

Fatpipe Networks India Ltd

**IPO Grading: BWR IPO Grade 2
(Below Average Fundamentals)**

Brickwork Ratings has assigned BWR IPO Grade 2 for the proposed IPO of Fatpipe Networks India Limited ("FNIL" or "the Company"). Brickwork Ratings' BWR IPO Grade 2 indicates below average fundamentals for the issue in relation to the listed peers. BWR assigns IPO grading on a scale of IPO Grade 5 to IPO Grade 1, with Grade 5 signifying strong fundamentals and Grade 1 signifying poor fundamentals of the issue in relation to the listed peers.

The grading factors FNIL's track record in US market, management's experience and understanding networking industry, large customer base in US. However, the grading is constrained by FNIL's scale of operations in the country, competitive nature of the industry, threat of substitute products, and high share of intangible assets in total fixed assets. The project is not appraised by term lending institution and is fully funded by IPO proceeds.

Company Profile

FatPipe Networks India Limited was incorporated in December, 2002 as a Private Limited Company under the name and style "FatPipe Networks India Private Limited". It became a Public Limited Company in September 2008. FNIL is promoted by Dr. Ragula Bhaskar and Ms. Sanchaita Datta

Ragula Systems Development Company (RSDC) dba FatPipe US was incorporated in the year 1989 in the State of Utah. RSDC was promoted by Dr. Ragula Bhaskar. FatPipe US provides WAN reliability, a redundancy and transmission security appliance that ensures reliability.

FNIL had filed a scheme for amalgamation of RDSC with itself. The amalgamation was approved by High Court of Tamil Nadu. Pursuant to the scheme of amalgamation, the share holders of RSDC were allotted 12,449,288 of FNIL in Oct 2008.

FNIL is a provider of router clustering products for wide area network (WAN) optimization, reliability, security, and bandwidth management applications. Its products enable high-speed data transfer through multiple lines, ISPs, and backbones over the Internet or other WANs with the re-assembly of data streams. The company's products allow corporations to implement Intranets, e-commerce strategies, virtual private networks, as well as to utilize application specific servers over the Internet or WAN. It offers its products through a network of distributors and dealers in the United States and internationally. It has offices in the United States, the United Kingdom, Australia, and India.

Management

FNIL management has experienced team of professionals with track record of management and leadership across various fields like technology, venture capital, public sector undertakings, and civil services.

Dr. Ragula Bhaskar, Managing Director, is Ph.D. in Engineering, a dual M.S. in Engineering and Operations Research and M.S. in Business Administration (Honors) with specialization in Finance, all from the Pennsylvania State University. He is the co-inventor of router-clustering technology that provides highly redundant, secure, and high-speed Internet/WAN access for various business applications. Dr. Bhaskar has received several prestigious awards and has been profiled in leading US magazines. He has also held chairmanships in many committees and boards of institutions based in Utah, US.

Ms. Sanchaita Datta, Whole-time Director, is the co-inventor of Router-Clustering technology. She holds a MS in Electrical Engineering from Pennsylvania State University. She is a candidate for PhD in Electrical Engineering at the University of Utah. In recognition of her achievements in the field of communications technology, Ms. Datta has received several awards and honors from leading US magazines and institutions.

Mr. RSSLN Bhaskarudu, Independent Director, is an electrical engineer from College of Engineering, Kakinada, Andhra University. He has over 43 years of experience with enterprises such as Bharat Heavy Electricals Limited (BHEL), Maruti Udyog Limited (MUL). He has served as a member/chairman of the Public Enterprises Selection Board of the Government of India.

Mr. Ravi Adusumalli, Independent Director, is a Bachelor of Arts in Economics and Government from Cornell University. He is currently a General Partner and Head of SAIFs India Operations. He has worked with Mobius Venture Capital, Credit Suisse First Boston and Wasatch Funds. He was named as one of the Forbes.com Top 100 Venture Capitalists with a Midas touch.

Mr. Naresh Narad, Independent Director, is a B.A., LL.B. and a retired IAS Civil Servant. He was the chairman of Public Enterprises Selection Board and a member of the Board of Governors of Indian Institute of Management, Ahmedabad and Kolkata. Mr. Naresh Narad has served as Secretary in various ministries such as Ministry of Heavy Industries and Public Enterprises, Ministry of Petroleum and Natural Gas and as Joint Secretary in the Ministry of Steel, Govt. of India.

Corporate Governance

To comply with provisions of Clause 49 of the Listing Agreement, FNIL has constituted its Board of Directors and has formed various committees namely Audit Committee, Shareholders'/Investors' Grievance Committee and Remuneration Committee. The company has adopted Corporate Governance practices to enable the Board to function independently while ensuring transparency. Presently, the company has Five Directors on the Board that includes two promoters and three independent directors. Mr Bhaskarudu, an independent director, joined the Board in Nov 2008. The other two independent directors, Mr Ravi Adusumalli and Mr Naresh Narad joined the Board in August 2009.

Objectives of the issue

FNIL is raising equity funds to expand the product line by enhancing the research and development activities especially for development of new products, set up new marketing offices across the globe including USA, strategic acquisition of business/company. Part of the issue

proceeds will be used to meet the working capital requirements, issue expenses and for listing the company's share on stock exchanges. Table 1 gives summary of the project cost.

Table 1: Cost of the Project

Particulars	Total Cost (in Rs. Crore)
To expand the product line with enhanced Research and Development	6.76
To establish marketing offices	10.08
Strategic Acquisitions of business/ company	15.00
To meet working capital requirements	7.20
To meet Public Issue Expenses	3.55
General Corporate purposes	6.41
Total	49.00

FNIL operates in an industry where technological innovations happen at very fast pace. In order to remain competitive, FNIL seeks to enhance its R&D capabilities by inducting additional staff that can engage in cutting edge research and develop new products to suite market needs. FNIL also intends to strengthen its presence across the globe by setting up additional offices which is expected to increase the revenues. In order to further strengthen the company's existing capabilities, FNIL seeks to acquire businesses with complimentary technology which will enable FNIL to serve existing and new customers better.

According to the management's estimate, the project activities are expected to be completed by March 2011. However, the project is in very preliminary stage as the funding will be through issue proceeds. The company has also not entered into agreement or commitment for strategic acquisition. Any delays in the activities can lead to cost and time overruns and can adversely affect the company's operations.

Project Funding

To meet the funding requirements, FNIL plans to issue [#]1 Equity Shares of Rs.10/- each at a premium to be decided later and internal accrual. The promoters are not participating in the public issue. The funding requirements for the project is neither appraised nor funded by any term lending / financial institution. In absence of participation by term lending / financial institution the utilization of issue proceeds will be by the company.

Table 2 gives present shareholding pattern of the company.

Table 2: Shareholding Pattern

	Pre-Issue (%)	Post-Issue (%)
Sanchaita Datta	16.60	*
vSpring Management	16.28	*
Ragula Bhaskar	16.09	*

* To be disclosed by the company

Wasatch Ventures	8.85	*
vSpring SBIC Management LLC	5.85	*
R. Ethiraj	4.36	*
Draper & Associates	3.99	*
Trans Cosmos Inc.	2.69	*
Odessey Capital LLC.	2.30	*
Dinesh Patel	1.44	*
Others	21.56	*
GRAND TOTAL	100	100

Industry Risks

The computer networking equipment industry comprises of companies engaged in design and manufacture of network access and communication devices, security hardware, routing and switching equipment and other products. The domestic transmission equipment market has witnessed high growth over past few years mainly due to ongoing expansions and enhancements to existing infrastructure by various sectors such as IT/ITeS, BFSI and Telecom which have started to pick up post global meltdown. After a moderate growth during 2009, the domestic IT/ITeS market is expected to grow at 15% in 2010 while the Indian telecom market has been growing at a rapid pace, fuelled by the exponential growth in cellular subscribers and demand for voice services.

In addition to network expansion, there has been increased demand for high quality, high performance, scalable, reliable and secure applications which are expected to provide thrust to the networking equipment market. The profitability of networking industry is expected to remain high as the contribution of IT/ITeS industry to GDP is expected to increase from 5.5% to 8% by 2016. Indian markets are beginning to see IT infrastructure growth, aggressive expansion by Indian companies in foreign markets and inflow of MNCs in India which increases their requirement for network connectivity solutions.

Indian networking industry is competitive in nature and is dominated by few large players and large number of small-medium enterprises offering cutting edge solutions for network optimization, data transmission, data security and other technologies. The entry barriers are not very high as compared to other industries. While revenue and profitability show an increasing trend, companies face significant threat of technology obsolescence. Innovations happen at very fast pace and newer products may drive existing products out of the market. Threat of substitute products/technologies is also high in the networking industry as several companies offer plethora of products to meet customer's networking requirements.

Business Risks

FNIL is a technology solutions provider using its patented "router clustering" technology that is used for high-speed data transfer through multiple lines, ISPs and backbones over the internet or other WANs. The company offers range of patented products that enable its clients to optimize data transfer, maximize their network bandwidth and also enhance data security over public and private networks.

FNIL's management believes that its technology reflects the current state of the art for highly redundant and reliable systems for intra-corporate communications. The Computers Networking industry is evolving rapidly and it is a challenge to keep up the pace. The Company's failure to respond in a timely manner to changing market dynamics or client requirements would have a material adverse affect on its business, prospects, financial conditions and results of operations. The Company's success will depend, on its ability to keep pace with changing technology.

FNIL's operations are primarily focused on US markets with significant portion of revenues generated from customers based in US. RSDC which accounted for the major portion of the revenue prior to amalgamation will now become the branch office. The amounts remitted by the Indian company to its USA branches are subject to foreign exchange restrictions. Such payment restrictions may adversely affect the operations of the branch offices of the Company in the USA which may in turn affect the Company's business and profitability.

FNIL and RSDC were amalgamated into single entity in FY09 with a view to strengthen FNIL operations and shift the headquarters to India. The amalgamation of RSDC with FNIL was passed by Hon'ble High Court of Madras. Post amalgamation the paid up share capital of FNIL increased from Rs 1 lac to Rs 1302.65 lacs and the promoters of RSDC were issued 1,24,49,288 shares of face value of Rs 10 each, which is the nearly ninety five percent of the post amalgamation equity of FNIL.

The company does not have significant operations in India since the Indian entity only provided support operations because of which it does not enjoy significant market share in India. The company may face substantial competition in the Indian markets.

The company has been issued 7 patents with 3 pending patents which protect it from infringement on its intellectual property. The patents have been valued at the research and development cost incurred their development. The development cost is being amortized over approximately twenty years period. More than eighty percent of the company's networth is due to the value of the patents. The amortization period for writing off the R & D expenses to develop the patents is as per US Laws is long considering fast changing technology in the industry.

Financial Performance

During FY09, there was amalgamation of Fatpipe Networks India Pvt Ltd based in Chennai, India and Ragula Systems Development Company (RSDC) based in Utah, US via share exchange transfer with the shareholders of RSDC. As a result of the amalgamation, the operating income increased significantly from Rs 3.16 Crore in FY08 to Rs 41.98 Crore in FY09. Profit after Tax increased from Rs 0.17 Crore in FY08 to Rs 3.99 Crore in FY09, which reflect the financials of the company for the first year after amalgamation. The cash flows from operating activities of FNIL have been positive for last three years and increased from Rs 0.14 Crore in FY08 to Rs 6.18 Crore in FY09 due to the amalgamation. The cash flows from investing activities however have been negative for last three years on account of purchase of fixed assets and intangible assets. Table 3 gives snapshot of the Profit and Loss statement of FNIL.

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February 2010
K. HOLLW
Vice President

Table 3: Abridged Profit and Loss statement

In Rs Crore	2009	2008	2007
I. INCOME			
Sales & Operating Income	41.98	3.16	2.22
TOTAL INCOME	42.3	3.16	2.22
II. EXPENDITURE	35.9	2.81	1.80
III. NPBITD	6.42	0.34	0.43
Less: Interest & Finance charges	0.25	-	-
Less: Depreciation	1.92	0.14	0.11
V. NET PROFIT BEFORE TAXATION	4.24	0.20	0.32
Less: Taxes	0.25	0.03	0.01
VI. NET PROFIT AFTER TAXATION	3.99	0.17	0.31

The operating profit margin and net profit margin stood at 15.30% and 9.50% respectively during FY09. The Return on Capital Employed was at 43% for FY09. The total debt to equity ratio stood at 0.08 times in FY09. The total debt as on 31st March, 2009 stood at Rs 1.41 Crore due to inheritance of loans from RSDC while there was negligible debt in the previous years. It may be noted that financial performance for FY07 and FY08 are not strictly comparable with the reported figures of FY09 as the year FY09 witnessed amalgamation of RSDC with FNIL. Summary of key financial performance parameters is shown in Table 4.

Table 4: Key performance indicators

Particulars	2009	2008	2007
Operating profit margin [NPBITD/Operating Income]	15.30%	10.75%	19.36%
Net profit margin [PAT/Operating Income]	9.50%	5.37%	13.96%
Return on Capital Employed (%) [PBIT/Average Capital Employed]	43%	21%	42%
Debt - Equity Ratio (times)	0.08	-	-
Interest Coverage Ratio (times) [NPBITD/Interest Charges]	25.7	-	-
Total Debt (Rs Crore)	1.41	-	-
Tangible Net worth (Rs Crore)	18.4	1.07	0.90

Other factors – Compliance and Litigation

There were no cases of civil nature against the company and the amalgamation between RSDC and FNIL has been approved by the High Court and RBI.

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