall CPaaS industry, leaders in this space have grown at a much faster clip (refer to exhibit 15). Over the past six years, while Twilio's revenue has surged 13x, revenues of Sinch, Tanla Solutions and Route Mobile revenue have jumped 8.3x, 8.0x and 7.3x, respectively.

Staggering revenue growth for leaders is largely due to economies of scale driving better unit economics for leaders and slower growth of smaller companies accelerating consolidation. We believe considering fragmented nature of the industry and sustenance of this tend will propel faster growth of leaders.

Exhibit 15: Revenue of key CPaaS/A2P companies indexed to 100



Source: Company, Edelweiss Research. For Route and Tanla, 2014 corresponds to FY15 and so on

Cost advantage with consolidation

While the A2P industry lacks pricing power considering absence of product differentiation, leaders tend to have better unit economics as larger scale enables them to negotiate better pricing terms with telecom operators. This renders smaller operators less competitive, impacting their growth. However, A2P customers tend to be sticky as integrating a new vendor requires giving access to the company's technology stack, thus creating a security risk. Hence, larger companies have resorted to acquisitions to shore-up their scale, which has further enhanced growth of these companies.

Exhibit 16: A2P consolidation driver

Source: Edelweiss Research

Considering most of the platforms of A2P companies are cloud based, they do not require additional capex to augment capacity. Hence, scale also enhances their capex productivity, in turn expanding return ratios. Industry growth has slowed and smaller players are losing market share due to limited ability to invest. Consequently, smaller players are willing to merge with larger players, further enhancing scale of larger players. Global A2P leaders have aggressively acquired companies to enhance scale, establish presence in new geographies and acquire new capabilities.

Valuation

- We initiate coverage on Route with **'HOLD/Sector Neutral'** rating with a target price of INR1,280, implying 10% upside
- Global peer company valuations vary depending on growth rate, product portfolio, geographic presence etc.
- CPaaS companies have outperformed market over last one year as pandemic has accelerated their revenue growth profile

Strong growth expectations driving up valuations

Niche technology companies in India, such as IndiaMART InterMESH, Info Edge etc., are trading at 40-60x forward earning multiple due to differentiated business model

We initiate coverage on Route with **'HOLD/Sector Neutral.** Our target price of INR1,280 is based on 45x FY22E EPS, which is at discount to global peers considering the company's lower margin profile. We estimate Route to report 44% earnings CAGR over FY20–23 driven by strong revenue growth (30% CAGR) and high operating leverage. The stock is trading at 41x FY22E EPS, which is lower than global peers. We note that peer valuations range varies a lot and our valuation implies 1x PEG ratio. We note that other niche companies like IndiaMART InterMESH, Info Edge etc. trade at 40-60x valuations for their core business considering their unique business model, cash flow generation. Hence, we believe that Route valuations are at similar level.

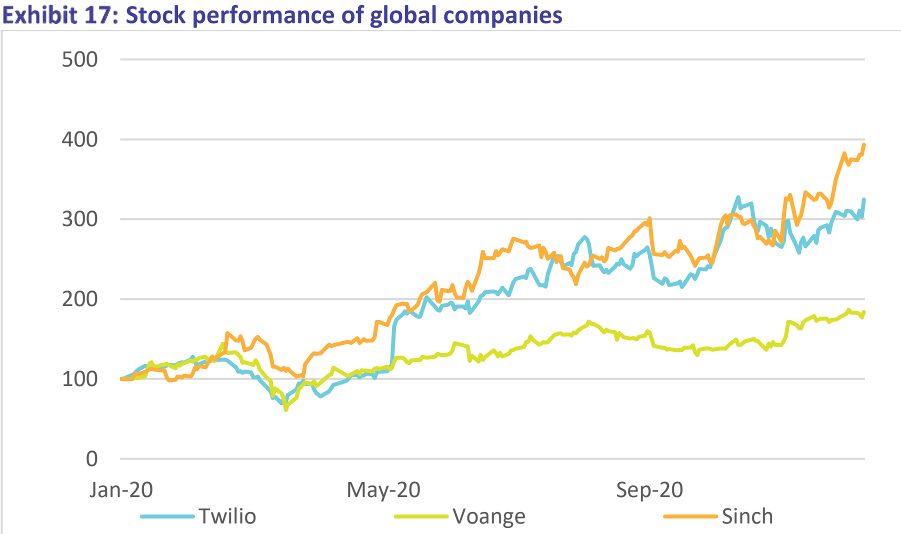
While we are confident of Route's strong growth, with 232% stock returns since the IPO, we believe the market is already factoring in high growth. While any value accretive acquisitions will be key upside risk to our hypothesis, disappointment in revenue growth and further margin compression will be downside risks.

Riding the CPaaS wave

Stock prices of CPaaS companies have jumped 80-300% YTD as the pandemic has accelerated growth

Covid-19 has accelerated digital investments by brands and enterprises, leading to higher growth expectations for providers of such services, including CPaaS. Consequently, stock prices of these companies have skyrocketed with Twilio, Sinch, and Vonage returning 211%, 281% and 80% YTD, respectively. Route's stock price has also jumped 223% since the IPO, while Tanla Platforms'--one of its listed Indian peer--stock price has catapulted 12x YTD. While we do believe that the CPaaS space will see accelerated growth considering swift adoption of digital technologies, we believe the market is already factoring in the strong growth.

Exhibit 17: Stock performance of global companies



Source: Company, Edelweiss Research

Significant variation in peer group valuations

Route's valuations are at a discount to global peers on almost all parameters, its despite superior return ratios. We attribute this valuation disconnect largely to: 1) lower gross margin; 2) revenue growth differential; and 3) product diversification. We note valuations of Route's peer group in the CPaaS space vary significantly basis maturity of the product, growth rate and area of operations.

Companies with high gross margin in CPaaS space are richly valued

Some of the companies like Twilio and Vonage are loss making and hence we cannot consider their valuations on P/E basis. Also, Route largely operates in the emerging market geography, which results in ~20% gross margin, whereas Twilio and Vonage operate in developed markets, where gross margins exceed 50%. Sinch has a mix of emerging and developed market geographies, resulting in 28% gross margin. Since gross margins in the A2P business are market defined, companies individually have little control on them. Hence, there is limited scope of margin expansion in the absence of change in business mix.

Exhibit 18: Peer comparison

	2020-22 CAGR			ROE	Gross Margins (%)	EBITDA Margins (%)	EV/ Revenue			EV/ EBITDA			P/E		
	Revenue	EBITDA	EPS	2020	2020 YTD	2020	2020	2021	2022	2020	2021	2022	2020	2021	2022
Twilio	36.5	20.9	1.5	0.4	52.3	7.4	32.4	24.5	18.7	438.5	489.6	281.4	(120.7)	(117.2)	(146.2)
Vonage	6.1	8.1	(189.84)	5.1	56.3	13.6	3.1	3.0	2.7	23.0	21.8	19.3	(139.1)	(586.5)	232.6
Sinch	44.5	47.6	50.0	10.8	27.8	10.8	9.1	5.3	4.7	84.2	49.3	39.7	187.7	98.9	69.4
Route	29.7	38.7	36.6	28.7	19.5	12.2	4.4	3.5	2.9	36.5	27.9	22.5	48.3	40.7	33.1

Source: Bloomberg, Edelweiss Research (Note: For Route, 2020 corresponds to FY21 and so on)

We note that companies like Twilio are trading at exorbitant valuations despite lack of profitability due to their leadership in the CPaaS space. The Street expects long-term sustainable high growth rate for the company driven by class-leading product offerings and affinity from the developer community.

Twilio does clock high gross margin (52% on consolidated basis and 45% for messaging business) and hence although it is not profitable and will continue to burn money for a few years, the Street envisages it to become one of the leading CPaaS products companies with high profitability in the medium to long term.

Sinch's stock price has catapulted 13.5x over the past two years as it has been clocking strong revenue growth and a string of acquisitions have bolstered its global presence. The company posts 27% gross margin due to its presence in low-margin emerging countries as well as high-margin developed countries. The company is looking to expand its offerings in voice and video services, but messaging services still contribute 96% to its revenue. Vonage is also trading at higher valuations, despite low growth expectations, due to more diversified products and higher gross margin.

Financial Outlook

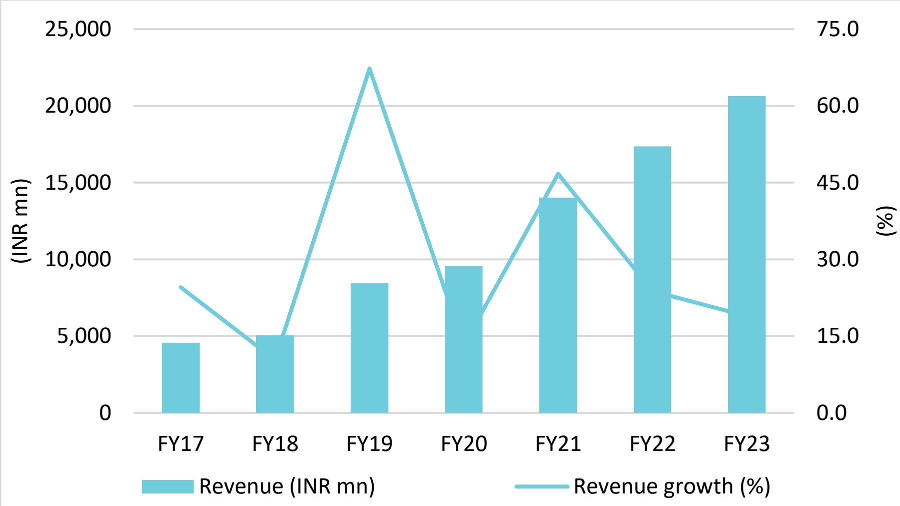
Strong revenue growth momentum to sustain

Over the past three years, Route has reported 27.9% revenue CAGR driven by strong growth in A2P volumes and a couple of tuck-in acquisitions. The company clocked 21% CAGR in transaction volumes over the same period. While the industry was growing at a slower pace, Route could capture higher volume market share due to its direct connect with 240+ operators.

FY20-23E revenue CAGR of 30% will be led by 48% revenue growth in FY21

We are building in 18.6% volume CAGR over FY20-23 led by continued consolidation in the A2P industry. On back of higher pricing, we are building in 47.7% revenue growth in FY21, while in FY20-23 it is estimated at 29.7%. We do expect new CPaaS services to incrementally start contributing to growth.

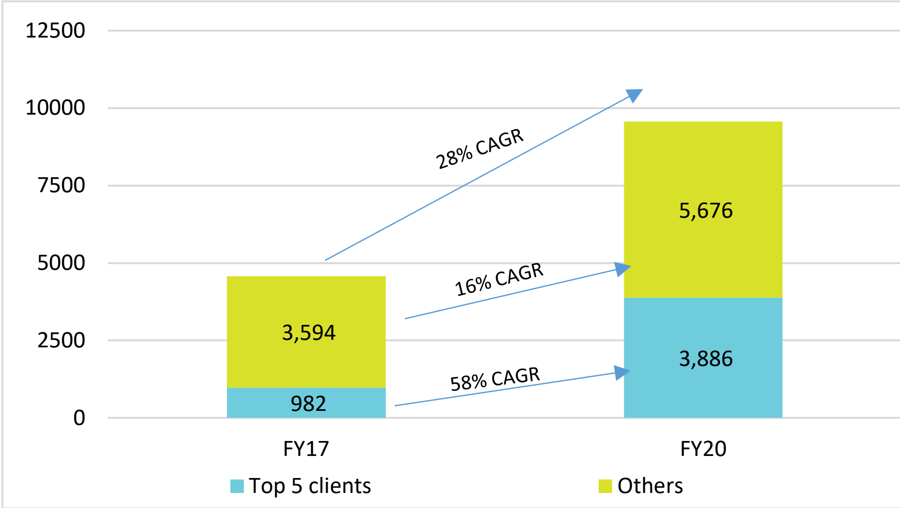
Exhibit 19: Strong revenue growth to continue



Source: Company, Edelweiss Research

Scaling up to find a place in the top-5 clients has been one of the key reasons for Route's stupendous revenue growth. Over FY17-20, revenue contribution from the top-5 clients jumped to 40.6% from 21.5%. We believe the company could capture this growth as it could leverage its connectivity with multiple operators and focus on these accounts. Strong traction in the top-5 accounts and further hunting of other accounts will be key for growth, in our view.

Exhibit 20: Top-5 clients scale up key growth driver



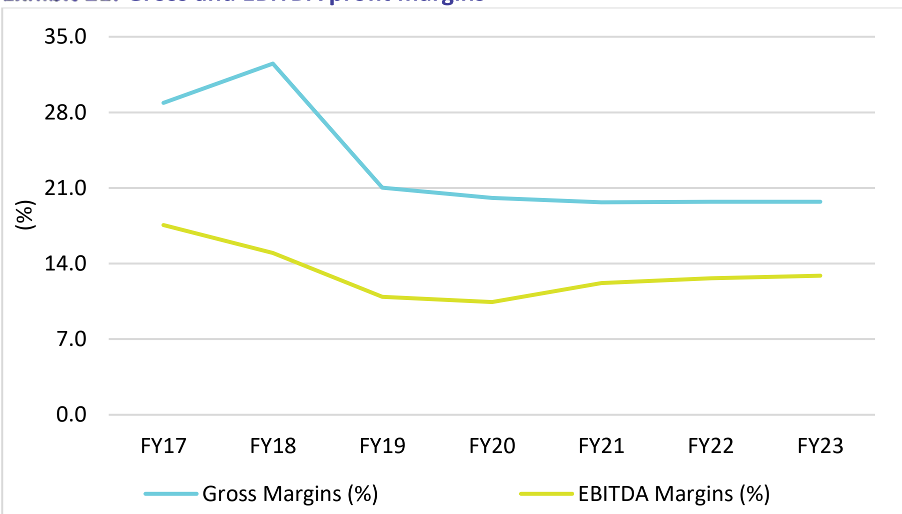
Source: Company, Edelweiss Research

Gross margin to remain steady; EBITDA margin to expand

While we estimate flat gross margin over FY20-23, we expect EBITDA margin to expand 230bps

Route was enjoying higher gross margin of 28.9% in FY17 due to higher proportion of revenue coming from international geographies, which entailed higher gross margin. However, as the mix changed, the company's gross margin dipped to 20.1% in FY21 and 19.5% in H1FY21. We do not estimate further deterioration as we expect the business mix to remain the same.

Exhibit 21: Gross and EBITDA profit margins



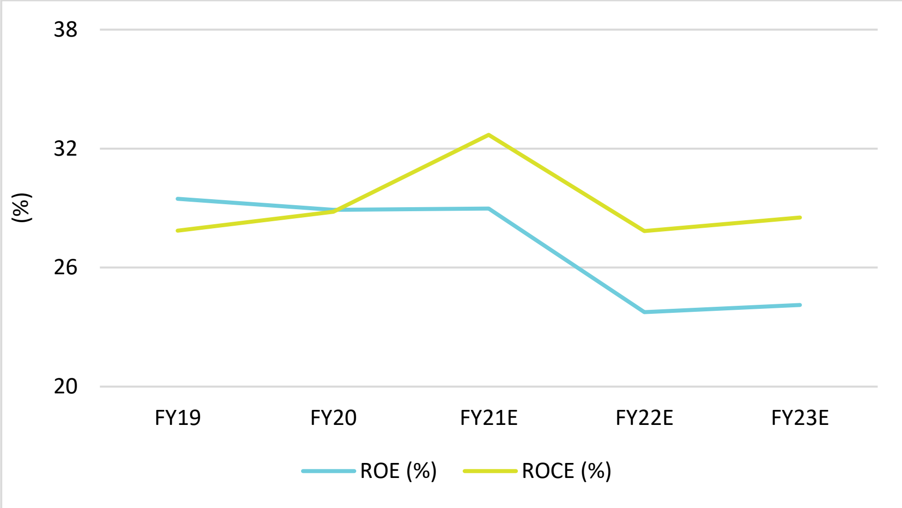
Source: Company, Edelweiss Research

While the company's gross margin has dipped, its other expenses have grown at a much slower pace than revenue. Employee and other expenses as a % of revenue have dipped from 11.3% in FY17 to 9.7% in FY20. We expect this trend of lower operating cost growth versus revenue to sustain, which will lead to strong EBITDA growth. Consequently, we are building in 38.9% EBITDA CAGR over FY20-23.

ROE/ROCE to remain high

Route has reported sustainably high ROE and ROCE due to low capital requirements of the business. Despite INR9.6bn top line in FY20, the company's balance sheet size was only INR1.5bn, indicating 10x fixed asset turnover ratio. Consequently, it has posted 28.9% ROE and 35.1% ROCE. With most of the incremental deployments happening on cloud, we see negligible capex requirements, which will in turn keep return ratios high. We believe despite high return ratios, we do not see increasing competition as connecting with MNOs for new players remains a challenge.

Exhibit 22: ROE and ROCE to remain high

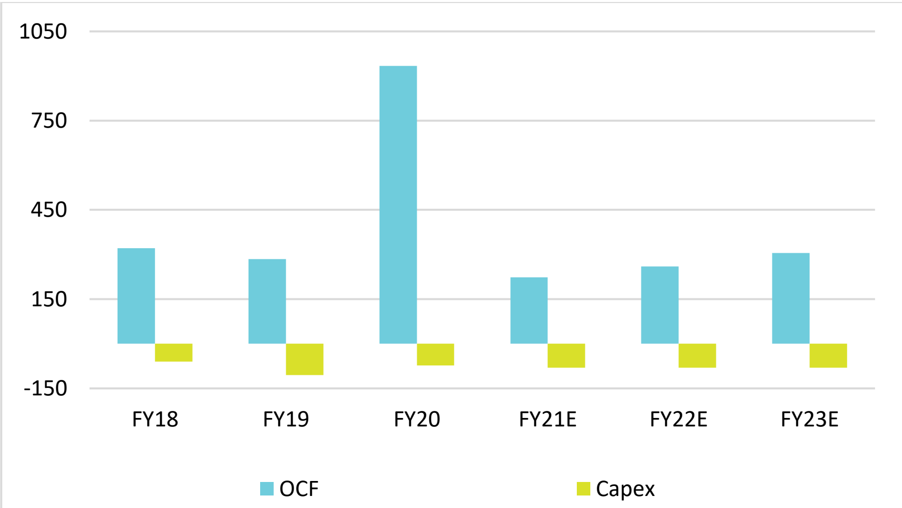


Source: Company, Edelweiss Research

Low capex to aid cash flows

Route has generated INR1.3bn FCF over FY18-20 led by INR1.5bn OCF and meagre INR238mn capex. Low capex is a result of leveraging cloud technology solutions, which are readily scalable and work on the pay-as-you go model. The company has invested FCF in acquiring business to further bolster its capabilities. We expect strong revenue and profit growth to continue to boost OCF, leading to sustained FCF generation. Capex is expected to remain low due to adoption of cloud-based technologies.

Exhibit 23: Cash flows to remain healthy



Source: Company, Edelweiss Research

Key Risks

Ability to main strategic relationships with third parties

Route is dependent on arrangements with third parties and MNOs in particular for connectivity in various regions around the world to provide services to clients. Further, in certain regions where the company is unable to provide services and solutions in a cost-efficient manner and in the absence of such relationships, it has to rely on indirect relationships with MNOs. The business depends on continuity of relationships with these MNOs. Inability to enter into or maintain such relationships could adversely affect the business, financial condition and results of operations.

Client concentration risk

Route is dependent on a limited number of clients for a substantial portion of its revenue. A reduction in services for such limited number of clients or the loss of a major client could result in significant reduction in revenue. Factors that may result in a loss of a client include service performance, reduction in budgets due to macroeconomic factors or otherwise, shift in policies and political or economic factors or changes in their outsourcing strategies. If any one or more of work orders or client contracts are terminated, revenues and profitability could be materially and adversely affected.

Technological obsolescence

The markets in which Route operates are highly competitive and subject to frequent changes due to technological improvements & advancements, availability of new or alternative services and changing client preferences & demands and can require significant investment in research and development by market participants. Any failure by Route to adapt to the changes in the market or respond quickly successfully or adequately to new or changing opportunities, technologies, standards or client demands could impair its ability to compete and retain clients. This could adversely affect its business, financial condition and results of operations.

Threat of rising competitive intensity

The industry is characterised by fragmented and highly competitive market participants. Some or all of the competitors may have advantages over Route, which include greater financial resources, stronger brand recognition, longer operating histories, broader geographic presence and more extensive relationships with clients. Thus, they may be able to respond more quickly and effectively to new or changing opportunities, technologies, standards or clients' demands. Increased competition may result in pricing pressure and force Route to lower the selling price of its services or cause a loss of business. In addition, competitors may offer new or different services in the future which are more popular than its current services.

Acquisition related risks

Route's business and operations are subject to various risks arising out of the various acquisitions and investments made by the company in the past, as well as potential investments or acquisitions in the future. If Route is not able to realise anticipated benefits or expected return on its investments or acquisitions or is unable to complete acquisitions or integrate operations, software, technologies or personnel gained through any such acquisition, it could have an adverse effect on the business, financial condition and results of operations. Inability to identify, complete and successfully integrate any acquired businesses into operations, could affect Route's growth strategy, market share, profitability or competitive position.

Company Description

Route is a leading cloud communication provider, which caters to enterprises, OTT players and MNOs. The company provides a range of services encompassing smart solutions in messaging, voice, email and SMS filtering, analytics and monetisation.

The company offers a range of these cloud services to clients across domain including BFSI, aviation, retail, e-commerce, logistics, healthcare, hospitality, media & entertainment, pharmaceutical and telecom. It is present across more than 18 locations across Africa, Asia Pacific, Middle East and North America.

Route addresses concerns of businesses regarding spiking costs, data security and regulatory policy concerns. In addition to the traditional A2P SMS coverage, Route also has specialised messaging products like Route OTP products that generate, deliver and authenticate OTPs automatically. The Route connector automates the entire data messaging process with additional database security without the need for additional IT resources. Long and indistinct URLs can be shortened, branded and tracked in real time using Acculync. For voice solutions, the outbound dialler enables users to schedule automatic dialling, play promotional messages. Route IVR efficiently delivers voice messages and captures customer inputs through the response they have selected. The Route mailer allows customers to run e-mail campaigns. Route Mobile empowers mobile network operators to monetize their A2P services. Route Hub and Route Shield help mobile operators connect to a large number of customers through a secured network.

Exhibit 24: Key services

Source: Company

A2P Messaging

Application to person or Application to peer (A2P) is a SMS generated by an application- or web-based system. These messages could range from bank notifications, delivery alerts, travel updates, promotional offers, value added services etc. Route offers value-added services within the A2P messaging service. Its messaging platform can be integrated with existing business applications, which helps companies manage their SMS campaigns. These messages can be customised according to customer segmentation and preferences. It also allows customers to layer their messages with voice, e-mail and API calls. Route also provides analytics, which allows customers to track the performance of their campaign in real time. It provides direct routing, premium routing and wholesale routing. Its messaging service can reach global audiences given its partnerships with more than 850 mobile operators. Route provides its customers with a range of reports--credit details, current statistics, SMS reports and SMS summary—enabling them to evaluate their campaigns.

RCS Business Messaging

RCS Business allows for smart 2-way communication and includes features like verified sender, branding, rich media and true metrics and suggested replies and actions. Its features include providing users with a personalised experience, run rich promotional campaigns, product cross selling possibilities, higher engagement and AI/ML based chatbot integration.

Acculync

Using Acculync, customers can trim the URL and have analytics within the RML messaging platform. The benefit that it provides is concise & customised SMS and allows real-time customer insights.

Route Shield and Hub

On occasions, a few entities send their messages via unsolicited networks that violate global traffic norms. Route Shield provides real-time monitoring and identification of illicit messages ensuring these are not passed on to customers. It helps MNOs effectively monetise A2P messages by blocking messages from unidentified sources. Route Hub is a one-time solution that lets subscribers send SMS to any mobile across the globe.

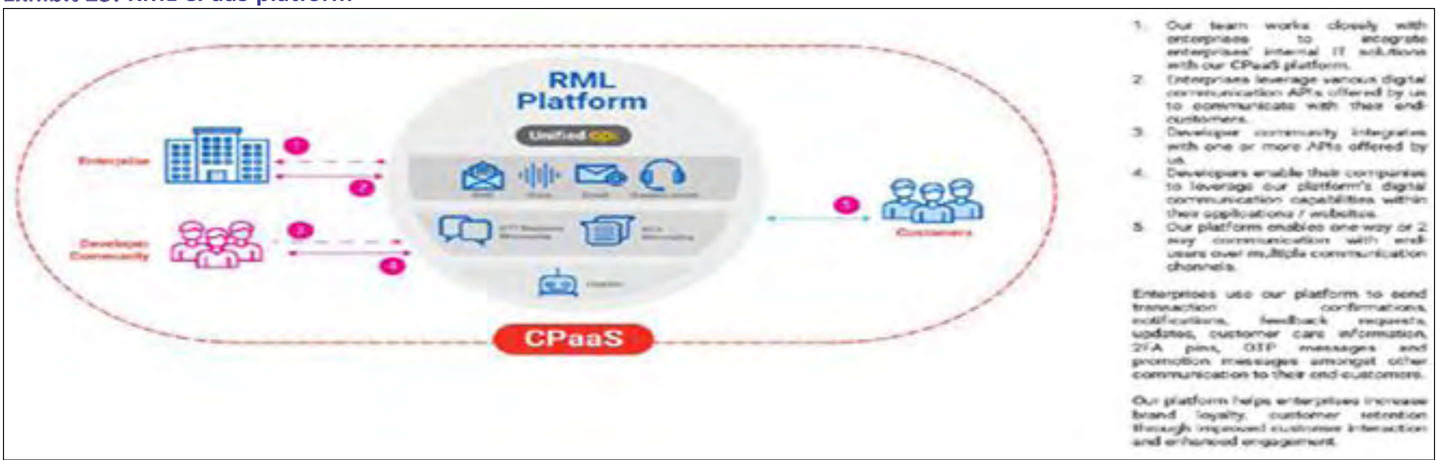
Instant Virtual Number

Instant Virtual Number (IVN) is configured on top of the existing primary mobile number which allows users to control their privacy. It provides protection from fraudulent customer calls, easy access to a temporary number, easy linkage to the original number, privacy sharing, option to hide the original number from the receiver. Its benefits include configuring a secondary virtual number, automated timely activation/ deactivation of virtual number, toggling between virtual and original number and separate list of calls/ messages on both numbers.

CPaaS

CPaaS allows to develop, run and manage applications without the complexity of building and maintaining the infrastructure. Benefits of CPaaS include hosted on premise/ cloud solution, direct connectivity with operator, scalable to cater to volumes, enterprise grade security, provides quick integration via API to enterprises, provides analytics and reports, provides for advanced user management capabilities and auto route management based on pricing.

Exhibit 25: RML CPaaS platform



Source: Company

Competitive intensity

The industry in which Route operates is highly competitive and subject to frequent changes due to technological advancements, availability of new services and changing client preferences. As new opportunities emerge, newer players may enter the market, putting further pressure on Route.

The overall industry is characterised by fragmented and highly competitive market participants. Some of these players are slightly larger, have access to better resources and have better relationships with clients. This is likely to ensure little pricing power for Route in an industry in which products and services are slightly commoditised.

Having said that, Route does have certain advantages over its competitors. This includes a superior network with 99.9% coverage, RML APIs for all OTTs and the first mover advantage in the RCS space. Apart from this, the company is also a one-stop provider acting as an omni-channel platform and is well equipped with future technologies. It also has one of the best latency in the industry.

Exhibit 26: Strong positioning

Source: Juniper Research

Exhibit 27: Established in global space

Source: Juniper Research

History

The company was established as Routesms Solutions, a private limited company in 2004, in Mumbai (Maharashtra). Route's overall journey can be divided into three phases. During **Phase 1**, the company started operations to cater to the global market and an aggregator of traffic to gain MNO access. During this period, it hosted Short Message Service Centres (SMSC) in India and UK. It posted revenue of USD7mn at the end of the first phase in FY13.

During **Phase 2** from FY14-17, the company transitioned from an aggregator model to a direct enterprise model. Route further opened offices in new regions like EMEA and South East Asia. During this phase, it also completed acquisitions of 365squared, Cellent Technologies, Start Corp India and Call2Connect. The company ended with revenue of USD62mn at the end of FY17.

During the **third phase,** which began in 2018, Route developed next gen services like RCS and OTT services. It also entered the lucrative North American market, became hubbing partners with top telecom partners globally and had a full messaging technology stack through the TeleDNA acquisition. At the end of FY20, Route posted revenue of USD131mn.

Management Overview

Mr. Rajdipkumar Gupta

Mr. Rajdipkumar Gupta is the Managing Director and Group Chief Executive Officer of Route. He holds a bachelor's degree in science (physics) from the University of Mumbai and a master's diploma in software engineering from Aptech Computer Education. He is also a certified HTML programmer, Perl programmer and active server pages programmer from Brainbench. Mr. Gupta is the Promoter of the company and has been associated with Route since inception. Prior to incorporating the company, he has worked with Approved Information Systems (I) GurukulOnline Learning Solutions. He has more than 18 years of experience in the field of software designing and development.

Mr. Sandipkumar Gupta

Mr. Sandipkumar Gupta is Route's Non-Executive Director. He holds a bachelor's degree in commerce from the University of Mumbai. He is also a qualified Chartered Accountant and a member of the Institute of Chartered Accountants of India. He is a SAP certified solution consultant – mySAP Financials – Managerial and Financial Accounting. Mr. Gupta is also the Promoter of the company and has been associated with Route since inception. Prior to incorporating Route, he has worked with Covansys (India) and PricewaterhouseCoopers. He has over 19 years of experience in audit and accounts and business analysis, and over 15 years of experience in SAP configuration and software system consulting.

Mr. Gautam Badalia

Mr. Gautam Badalia is the Chief Strategy Officer of Route. He holds a bachelor's degree in economics from the University of Calcutta and a master's degree in Business Administration (finance) from ICFAI University. He has 13 years of experience in investment banking, mergers & acquisitions and structured finance. Prior to joining Route, Mr. Badalia worked with YES Securities (India). He is responsible for development and execution of strategic initiatives to support long term growth of Route and enhance shareholders value.

Mr. Rathindra Das

Mr. Rathindra Das is the Head Legal, Company Secretary and Compliance Officer of Route. He holds a bachelor's degree in commerce and a bachelor's degree in law from Assam University. He is a member of the Institute of Company Secretary of India. Mr. Das has over eight years of experience in compliance and secretarial matters. Prior to joining Route, he has worked with Piramal Roads Infra, Cipla, NSEIT, Metropolitan Stock Exchange of India, Hinduja Energy (India), Peninsula Land, Reliance Infrastructure and Neterwala Consulting and Corporate Services. He is responsible for secretarial matters and ensuring compliance with various regulatory requirements applicable to Route.

Mr. Rahul Pandey

Mr. Rahul Pandey is Route's Chief Credit Officer. He holds a bachelor's degree in science from Mumbai University. He has 16 years of experience in the telecommunications industry. Prior to joining Route, he has worked with DuFlon Polymers. He is responsible for coordinating the debts of existing creditors and deciding whether to allow credit to a debtor and overall managing all money borrowed or owed to the business.

Mr. Suresh Jankar

Mr. Suresh Jankar is the Chief Financial Officer of Route. He holds a bachelor's degree in commerce from the University of Pune and is a qualified Chartered Accountant from the Institute of Chartered Accounts of India. He has 10 years of experience in finance sector. Prior to joining Route, Mr. Jankar has worked with Capricorn Lifestyle. He leads the finance and accounts team and is responsible for activities pertaining to the accounts of Route in India.

Mr. Ramesh Helaiya

Mr. Ramesh Helaiya is the Chief Technical Officer. He holds a bachelor's degree in science (information technology) from University of Mumbai and advance diploma in software engineering from APTECH Computer. He has over 12 years of overall work experience in the information and technology sector. He is responsible for the company's messaging platform and technology related to the platform.

Industry Outlook

Cloud communication

Cloud communication is a new way to build, deploy and scale communications systems of enterprises. It offers enterprises cost-effective communication solutions that combine voice, messaging and data communication services over networks of telecom operators (MNOs) leveraging cloud-based infrastructure replacing the need for in-house software and hardware resources. With burgeoning internet penetration, enterprises are leveraging cloud-based solutions for streamlining back-end operations as well as for engaging with customers, employees and other stakeholders.

Following are certain consumer facing use-cases for cloud communication services used by enterprises across diverse sectors:

- One Time Passwords or OTPs received through messages while using net banking or online payment gateways for online transactions.
- Message updates related to change in flight schedule or boarding gate from airlines to passengers.
- Transaction confirmation and delivery update message for e-commerce transactions.
- Soliciting missed calls for supporting a cause and polling for television shows.

Exhibit 28: Key messaging formats for enterprises

Technology	Description
Short Message Service (SMS)	Referred to colloquially as a 'text message', or simply as a 'text'. An individual SMS is 160 characters in length, though several can be strung together to create longer messages – but nevertheless being billed per 160 character "message"
Multimedia Messaging Service (MMS)	Referred to colloquially as a 'picture message', though this tag is based on its predominant usage. MMS also facilitates sending of audio and video files, and is becoming more common as handset and network technologies develop
Instant Messaging (IM)	Referred to within the industry variously as either Over-the-Top or OTT owing to the fact that the message is carried over networks of MNOs as 'anonymous' data, and billed to the end-user as such, rather than as a SMS or MMS that is billed on a per message basis or internet protocol or IP based (because messaging service uses IP). IM has the ability to provide text, picture and video messaging, as well as file sharing. These services are perceived as being in competition with SMS/MMS (and consequently, with MNOs);
Email	Arguably the personal computer equivalent of SMS. In general, this market is considered to have less in common (and consequently, not in competition) with other forms of messaging, being more formal or less conversational (with mobile being on-the-go communication, as opposed to in-depth)
Social Messaging	This includes posting messages or uploading photo/video content to social networks like Facebook and micro-blogging via services such as Twitter.

Source: Route mobile RHP, Edelweiss Research

As cloud communication is a rapidly evolving field, there are no well-defined boundaries on what is included and what is not. Hence, the industry size and its growth estimates vary according to the definition. Following are some of the key estimates of the industry size according to various agencies:

- The market for **enterprise messaging using SMS**, which is a growing, global, but highly fragmented market with an estimated total market size of USD 17bn (MobileSquared, 2019).
- The market for **rich & conversational messaging** using next-generation messaging formats like WhatsApp Business and RCS – markets still in a nascent

stage but which is expected to grow by 100-300% in coming years (MobileSquared).

- The market for **CPaaS**, which reflects the software value-add from products leveraging mobile messaging, voice or video, and which has an estimated market size of USD4-8bn in 2021 and a growth CAGR of 35-57% (Gartner, IDC, Juniper).

Cloud communication involves the following sender – recipient relationships:

Application-to-Person (A2P): An automated message sent by a software application to a device controlled by a human being. For instance, a message containing an OTP for an online payment. Given the infrastructure needed for this type of application, it will more likely be acting on behalf of an enterprise, while the recipient could be a potential or existing customer, business client or employee.

Person-to-Application (P2A): A message sent by a device controlled by a human to a software application. For instance, a missed call for voting in support of a television reality show contestant.

Machine-to-Machine (M2M): A message sent by a device controlled by a software application to another software application. For instance, a vehicle manufacturer's measurements of a car's health can offer advice as regards pre-emptive maintenance before more serious events occur that might incur increased repair costs. This allows the vehicle manufacturer to maintain a good relationship with the consumer and improve brand loyalty.

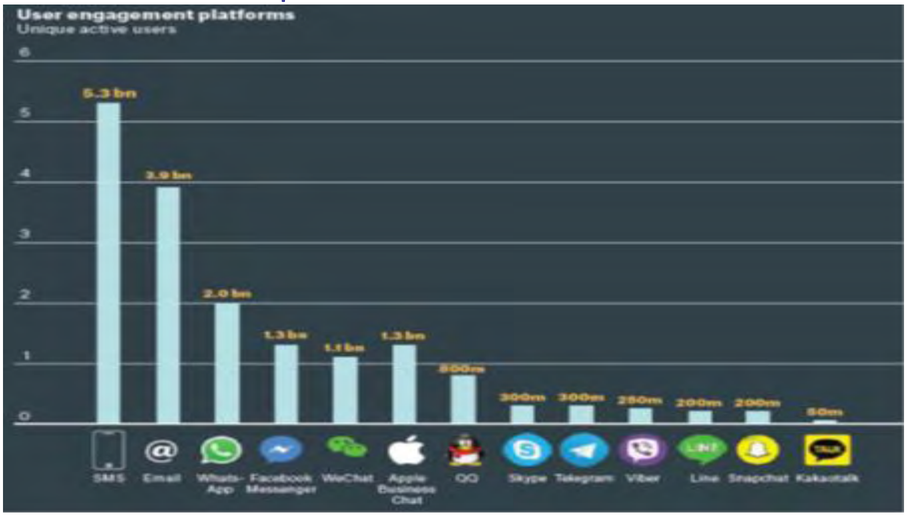
A2P and P2A messaging are referred interchangeably due to the fact that these type of messages are often two sides of a 'conversation'. For instance, a customer (person) sends a P2A message to his/her bank (or rather, an application on its server) requesting account information, and the bank (application) sends an A2P message back to the customer (person) with the requested information.

Due to its reach, ubiquity and reliability, SMS based A2P messaging is currently the largest enterprise cloud communication segment. A2P voice is a sub-scale, but fast growing segment. IoT, currently at conceptual stage, represents the concept of providing a connected digital identity to physical objects and networking those identities and their data together. The interconnection of these objects is expected to usher in automation in enterprise workflow, while also enabling advanced applications like a smart grid and expanding to areas such as smart cities. Analysis of the data that these objects produce aims to improve quality of life, efficiency, create value or reduce costs.

Enterprise messaging using SMS (A2P messaging)

Due to its ubiquity and reliability, SMS based messaging is currently one of the largest segments of enterprise communication. With over 5bn mobile phone users, SMS offer unparalleled reach. Hence, businesses are incrementally leveraging text messages to reach out to customers. The open rate for SMS messages is 4.5x higher than email and most people read their text messages in a minute or two, which makes SMS attractive for businesses.

Exhibit 29: SMS offers unparalleled reach to customers



Source: Sinch Annual Report 2019

Messages are sent from companies in all industries and tend to fall into a few broad categories. Estimates from MobileSquared indicate that 37% of all text messages sent by businesses are reminders & alerts, 28% are passwords, 19% promotions & adverts and 17% are customer service updates.

There has been significant evolution in the range of use cases for A2P messaging in recent years:

- Historically, A2P was used for alerts and, as PSMS (Premium SMS), a billing mechanism and carrier for simple content and services, both for one-off downloads or actions (e.g. voting) and for recurring payments.
- The latter use case has declined markedly in the past five years. This is due to a combination of the transition to an app-based economy, largely driven by card billing, and by regulatory action (in markets such as the US and the UK) against fraudsters.

Emerging messaging technologies, such as RCS, will begin to accumulate traffic share as operator and handset support increases. However, smartphone update cycles will limit adoption of the technology, thus limiting future RCS traffic. Nevertheless, the technology’s potential cannot be understated, considering the revenue that operators can achieve through implementation of the technology compared to the minimal investment needed to support it.

It is believed that CPaaS vendors and Messaging-as-a-Platform (MaaP) solution providers will have a significant role to play in future roll-outs of these services. Companies such as Infobip, Sinch, CM.com and OpenMarket will continue to act as the key link between operator networks and brands and enterprises that wish to use them.

The A2P SMS market is well established in North America and Europe. Further, future growth in these regions is forecasted to emanate from SMEs which have not yet adopted A2P as a communication tool, rather than any increase in messaging traffic per mobile subscriber or increase in the mobile subscriber base itself.

According to Juniper Research, the size of the global A2P messaging market (including only directly connected A2P revenue) was USD37.9bn in 2017 and is projected to post CAGR of 4.4%. Emerging markets like Latin America, Africa and Middle East are expected to grow faster.

Exhibit 30: A2P market across regions (USD mn)

Region	2017	2018	2019	2020	2021	2022	CAGR (%)
North America	14,484	15,689	16,981	17,742	17,952	18,074	4.5%
Latin America	2,800	3,280	3,732	4,157	4,528	4,913	11.9%
Western Europe	3,244	3,477	3,704	3,914	4,128	4,341	6.0%
Central and Eastern Europe	2,673	2,906	3,114	3,166	3,154	3,123	3.2%
Far East and China	8,246	8,363	8,412	8,323	8,210	8,096	-0.4%
Indian Subcontinent	1,924	2,107	2,238	2,322	2,346	2,360	4.2%
Rest of Asia Pacific	2,258	2,463	2,655	2,831	2,922	3,014	5.9%
Africa and Middle East	2,246	2,590	2,839	2,932	2,966	2,991	5.9%
Global	37,876	40,875	43,674	45,387	46,206	46,911	4.4%

Source: Juniper Research, Company

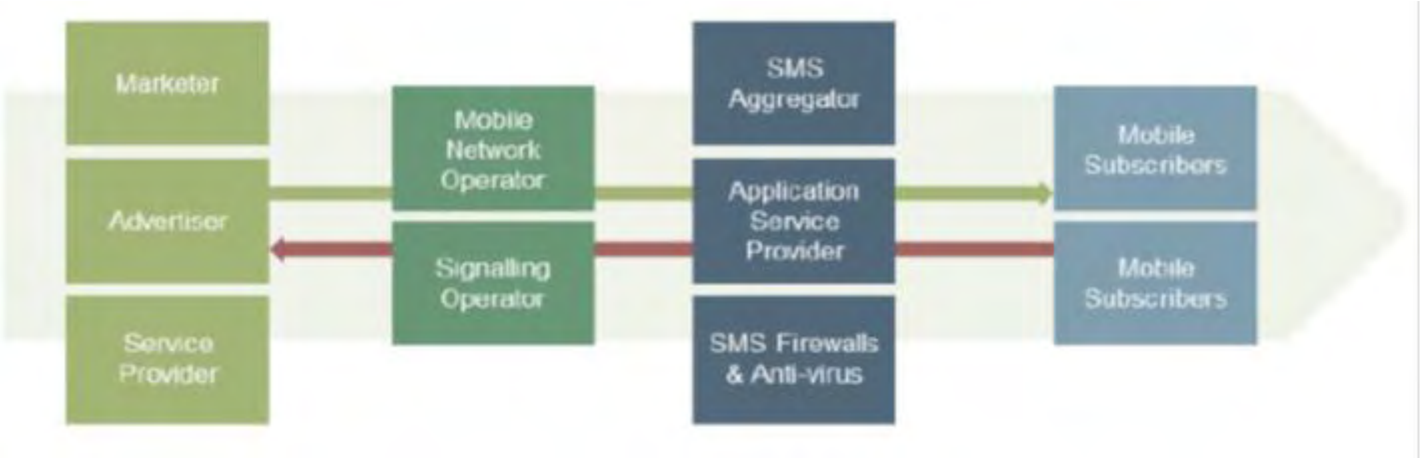
A2P value chain

A2P value chain consists of SMS aggregators (pure play aggregators or cloud communication companies) that operate the gateways that provide connectivity to networks of MNOs for enterprises seeking to use A2P messaging. Tier 1 aggregators processing over 1bn A2P messages per annum, typically rely primarily on direct connectivity to the MNO's SS7 network, using the Short Message Peer to Peer or SMPP protocol. However, below these tier-1 players are numerous smaller players, often processing far minuscule numbers (tens or hundreds of millions) of A2P messages per annum, in many cases wholly reliant on grey routes to deliver their messages.

SMS firewalls provide protection against malicious attacks, unsolicited SMS and fraud. Next-generation firewall providers are capable of identifying (and blocking) grey route traffic, thereby increasing monetisation of legitimate traffic. A number of firewall providers also allow operators to understand profile of the messaging traffic by conducting analytics of traffic flow.

Tier-1 players can fulfil multiple roles within the value chain. Several tier-1 players within SMS aggregation are also amongst the market leaders for firewalls.

Exhibit 31: A2P messaging value chain



Source: Company

Important to keep pace with technological changes

The A2P messaging industry still continues to grow even in developed markets as: 1) various use cases of technology are emerging; 2) more enterprises continue to adopt this technology; and 3) the technology offers one of the most ubiquitous ways of reaching customers globally. However, with rising smartphone adoption and technology evolution, there are new and more engaging ways of reaching customers such as OTT platforms, in-app communications, RCS, etc.

While existing players are developing new solutions as well, considering there are ready APIs for integration, deployment can be done by the software vendor sans a third party. Hence, we do expect increased competition in the OTT space and in-app communication as existing A2P providers will have to compete with a new set of providers. Some of the A2P providers have already deployed OTT solutions for enterprises, but for long-term success, they will have to demonstrate an ability to create solutions for enterprises.

On the other hand, higher adoption of RCS could spur integration with A2P providers as the RCS platform is agnostic and will require connectivity with operators. Since RCS offers much richer media with significantly more use cases, A2P providers capitalise on this space. However, these technologies are at early stages and hence it is difficult to estimate whether A2P providers will be able to capitalise on the OTT and in-app communication piece or RCS will gain meaningful traction.

Key players in A2P business

The A2P industry is fragmented with presence of large players in each market. Most players have regional presence with strong connectivity in particular areas. In India, Tanla Platforms (Karix), Route Mobile, ValueFirst Digital Media and Gupshup Technology are the key local players and Infobip & Sinch (ACL) are global players. Globally, Twilio, Sinch, Infobip, Mavenir Systems, MessageBird, Vonage and Syniverse are major players.

Since A2P SMS as a product is fairly standardised, little differentiation with respect to service offerings is possible. Hence, pricing tends to be standardised. However, as larger A2P players carry higher volume, they tend to get better pricing from MNO, which results in lower cost versus smaller players. This is resulting in consolidation in the industry as higher volume results in lower cost of operation.

Key company profiles

Gupshup Technology

Gupshup is a smart messaging platform which enables businesses to build engaging conversational experiences across more than 30 channels using a single API. Its messaging platform handles over 4.5bn messages per month, allowing close to 37,000 businesses send messages to business users. Some of its largest clients include Facebook, Twitter, WhatsApp, Ola, ICICI, HDFC, Citibank, Dish TV, etc. Some of the key channels that are supported are SMS, voice, WhatsApp, Facebook, Teams, Alexa, Jiochat, etc.

A single API is used to create conversations across SMS, voice and IP messaging. The API supports several features like two-factor authentication, outbound dialler, smart messaging, link tracking, Bot messaging, number masking, etc. The company has been profitable since 2011 and had last raised funding of USD10mn in 2011. It was the only Indian brand to feature among top global firms in the bot services market. While it started as a B2C company, it pivoted to a B2B model when it found monetisation difficult.

Infobip

Infobip is a telecommunication and IP platform provider which specializes in A2P messages, RCS, voice, email, push notifications and chat applications. It is more focused on enterprise solutions and has a smaller presence in the overall messaging space. The company has 56 staffed offices and serves customers in over 190 countries. Its customers include internet companies, mobile and digital companies, OTTs, banks and other large enterprises.

Communication channels offered by Infobip include WhatsApp business, SMS, voice, email, mobile app messaging, RCS, Viber business, live chat and Facebook messenger. Solutions provided by Infobip include security, customer onboarding, customer engagement, customer service, customer retention and operational efficiency.

Large companies like Unilever have implemented WhatsApp Business API to streamline their marketing solutions. Companies like BlaBla car, Marham, Bukalapak, medGo and Asia Insurance 1950 use Infobip's SMS solution to improve communication. Other major clients include Uber, Sberbank, Burger King, Raiffeisen Bank and Strava.

Business solutions provided by the CPaaS platform has three features: (i) expand the Mobile Network Operator's portfolio including RCS, email, chat and app messaging; (ii) provide new streams by allowing monetization of non-core telecom products and SMS off-net traffic; and (iii) faster revenue for enterprises with local support.

Mavenir Systems

Mavenir is an end-to-end, cloud native network software and solutions provider for 4G and 5G. It is focused on accelerating software network transformation for communication service providers (CSPs). It offers a comprehensive end to end product portfolio across every layer of the network infrastructure stack. The company was established in 2005 and was acquired by Mittel in 2015.

It has a large customer base of 350 CSPs, serves 3.5bn mobile subscribers and reaches over 60% of global subscribers. Mavenir's operator partner base ensures it delivers services in over 140 countries. It offers CSPs solutions for cost reduction, revenue generation and revenue protection. Its core solutions include cloud native IMS (IP Multimedia Subsytem), messaging evolution/ RCS, cloud packet core and voice evolution. The virtualized IMS platform serves as the foundational technology for all IP communication services in 4G and 5G networks. The RCS platform and hub offers a virtualized RCS environment which allows for no investment in infrastructure. Mavenir's fraud messaging service, spam shield detects and prevents fraud A2P traffic.

MessageBird

MessageBird was founded in 2011 and is headquartered in Amsterdam, Netherlands. It offers SMS, voice and chat APIs to clients. It has connections with 900 carrier operators globally. Some of its well-known clients include Huawei, Uber, Doordash, Heineken, Telegram and ABN Amro. Over 15,000 customers rely on Messagebird's algorithm for routing.

Its highly popular SMS gateway uses proprietary algorithms to route messages in an efficient manner. Products offered by MessageBird are related to management of inbox, conversation, phone numbers, channels, integration, flow builders etc. The highly popular Verify API is used to confirm identity to secure accounts, authenticate transactions and prevent fraud with a REST API for a two factor authentication and one-time password. Its other popular services include Lookup, which allows clients to incorrect numbers reducing the undesired traffic. It currently boasts of a of 99.98% uptime rate. It is smaller in size compare to the other companies in the A2P sector and possesses lesser experience as compared to its peers. However, its geographical reach has been its strongest factor.

Sinch

Sinch is a leading cloud communications platform which connects businesses to people through mobile messaging, voice and video. The company was back in 2008 in Stockholm and is currently present in 33 countries. It counts Top 8 of the 10 companies in the world as its clients. Sinch offers cloud-based Saas that allows businesses to take advantage of the new opportunities in rich media and conversational messaging. It offers A2P SMS through a range of APIs including HTTP, SMPP and REST. The REST API is the most advanced and is able to implement long messages, batch sending, message scheduling, group messaging, etc. It also offers RCS messaging services for enterprises and SMS solutions (acquired through Symsoft acquisition).

The company generates revenue from messaging services and sales of software licenses, updates and equipment support. A large part of the revenue that Sinch receives from its clients is passed on to mobile operators to place calls and transmit messages. Variation in gross margin reflects a change in geographical mix given that cost per message charged by operators varies widely across countries. Unlike COGS, the operating expenditure is largely fixed and hence, increased traffic/ volumes results in higher profitability.

Earlier Sinch reported four operating segments--Enterprise, Operator, Sinch Voice & Video and Vehicle. From 2019, the group's operating segments are messaging, voice & video and operators. Revenue in the messaging segment consists of fees for handling messages and executing & handling of MMS and dynamic videos for enterprises. Voice & video revenues are for handling these communications and revenues within the operator segment are for software licenses including upgrades and software fees.

Net revenue jumped 26.3% YoY to SEK5.0bn. 91.7% of the revenue came from the messaging segment, 4.9% from the voice & video segment and balance 3.3% from the operators segment. In terms of geographical contribution, United States contributed the highest at 35.9%, followed by United Kingdom at 14.3%. In terms of products and services, messaging services contributed the majority 94.3% to revenue and balance was contributed by initial software licenses and upgrade, hardware and support. Sinch has been profitable and cash generative since 2008. EBITDA margin grew 160bps to 11% in 2019. PAT jumped 53% YoY to SEK275mn in 2019.

Syniverse

Syniverse provides technology and business services to multiple enterprises. Its product and services include consumer mobile marketing and customer experience, mobile security, mobile network operator solutions and outsourcing and consulting.

Syniverse was founded in 1987 and was delisted in 2011 after it was acquired by the Carlyle Group. Its tie up with more than 1,500 service providers enables it to provide its communication services to consumers in more than 200 countries. In the past, it has acquired companies (or part of companies) to enhance its capabilities like VeriSign, Mach, Aicent. In terms of capacity and capabilities, Syniverse is one of the larger companies in the A2P sector.

The company offers a diverse range of omni-channel communication technologies like SMS, RCS, Push Notifications and voice. It has also added APIs to take advantage of OTT channels like WhatsApp and Facebook Messenger.

Syniverse has partnered with Mavenir leading to the development of the Syniverse-Mavenir RCS business messaging platform which can offer the following functionalities- RCS Chatbots, Real-time chatbots and OTT services.

Tanla Platforms (Karix)

Tanla Solutions (earlier Tanla Platforms) is a cloud communications provider based in Hyderabad, India. It initially started as a bulk SMS provider in Hyderabad catering to SME. The company evolved into a cloud communication provider offering services to over 1,500 enterprises in FY19-20. Tanla acquired Karix Mobile (formerly mGage India) in 2018 from GSO Capital partners, a Blackstone company, which established its leadership in India's A2P market.

The company derives its revenue primarily from A2P messaging services, international long distance and voice services. Tanla receives revenue from telecom operators in the form of revenue share measured at fixed value/ percentage of transaction rate applicable to each individual communication processed on their network. Tanla receives revenues from enterprises for the use of its platform at an agreed rate per communication, calculated on monthly basis, for an aggregate number of communications processed in the month. Cost of services for platforms includes hosting charges paid to data centers and bandwidth charges paid to telecom operators. Operating expenses include costs related to network operations, data center maintenance costs, related utilities and maintenance & personnel costs.

Tanla's products can be classified for messaging, voice and IoT. Within messaging, it offers services like SMSC, SMS firewall, SMS Hubbing, Unstructured Supplementary Service Data (USSD) center and push notifications. In voice, Tanla offers services like Hosted IVR, voice broadcast, Free ring and source trace. Its IoT platform enables business transformation by creating a smart connection between people, machines and processes. The key messaging platform has advanced security, reliability, analytics, and service levels along with ability to process large volumes messages per second. The A2P messaging monetisation solution allows mobile operators to capitalise on hidden A2P opportunities by creating new profit lines and plugging the cost-revenue gap. For enterprises, Tanla offers solutions like SMS campaign manager, two-factor authentication and Boomering.

For FY20, Tanla generated revenue of INR19.4bn, up 94% YoY. The sharp jump in revenue includes the acquisition of Karix and Gamooga during the year. Overseas revenue was INR4.5bn, 23.3% of overall revenue. The overseas business grew 143% YoY largely due to the acquisition of Karix, which has substantial international business. Domestic business jumped 82% YoY to INR14.9bn and contributes 76.7% to overall revenue. Gross profit grew 173% YoY to INR3.9bn. Gross margin expanded 580bps YoY to 20.1%. EBITDA grew 91% YoY to INR1.85bn. Margin was flat with an increase in employee costs, other expenses and provision for bad debt.

Twilio

Twilio is a leader in the cloud communications platform category. It offers developers to build, scale and operate real-time communication within software applications. It was founded by Jeff Lawson in 2008. Twilio's programmable application programme interfaces (APIs) are a set of building blocks that developers can use to build exact customer experiences that they want. It enables communications for more than 190,000 and assists in nearly 932bn human interactions. While Twilio allows developers to build applications within its API, it manages the connections between the internet and global communications network.

Twilio generates majority of its revenue from customers based on their usage of its software products that they have incorporated in their applications. The Flex contact center platform is offered on a per user, per month or a usage basis per agent hour basis. Similarly, the email API is offered on monthly subscription and the marketing campaigns pricing is based on the number of email contacts stored and number of monthly emails sent to these contacts via the Twilio platform. The network service provider fees form bulk of the cost of revenue. It also includes cloud infrastructure fees, personnel costs and depreciation and amortization related to data centers and hosting centers. The business model is primarily focused on reaching and serving the needs of software developers.

Common use cases provided by Twilio include anonymous communications, alters & notifications, contact center, call tracking, marketing and user security. Twilio provides developers with channel APIs that allow developers to embed voice, messaging, video and email capabilities into their applications. Channel APIs provided by Twilio include Programmable voice, Programmable video, Programmable messaging and email. Twilio's channel APIs are built on top of its global software which it defines as a Super Network. The Super Network intelligently interfaces with communication networks globally. It analyzes massive volumes of data to optimise its customer's quality of communication and cost.

Twilio generated revenue of USD1.1bn for the year ending December 2019, up 75% YoY. This included revenue from its newest acquisition SendGrid, which was acquired on February 1, 2019. GAAP loss from operations widened to USD369.8mn in 2019 from USD115.2mn in 2018. Active customer accounts jumped sharply to 179,000 in 2019 from 64,286 in 2018 (includes SendGrid accounts as well).

ValueFirst Digital Media

Valuefirst assists businesses to connect with their customers over teleco006D and internet. Its services include AI Chatbots, automation, engagement solutions, email, voice and SMS. It was founded in 2003.

Its solutions include messaging, conversational AI and Marketing Technology (MarTech). In messaging, Valuefirst provides services like WhatsApp API, Enterprise SMS and Google Verified SMS. In conversational AI, Valuefirst provides products like Surbo and Botsup. Surbo is a conversational AI platform for enterprises which enables cognitive conversations with customers through chatbots on OTT platforms. Botsup allows creation of conversational and engaging chatbots with a do-it-yourself platform. Valuefirst also has Octane, its email platform, which assists in customer engagement with personalised email campaigns. Augmento is an AI driven cross-channel marketing automation platform which helps and identifies customer behaviour and automates interactions. Its enterprise voice function allows to connect with customers at scale. The cloud-based voice suite allows for inbound IVR, outbound IVR, missed call, text to speech, click to call and outbound dialling.

Vonage

Vonage provides cloud-based UCaas solutions, consisting of integrated voice, text, video, data, collaboration, contact center and mobile applications over its network. The API platform group also offers CPaaS solutions via communications APIs to developers. It was founded in 2001 and was one of the first companies to offer VoIP technology offering feature-rich, low cost voice services. Ove the years, it has transitioned to a SaaS company offering a suite communication solutions for businesses.

Revenues include service revenue, customer equipment and shipping fee revenue. Majority of the revenues are services revenue. The cost of revenue primarily consists of costs that are paid to third parties such as access and interconnection charges. Other costs include costs to lease phone number, to co-locate in other companies and provide local number portability. Overall cost of revenues is classified as service cost of revenue, access & product cost of revenue and USF cost of revenue. The sales and marketing cost of revenue consist of the cost of personnel and related costs for employees and contractors associated with these activities.

Products offered by Vonage include communication APIs, unified communications and contact centers. Communication APIs allow developers to build omni-channel conversations that transform customer experience with programmable messaging, voice, video, etc. Unified communication allow for flexible communication and collaboration solutions for employees across every channel. Contact centers provide for CRM integration across every channel assisting sales and service agents to assist the customers.

Total revenue increased 13% YoY to USD1.2bn in 2019. The growth in revenue was driven by increase in business customer growth, offset by a decline in customer revenue. Cost of revenue increased 20% YoY to USD511.8mn driven by an increase in costs servicing business customers. Total other operating expenses increased 18% YoY in 2019 led by a 17% YoY increase in sales and marketing costs due to the recent acquisitions and 33% YoY increase in engineering and development expenses due to the companies' focus on its proprietary platform.

Financial statements

Income Statement (INR mn)

Year to March	FY20A	FY21E	FY22E	FY23E
Total operating income	9,563	14,123	17,520	20,856
Gross profit	0	0	0	0
Employee costs	582	601	684	779
Other expenses	341	456	568	677
EBITDA	998	1,722	2,204	2,661
Depreciation	227	272	322	315
Less: Interest expense	49	33	33	33
Add: Other income	119	167	195	256
Profit before tax	841	1,584	2,043	2,569
Prov for tax	150	293	388	488
Less: Other adj	0	0	0	0
Reported profit	692	1,297	1,661	2,087
Less: Excp.item (net)	0	0	0	0
Adjusted profit	692	1,297	1,661	2,087
Diluted shares o/s	50	54	58	60
Adjusted diluted EPS	13.8	24.0	28.4	35.0
DPS (INR)	3.0	2.4	2.8	3.5
Tax rate (%)	17.9	18.5	19.0	19.0

Balance Sheet (INR mn)

Year to March	FY20A	FY21E	FY22E	FY23E
Share capital	500	569	569	569
Reserves	2,204	5,690	7,169	9,026
Shareholders funds	2,704	6,259	7,737	9,594
Minority interest	(22)	(28)	(34)	(40)
Borrowings	411	411	411	411
Trade payables	1,813	1,745	2,155	2,560
Other liabs & prov	1,282	1,282	1,282	1,282
Total liabilities	6,265	9,747	11,629	13,885
Net block	224	239	264	315
Intangible assets	1,542	1,435	1,308	1,207
Capital WIP	0	0	0	0
Total fixed assets	1,766	1,674	1,572	1,522
Non current inv	0	0	0	0
Cash/cash equivalent	1,026	4,064	5,430	7,129
Sundry debtors	2,037	2,573	3,192	3,799
Loans & advances	0	0	0	0
Other assets	1,016	1,016	1,016	1,016
Total assets	6,265	9,747	11,629	13,885

Important Ratios (%)

Year to March	FY20A	FY21E	FY22E	FY23E
Revenue growth (%)	13.2	47.7	24.0	19.0
Gross Margin (%)	20.1	19.7	19.7	19.7
Other cost (% of Rev)	3.6	3.2	3.2	3.2
EBITDA margin (%)	10.4	12.2	12.6	12.8
Net profit margin (%)	7.2	9.2	9.5	10.0
Revenue growth (% YoY)	13.2	47.7	24.0	19.0
EBITDA growth (% YoY)	8.2	72.5	28.0	20.8
Adj. profit growth (%)	23.6	87.6	28.0	25.6

Free Cash Flow (INR mn)

Year to March	FY20A	FY21E	FY22E	FY23E
Reported profit	692	1,297	1,661	2,087
Add: Depreciation	227	272	322	315
Interest (net of tax)	49	33	33	33
Others	28	(1,088)	(230)	(179)
Less: Changes in WC	119	604	209	203
Operating cash flow	934	825	1,607	1,970
Less: Capex	(73)	(180)	(220)	(265)
Free cash flow	862	645	1,387	1,705

Assumptions (%)

Year to March	FY20A	FY21E	FY22E	FY23E
GDP (YoY %)	5.0	(6.5)	7.5	6.0
Repo rate (%)	4.4	4.0	3.8	4.0
USD/INR (average)	70.9	75.0	73.0	72.0
Capex	72.7	180.0	220.0	265.0
Tax rate (%)	17.9	18.5	19.0	19.0
Payable days	51.4	51.4	51.4	51.4
Recievable days	66.5	66.5	66.5	66.5
Dividend per share	3.0	2.4	2.8	3.5
Employee exp (% of rev)	6.1	4.3	3.9	3.7

Key Ratios

Year to March	FY20A	FY21E	FY22E	FY23E
RoE (%)	28.7	29.0	23.7	24.1
RoCE (%)	29.8	33.2	28.1	28.8
Inventory days	0	0	0	0
Receivable days	66	60	60	61
Payable days	58	57	51	51
Working cap (% sales)	(0.8)	3.7	4.2	4.5
Gross debt/equity (x)	0.2	0.1	0.1	0
Net debt/equity (x)	(0.2)	(0.6)	(0.7)	(0.7)
Interest coverage (x)	15.8	44.1	57.3	71.4

Valuation Metrics

Year to March	FY20A	FY21E	FY22E	FY23E
Diluted P/E (x)	83.8	48.3	40.7	33.1
Price/BV (x)	21.4	10.0	8.7	7.2
EV/EBITDA (x)	66.0	36.5	27.9	22.5
Dividend yield (%)	0.3	0.2	0.2	0.3

Valuation Drivers

Year to March	FY20A	FY21E	FY22E	FY23E
EPS growth (%)	23.6	73.6	18.5	23.1
RoE (%)	28.7	29.0	23.7	24.1
EBITDA growth (%)	8.2	72.5	28.0	20.8
Payout ratio (%)	21.7	10.0	10.0	10.0

Source: Company and Edelweiss estimates

Additional Data

Management

MD and CEO	Rajdip Gupta
Chairman & Ex. Director	Sandip Gupta
CFO	Suresh Jankar
CSO	Gautam Badalia
Auditor	Walker Chandiok & Co LLP

Holdings – Top 10*

	% Holding		% Holding
Goldman Sachs	4.94		
Nippon AMC	4.35		
Abakkus Fund	3.49		
Kuwait Inv. Fun	1.43		
Pinebridge Fund	1.32		

Latest public data

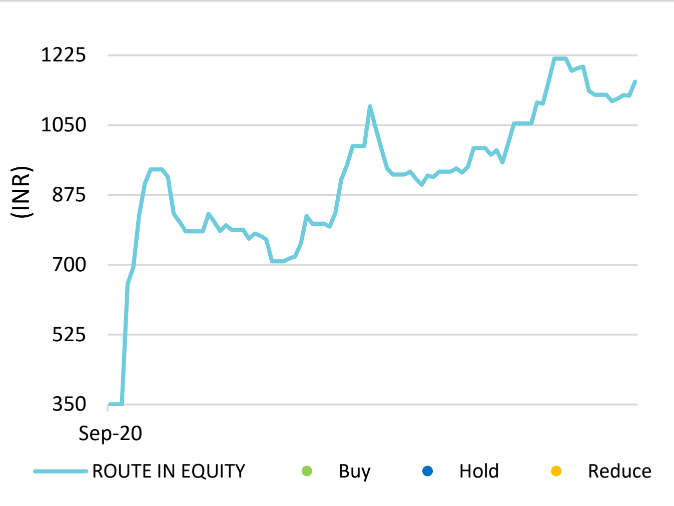
Recent Company Research

Date	Title	Price	Reco

Recent Sector Research

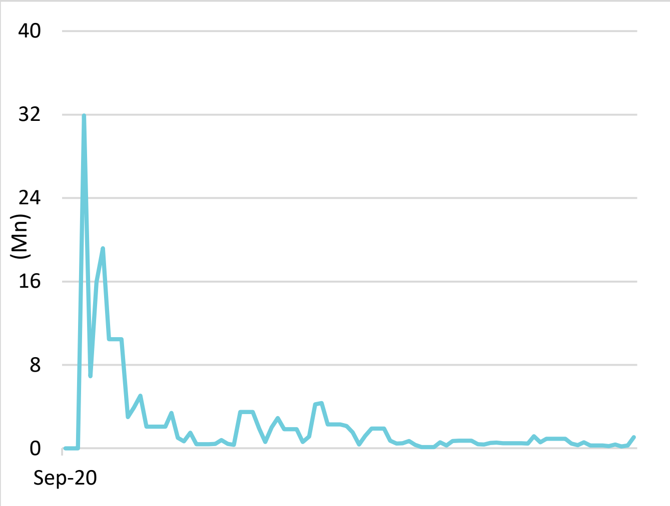
Date	Name of Co./Sector	Title
30-Oct-20	Vodafone Idea	Fighting it out; *Result Update*
28-Oct-20	Bharti Airtel	Quality begets quality; *Result Update*
27-Oct-20	Bharti Airtel	Beat on all counts; *Oven fresh*

Rating Interpretation



Source: Bloomberg, Edelweiss research

Daily Volume



Source: Bloomberg

Rating Distribution: Edelweiss Research Coverage

	Buy	Hold	Reduce	Total
Rating Distribution*	162	63	14	239
	>50bn	**>10bn and <50bn**	**<10bn**	**Total**
Market Cap (INR)	184	58	6	248

* *stocks under review*

Rating Rationale

Rating	Expected absolute returns over 12 months
Buy:	>15%
Hold:	>15% and <-5%
Reduce:	<-5%

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Aditya Narain
Head of Reserch
Aditya.Narain@edelweissfin.com
