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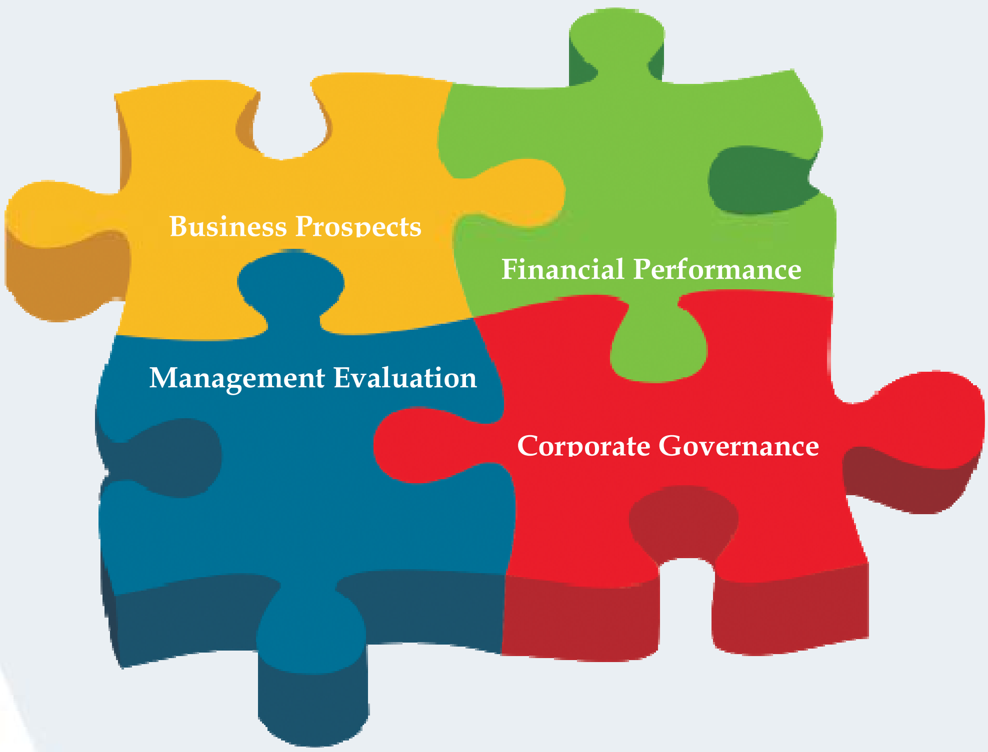


In-depth analysis of the fundamentals and valuation

GKB Ophthalmics Limited

Q1FY11 Result update

Explanation of CRISIL Fundamental and Valuation (CFV) matrix

The CFV Matrix (CRISIL Fundamental and Valuation Matrix) addresses the two important analysis of an investment making process – Analysis of Fundamentals (addressed through Fundamental Grade) and Analysis of Returns (Valuation Grade)

Fundamental Grade

CRISIL's Fundamental Grade represents an overall assessment of the fundamentals of the company graded in relation to other listed equity securities in India. The grade facilitates easy comparison of fundamentals between companies, irrespective of the size or the industry they operate in. The grading factors in the following:

- Business Prospects: Business prospects factors in Industry prospects and company's future financial performance
- Management Evaluation: Factors such as track record of the management, strategy are taken into consideration
- Corporate Governance: Assessment of adequacy of corporate governance structure and disclosure norms

The grade is assigned on a five-point scale from grade 5 (indicating Excellent fundamentals) to grade 1 (Poor fundamentals)

CRISIL Fundamental Grade	Assessment
5/5	Excellent fundamentals
4/5	Superior fundamentals
3/5	Good fundamentals
2/5	Moderate fundamentals
1/5	Poor fundamentals

Valuation Grade

CRISIL's Valuation Grade represents an assessment of the potential value in the company stock for an equity investor over a 12 month period. The grade is assigned on a five-point scale from grade 5 (indicating strong upside from the current market price (CMP)) to grade 1 (strong downside from the CMP).

CRISIL Valuation Grade	Assessment
5/5	Strong upside (>25% from CMP)
4/5	Upside (10-25% from CMP)
3/5	Align (+-10% from CMP)
2/5	Downside (negative 10-25% from CMP)
1/5	Strong downside (<-25% from CMP)

Analyst Disclosure

Each member of the team involved in the preparation of the grading report, hereby affirms that there exists no conflict of interest that can bias the grading recommendation of the company.

Additional Disclosure

This report has been sponsored by NSE - Investor Protection Fund Trust (NSEIPFT).

Disclaimer:

Independent Research Report
GKB Ophthalmics Limited

Disappointing results

Industry: Ophthalmic lens
Date: September 01, 2010

GKB Ophthalmics Ltd's (GKB's) Q1FY11 revenues de-grew by 17.7% y-o-y to Rs 71.7 mn on account of an overall y-o-y volume dip of 16.2%. The glass lenses segment de-grew by 28.5% y-o-y and the plastic lenses segment grew by 5.3% y-o-y in Q1FY11 against CRISIL Equities' expectations of 4% de-growth in the former and 35% growth in the latter for FY11. We do not expect the company to make up for this decline in the subsequent quarters and accordingly revise our revenue estimates downwards from Rs 397 mn to Rs 358 mn for FY11. We remain cautious about GKB's growth prospects, which are constrained by the competitive nature of the ophthalmic lens industry and the small size of GKB's operations. We maintain the fundamental grade of **'2/5'**, indicating that its fundamentals are **'moderate'** relative to other listed equity securities in India, and the valuation grade of **'3/5'**, indicating that the market price is '**aligned**' with our fair value.

Q1FY11 result analysis

- GKB's Q1FY11 revenues declined by 17.7% y-o-y to Rs 71.7 mn largely on account of a 28.6% y-o-y volume dip in the glass lenses segment and a 30.9% y-o-y realisation dip in the plastic lenses segment. Q1FY10 was an exceptional quarter as revenues were boosted by a one-time order from few clients. Thus, the decline in Q1FY11 revenues is on account of a high base effect coupled with the declining demand for the glass lenses variety.
- The contraction in EBITDA margin from 11.7% in Q1FY10 to 8.8% in Q1FY11 was due to an increase in employee costs and other operating expenditure.
- Q1FY11's net margin was 4.3% against 4.2% in Q1FY10. This improvement was due to higher other income of Rs 2.7 mn compared to Rs 0.3 mn in Q1FY10.
- GKB manufactures various value-added glass lenses under GKB Vision, where it holds a 38% stake. GKB Vision's revenues grew by 16.6% y-o-y driven by 11% y-o-y growth in the glass lenses segment.

Earnings and margin estimates revised downwards

- GKB's Q1FY11 revenues declined by 17.7% y-o-y, significantly lower than CRISIL Equities' full-year estimate of revenue growth of 5.2% for FY11. The decline in revenues was on account of de-growth in the glass lenses segment, which is mainly because plastic lenses are being preferred to glass lenses since they are lighter in weight and serve as a fashion-cum-function product. However, de-growth in the glass lenses segment was higher than we anticipated and we do not expect the company to make up for this decline in the subsequent quarters. Accordingly, we revise our revenue estimates from Rs 397 mn to Rs 358 mn for FY11.

-Based on the minimum wage hike in Goa and the expected increase in operating expenditure since the company is an expansionary mode, we revise our EBITDA margin estimates downwards from 12.2% to 9.2% in FY11 and from 13.7% to 10.5% in FY12.

Valuations – market price aligned with the fair value

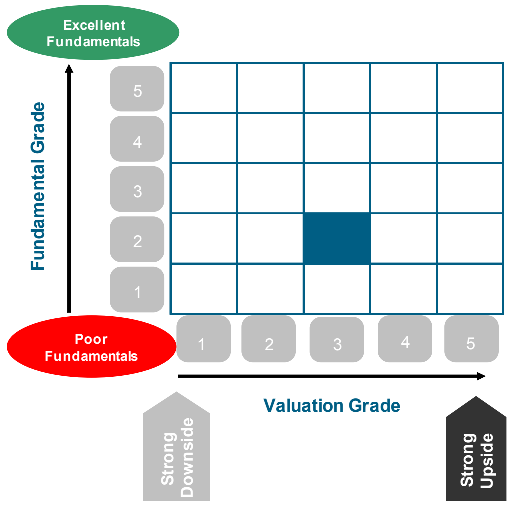
We initiated coverage on GKB (dated May 11, 2010) with a fair value of Rs 52 based on the sum-of-the-parts approach. We used the discounted cash flow method to value both GKB (standalone) and its 38% stake in GKB Vision. With the revision in earnings estimates, we arrive at a fair value of Rs 47 per share. We maintain the valuation grade of **'3/5'**, indicating that the market price is '**aligned**' with our fair value.

Key forecast

(Rs mn)	FY08	FY09	FY10	FY11E	FY12E
Operating income	189	285	378	358	365
EBITDA	30	36	36	33	38
Adj Net income	24	36	35	26	23
EPS-Rs	5.7	8.8	8.5	6.3	5.5
EPS growth (%)	18.7	93.0	(6.6)	(26.2)	(12.0)
PE (x)	16.9	5.5	6.1	8.3	9.4
P/BV (x)	2.7	1.3	1.1	1.0	0.9
RoCE (%)	9.6	10.2	9.8	6.5	6.2
RoE (%)	16.0	23.6	20.3	13.0	10.3

Source: Company, CRISIL Equities' estimate

CFV matrix

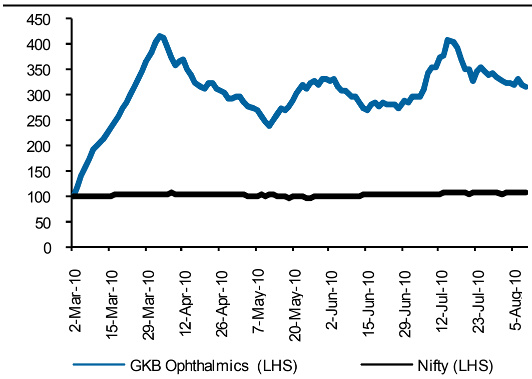


- Fundamental grade of '2/5' indicates moderate fundamentals
- Valuation grade of '3/5' indicates market price is aligned

Key stock statistics

NSE ticker	GKB-EQ
Fair value	47
Current market price (as on August 31)	52
Shares outstanding (mn)	4.2
Face Value (Rs)	10
Market cap (Rs mn)	237
Enterprise value (Rs mn)	311
52-week range(Rs)(H/L)	81/10
PE on EPS estimate (FY11E)(x)	8.3
Beta	0.9
Free float (%)	34.1
Average daily volumes	8,156

Share price movement



* Indexed to 100
** Came under the NSE 'permitted to trade category' on March 2, 2010

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Key Developments

Delay in capacity expansion plan

GKB is expanding its capacity of plastic lenses from 4,000 pieces per day to 10,000 pieces per day by FY12. Additionally, it is also setting up a capacity of 1,000 pieces per day each of indexed and photochromic lenses. The total estimated cost of the entire expansion plan is ~Rs 100 mn, which will be financed through debt. However, the progress of the capacity expansion has slowed down on account of a delay in the sanction of funds and equipment dispatch from the supplier's end. The capacity is now expected to come on-stream by the first half of FY12 against an earlier estimate of the start of Q1FY12.

Corporate governance structure corrected

Till end-FY10, GKB's board of five directors had only one independent director, which is not in compliance with Clause 49 of SEBI's listing agreement. In our initiation report, we had highlighted the management's plans to induct more independent directors on the board. During Q1FY11, the company inducted three more independent directors and is now in compliance with Clause 49.

Changes in Earnings Estimates

Revenue forecast revised downwards by 9.8% and 15.5% for FY11 and FY12 respectively

Taking into consideration the lower-than-anticipated growth in the plastic lenses segment and the higher-than-anticipated de-growth in the glass lenses segment coupled with a delay in the capacity expansion plan in the plastic lenses segment, we revise our revenue estimates downwards from Rs 397 mn to Rs 358 mn in FY11 and from Rs 432 mn to Rs 365 mn in FY12.

EBITDA margin estimates cut by 300 bps and 320 bps for FY11 and FY12 respectively

The company's EBITDA margin of 8.8% in Q1FY11 was lower than CRISIL Equities' estimate of 12.2% for FY11. The difference was mainly on account of high employee cost; the minimum wage was hiked in Goa from FY11 onwards. Factoring in the wage hike and the expected increase in operating expenditure since the company is an expansionary mode, we revise our EBITDA margin estimates downwards from 12.2% to 9.2% in FY11 and from 13.7% to 10.5% in FY12.

PAT margin estimates cut by 170 bps and 160 bps for FY11 and FY12 respectively

The company reported a standalone PAT margin of 4.3% and a consolidated PAT margin of 9.4% (after adding 38% share of profit from its associate GKB Vision) in Q1FY11. The consolidated PAT margin was in line with our estimate of 9.0% in FY11. However, with the contraction in margins and higher interest costs on account of the debt raised to fund the additional expansion of indexed and photochromic lenses, we have lowered our consolidated PAT margin estimates from 9.0% to 7.3% in FY11 and from 7.9% to 6.3% in FY12.

Consequently, the EPS of the company is revised to Rs 6.3 in FY11 and Rs 5.5 in FY12.

Table 2: Earnings revision summary

GKB	FY11E			FY12E		
(Rs mn)	Old	New	% change	Old	New	% change
Revenue (Rs mn)	397	358	-9.8%	432	365	-15.5%
EBITDA	49	33	-32.4%	59	38	-35.4%
EBITDA margin (%)	12.2%	9.2%	-300bps	13.7%	10.5%	-320bps
PAT (Rs mn)	36	26	-27.5%	34	23	-32.5%
PAT margin (%)	9.0%	7.3%	-170bps	7.9%	6.3%	-160bps
EPS-Rs	8.6	6.3	-27.0%	8.2	5.5	-32.6%

Source: CRISIL Equities

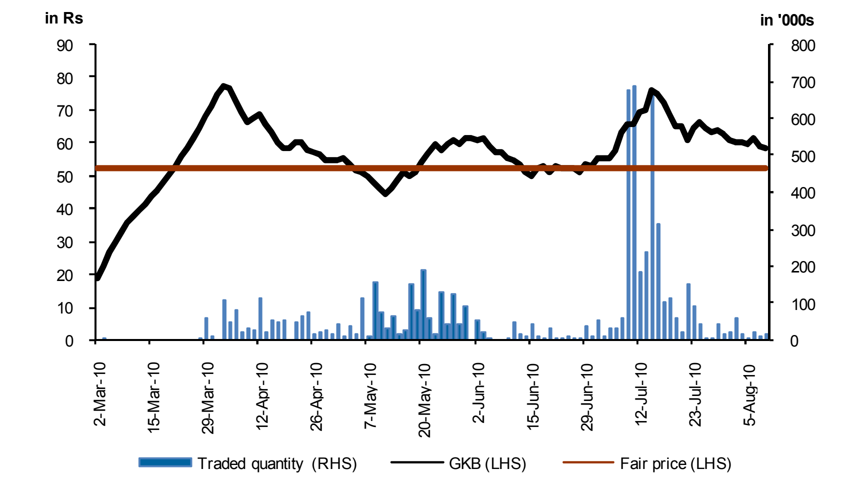
Valuation

We have revised the fair value to Rs 47 per share

We continue to use the sum-of-the-parts approach to value GKB. We have used the discounted cash flow method to value both GKB (standalone) and GKB's 38% stake in GKB Vision. With the downward revision in estimates, we now arrive at a fair value of Rs 47 (GKB's standalone business is valued at Rs 18 per share and GKB's stake in GKB Vision is valued at Rs 29 per share). The implied PER at the fair value estimate is 7.5x FY11 and 8.5x FY12 earnings.

The market price of the stock was Rs 48 when we initiated coverage on GKB (refer to our initiation report dated May 11, 2010 on www.ier.co.in). The stock is currently trading at Rs 52 per share (as on August 31, 2010). We assign GKB a valuation grade of '3/5', indicating that the current market price is 'aligned' with our fair value.

Chart 1: Share price movement since CRISIL initiated coverage



Source: NSE, CRISIL Equities

Table 3: Reports released on GKB Ophthalmics Ltd

Date	Nature of report	Fundamental grade	Fair value	Valuation grade	Market price (on the date of report)
11-May-10	Initiating coverage*	2/5	Rs 52	3/5	Rs 48
01-Sept-10	Q1FY11 result update	2/5	Rs 47	3/5	Rs 52

* For detailed initiating coverage report please visit: **www.ier.co.in**

Q1FY11 result analysis

Revenues de-grew due to a decline in the glass lenses segment

EBITDA margin contracted due to an increase in employee costs and other operating expenditure

PAT margin was flat on a y-o-y basis

(Rs mn)	Q1FY11	Q1FY10	Q4FY10	y-o-y (%)	q-o-q (%)
Net sales	71.7	87.1	88.5	-17.7	-19.0
(Increase)/decrease in stock	2.7	-6.8	1.7	-139.7	60.5
Raw materials and other manufacturing expenses	40.0	63.2	49.2	-36.7	-18.8
Personnel expenses	8.6	7.7	10.2	11.0	-15.7
Other expenses	14.1	12.9	19.5	9.4	-27.6
Cost of sales	65.4	77.0	80.6	-15.1	-18.9
EBITDA	6.3	10.2	8.0	-37.6	-20.5
EBITDA margin	8.8%	11.7%	9.0%	-28bps	-2bps
Interest and finance charges	2.5	3.2	3.0	-22.3	-17.1
EBTDA	3.8	7.0	5.0	-44.7	-22.6
Depreciation	2.1	2.0	2.1	5.3	0.3
Operating PBT	1.7	5.0	2.9	-64.9	-39.3
Other income	2.7	0.3	4.8		
PBT	4.4	5.3	7.7	-16.3	-42.6
Tax	1.3	1.6	2.3	-17.5	-42.6
PAT	3.1	3.7	5.4	-15.8	-42.6
PAT margin	4.3%	4.2%	6.1%	1bp	-18bps
No of equity shares*	4.2	4.2	4.2		
EPS (Rs)- Diluted	0.7	0.9	1.3	-15.8	-42.6

Note: 'Other income' in Q1FY11 includes foreign exchange gain and income from job work done for GKB Vision. GKB Vision is currently in an expansionary mode and received more orders than it could execute in Q1FY11; some of these orders were executed by GKB Ophthalmics. The management has indicated that it will not carry out job work for GKB Vision on a sustainable basis going forward.

Source: Company, CRISIL Equities

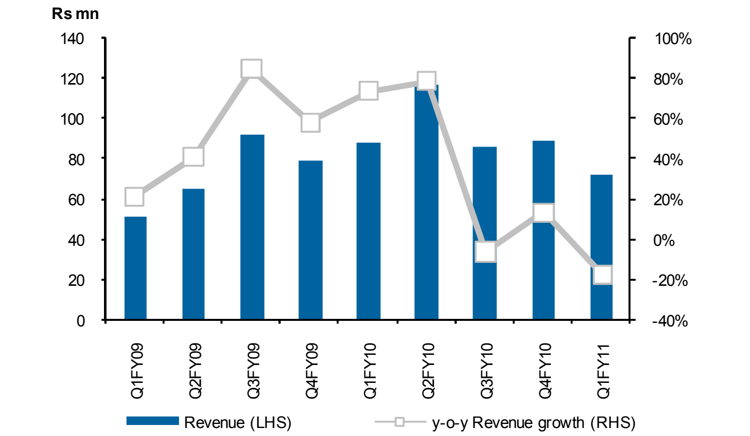
GKB Ophthalmics - segment-wise sales break-up

	Q1FY11	Q1FY10	Q4FY10	Y-o-Y	Q-o-Q
Sales Volumes					
Glass lenses	610,473	855,405	803,345	-28.6%	-24.0%
Plastic lenses	236,855	155,605	256,941	52.2%	-7.8%
Total	**847,328**	**1,011,010**	**1,060,286**	-16.2%	-20.1%
Realisation (in Rs. per lens)					
Glass lenses	86.93	86.76	82.41	0.2%	5.5%
Plastic lenses	57.33	82.90	82.14	-30.9%	-30.2%
Weighted avg Realisation	**78.66**	**86.17**	**82.34**	-8.7%	-4.5%
Net Sales (in mn)					
Glass lenses	53.1	74.22	66.20	-28.5%	-19.8%
Plastic lenses	13.58	12.90	21.11	5.3%	-35.7%
Total	**66.65**	**87.12**	**87.31**	-23.5%	-23.7%
Others	5.05	0.00	1.69	183584.1%	-99.8%
Total Revenue	**71.70**	**87.12**	**89.00**	-17.7%	-2.1%

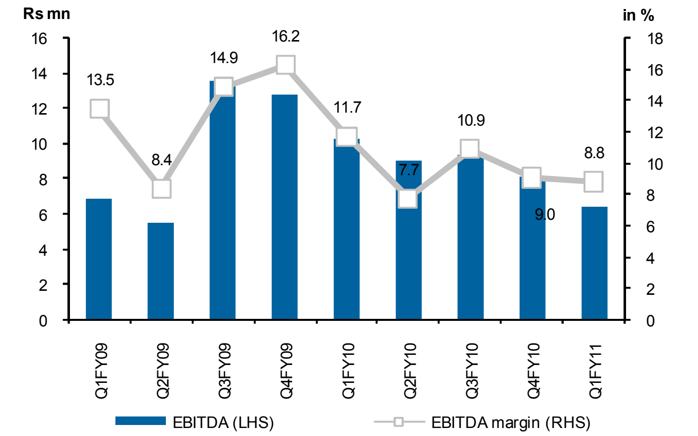
Source: Company

Focus Charts

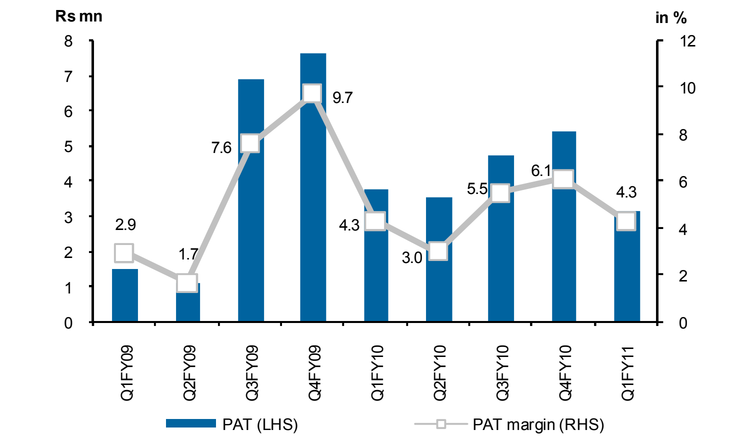
Earnings do a seesaw



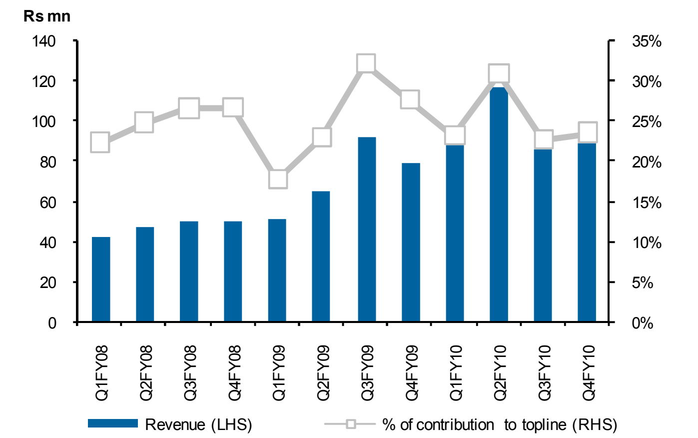
EBITDA margins on a declining trend



PAT margins also moving down



First quarter has lowest contribution to the top line



Source: Company reports, CRISIL Equities

Annexure: Financials

Income Statement

(Rs Mn)	FY08	FY09	FY10	FY11E	FY12E
Net sales	189	285	377	358	365
Operating Income	**189**	**285**	**378**	**358**	**365**
EBITDA	**30**	**36**	**36**	**33**	**38**
Depreciation	8	12	9	11	14
Interest	16	10	12	16	20
Other Income	9	8	0	2	3
PBT	**15**	**23**	**15**	**7**	**8**
PAT (before share in profit from associates)	**11**	**13**	**10**	**5**	**5**
Share in profit from associates	13	24	25	21	18
PAT (after share in profit from associates)	**24**	**36**	**35**	**26**	**23**
No. of shares	4.2	4.2	4.2	4.2	4.2
Earnings Per Share (Rs)	5.7	8.8	8.5	6.3	5.5

Balance Sheet

(Rs Mn)	FY08	FY09	FY10	FY11E	FY12E
Equity Share Capital (FV: Rs.10 per share)	42	42	42	42	42
Reserves	108	117	148	171	192
Debt	85	80	122	157	192
Current Liabilities and Provisions	83	134	176	164	165
Deferred Tax Liability/(Asset)	14	11	11	11	11
Capital Employed	**331**	**384**	**498**	**545**	**601**
Net Fixed Assets	93	84	100	124	150
Investments	42	44	44	44	44
Loans and advances	10	12	16	15	15
Inventory	131	159	228	216	215
Receivables	50	77	100	95	97
Cash & Bank Balance	6	8	10	51	80
Applications of Funds	**331**	**384**	**498**	**545**	**601**

Source: Company, CRISIL Equities estimates

Cash Flow

(Rs Mn)	FY08	FY09	FY10	FY11E	FY12E
Pre-tax profit	15	23	15	7	8
Total tax paid	(3)	(12)	(5)	(2)	(3)
Depreciation	8	12	9	11	14
Change in working capital	(13)	(7)	(54)	6	(0)
Cash flow from operating activities	**7**	**15**	**(35)**	**22**	**19**
Capital expenditure	(10)	(2)	(25)	(35)	(40)
Investments and others	17	22	25	21	18
Cash flow from investing activities	**7**	**20**	**0**	**(14)**	**(22)**
Equity raised/(repaid)	0	0	0	0	0
Debt raised/(repaid)	6	(5)	42	35	35
Dividend (incl. tax)	(4)	(6)	(5)	(2)	(2)
Others (incl extraordinaries)	(17)	(22)	-	-	-
Cash flow from financing activities	**(16)**	**(33)**	**37**	**33**	**33**
Change in cash position	**(2)**	**2**	**2**	**40**	**29**
Opening Cash	8	6	8	10	51
Closing Cash	6	8	10	51	80

Ratios

	FY08	FY09	FY10	FY11E	FY12E
Growth ratios					
Sales growth (%)	(25.3)	50.4	32.6	(5.2)	1.9
EBITDA growth (%)	(13.3)	18.8	0.7	(7.6)	15.2
EPS growth (%)	18.7	93.0	(6.6)	(26.2)	(12.0)
Profitability Ratios					
EBITDA Margin (%)	15.8	12.5	9.5	9.2	10.5
PAT Margin (%)	12.6	12.8	9.4	7.3	6.3
Return on Capital Employed (RoCE) (%)	9.6	10.2	9.8	6.5	6.2
Dividend and Earnings					
Dividend per share (Rs)	0.9	1.4	1.1	0.5	0.6
Dividend payout ratio (%)	36.4	45.8	45.0	45.0	45.0
Earnings Per Share (Rs)	5.7	8.8	8.5	6.3	5.5
Financial stability					
Net Debt-equity	0.5	0.5	0.6	0.5	0.5
Interest Coverage	1.4	2.5	2.2	1.4	1.2
Current Ratio	2.4	1.9	2.0	2.3	2.5
Valuation Multiples					
Price-earnings	16.9x	5.5x	6.1x	8.3x	9.4x
Price-book	2.7x	1.3x	1.1x	1.0x	0.9x
EV/EBITDA	16.1x	7.6x	9.1x	9.7x	8.6x

Source: Company, CRISIL Equities estimates

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