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Mumbai

CRISIL Research assigns IPO grade '1/5' to NetAlter Software Ltd

CRISIL has assigned a CRISIL IPO Grade "1/5" (pronounced "one on five") to the proposed initial public offer (IPO) of NetAlter Software Ltd (NetAlter). This grade indicates that the fundamentals of the IPO are 'poor' relative to the other listed equity securities in India. However, this grade is not an opinion on whether the issue price is appropriate in relation to the issue fundamentals. The grade is not a recommendation to buy, sell or hold the graded instrument, or a comment on the graded instrument's future market price or its suitability for a particular investor.

The IPO grade takes into account NetAlter's plans to launch its flagship peer-to-peer (P2P) network platform - NetAlter System - in FY13 as a secured and personalised alternative to the internet platform or the World Wide Web. The grade derives comfort from the fact that the promoters have already received a patent in India for the NetAlter System concept and are awaiting approval in the USA, Europe and other major countries.

However, the grade largely reflects NetAlter's small size in an industry dominated by internet behemoths. Being a start-up player, NetAlter may have a long gestation period coupled with uncertainty of success; our comparison of the performance of certain successful internet companies highlights that an internet-based business requires three to seven years to break even. Though NetAlter plans to have diversified revenue streams compared to internet companies, we believe that the gestation period may be similar, if not longer.

The grade also showcases the state of the internet industry - it is reeling under intense competition from larger players who already have an established user base. In this backdrop, NetAlter plans to use the IPO proceeds to develop NetAlter System whose success will solely drive the company's overall success. The success of this system, and the consequent growth, hinges on factors such as the ability to attract sizeable number of users by successfully marketing NetAlter System across geographies, to consistently innovate and offer differentiated solutions to retain its users. Since NetAlter System will take at least three-four years to generate revenues, funding its sales and marketing will be tough once the IPO proceeds earmarked for software development are exhausted. Also, the patent licensing agreement signed between White Vision Software Ltd (a promoter group company which was merged with NetAlter in January 2008) and the two promoters benefits the latter while minority shareholders will have to wait for NetAlter to earn profits. Further, the grade considers the fact that the promoters do not have any track record or execution experience in handling a large, complex IT project.

About the company and the issue

Incorporated on May 13, 2005, NetAlter develops software solutions for the social, commercial and collaborative networking sphere. The company's existing solutions portfolio includes software products for social networking, matchmaking and business communication amongst others. It is in the process of developing more software products for e-commerce; job search; and friend-to-friend, business-to-business and business-to-customer communication. In 2008, NetAlter merged with White Vision Software Ltd (WVSL), a promoter group company, and subsequently got ownership of the patent in India for WVSL's concept for NetAlter System. WVSL has applied for patents in the USA, Europe and other major countries.

In FY10, NetAlter reported operating income of Rs 6 mn and net profit of Rs 0.7 mn. The company reported EBITDA margin of 61% and PAT margin of 11.5% in FY10. RoCE and RoE in FY10 were less than 1% as investments in software development and infrastructure have been significantly underutilised so far.

NetAlter plans to issue 3.9 mn new shares through the IPO and will use the proceeds to fund the software development and commercialisation of NetAlter System and other software products, which is expected to cost Rs 482 mn. The proceeds will also be utilised for general corporate purposes.

About CRISIL IPO Grading

CRISIL IPO (Initial Public Offering) grading is an opinion on the fundamentals of the graded issue that reflects CRISIL's independence and expertise. This opinion is expressed as a relative assessment in relation to other listed equity securities in India. The assessment is based on a grading exercise carried out by industry specialists from CRISIL Research. A CRISIL IPO Grade 5/5 indicates strong fundamentals and a CRISIL IPO Grade 1/5 indicates poor fundamentals. CRISIL IPO Grading reflects its assessment of the graded company's equity fundamentals as distinct from an assessment of debt fundamentals. A CRISIL IPO Grade should not be construed to mean a comment on the price of the graded security nor is it a recommendation to invest or not to invest in the graded security.

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