

Independent Equity Research

Enhancing investment decisions



In-depth analysis of the fundamentals and valuation

**GKB Ophthalmics
Limited**

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- Customised research content for Information Memorandum and Offer documents

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).

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List of companies under coverage

Sl. No.	Report Date	Company Name	Sector	CMP	M. Cap (Rs. Mn)	Initiating Coverage		3QFY10 Update	
						Fundamental value	Fundamental grade	Fundamental value	Fundamental grade
1	02-Feb-10	Aarti Industries	Chemicals	49	3,757	56	3/5	56	3/5
2	31-Jan-10	ABG Shipyard	Shipping	315	10,286	242	3/5	259	3/5
3	01-Feb-10	Apollo hospitals	Hospitals	712	44,102	642	4/5	724	4/5
4	04-May-10	Beardsell Limited	Packaging/Expanded Polystyrene	64	245	54	3/5	-	-
5	06-Apr-10	Dhanuka Agritech Ltd	Pesticides	271	2,483	283	3/5	-	-
6	29-Jan-10	DLF	Real Estate	335	568,495	356	3/5	356	3/5
7	27-Jan-10	Dolphin Offshore	Oil & Gas	385	6,060	315	3/5	417	3/5
8	05-Feb-10	EID Parry	Sugar	348	30,050	394	4/5	395	4/5
9	01-Feb-10	Everest Kanto	Manufacturing	131	13,252	270	4/5	135	4/5
10	11-May-10	GKB Ophthalmics Ltd	Ophthalmic Lens	48	199	52	2/5	-	-
11	23-Feb-10	Havells India Ltd	Capital Goods	533	32,070	614	4/5	-	-
12	29-Jan-10	Hero Honda	Automobiles	1,889	377,240	1,747	5/5	1937#	5/5#
13	02-Mar-10	Hindusthan National Glass & Industries Ltd.	Packaging/Glass	240	21,049	314	4/5	-	-
14	11-Feb-10	Indiabulls Securities	Financial Services	31	7,932	60	4/5	48	4/5
15	05-Feb-10	JBF Industries	Textiles	111	6,882	119	3/5	129	3/5
16	05-Feb-10	JM Financial	Financial Services	39	30,550	57	4/5	57	4/5
17	21-Jan-10	KKCL	Fashion and apparels	265	3,292	336	3/5	-	-
18	01-Feb-10	KRBL	Agriculture/Rice	194	4,716	340	3/5	340	3/5
19	31-Jan-10	NTPC	Power	214	1,764,537	228	5/5	231	5/5
20	29-Jan-10	Pantaloon Retail (India)	Retail	406	77,282	*	4/5	*	4/5
21	04-Feb-10	Phoenix Mills	Real Estate	203	29,404	160	2/5	183	2/5
22	22-Apr-10	Polaris Software	Information Technology	186	18,407	247	4/5	-	-
23	19-Apr-10	Sangam (India) Ltd	Textiles	33	1,380	46	3/5	46	5/5
24	03-Feb-10	UTV Software	Media and Entertainment	498	17,066	548	3/5	538	3/5
25	07-May-10	Zylog System	Information Technology	456	7,494	530	3/5	-	-

CMP - Current Market Price (as on date of respective report)

M Cap - Market Capitalisation (as on date of respective report)

*NA - Not Applicable (Company has requested for a fundamental grading only)

Includes Q4FY10 result update

Independent Research Report – GKB Ophthalmics Ltd

Correcting vision through plastic

Industry: Ophthalmic Lens

Date: May 11, 2010

GKB Ophthalmics Ltd (GKB) is one of the established players in the ophthalmic lens industry in India. It manufactures glass and plastic lenses. We assign GKB a fundamental grade of '2/5' indicating that its fundamentals are 'moderate' relative to other listed securities in India. We also assign a valuation grade of '3/5' indicating that the current market price of GKB is 'aligned'.

Established player in the Indian ophthalmic lens industry

GKB manufactures basic single vision glass lens and has an installed capacity of 12,000 glass lenses per day. Besides the basic single vision glass lenses, it also manufactures value-added glass lenses – bifocal, progressive and photo chromic – through its associate company GKB Vision, where it holds a 38% stake. The company mainly exports (90%) since the Indian market is dominated by unorganised players which supply low quality, low priced lenses to the price-sensitive Indian market.

Foray into plastic lens - better late than never

GKB forayed into the manufacturing of plastic lenses in 2009. It currently has a capacity of 4,000 lenses per day which it plans to expand to 10,000 lenses per day by FY12. We expect the company to grow strongly in this segment, driven by a) increased outsourcing of plastic lenses from India and China due to closure of several unviable manufacturing units in Europe and b) low competition from Chinese players as they manufacture mainly the basic variety of plastic lenses.

Constraints - competitive industry, lack of unique value offerings

Although the ophthalmics industry globally is expected to grow at a steady rate of 3-4% (driven by growing population and replacement demand), the industry is competitive with many ophthalmic lens suppliers operating globally. The company has a capacity of 4.5 mn lenses (per annum) in a market of 1 bn lenses globally and, hence, does not have any advantage in terms of size or volume of operations, which can lead to client dependence. Also, the company has no unique value proposition compared to other players in the industry.

Weak corporate governance structure

GKB does not comply with Clause 49 of the listing agreement as there is only one independent director on the board. [0]Also, interaction with the independent director revealed that his level of engagement in the company's affairs is below the required level.

Revenues to grow to Rs 432 mn[0] by FY12 at a three-year CAGR of 15%

We expect GKB Ophthalmics' revenues to register a three-year CAGR of 15% to reach Rs 432 mn in FY12 driven by growth in plastic lenses which is expected to register a significant jump from ~Rs 19 mn in FY09 to ~Rs 166 mn in FY12E. EBITDA margin is expected to reduce to 9.5% in FY10, driven by higher rejection rates in plastic lenses, and then increase to 12.2% in FY11 and 13.7% in FY12, as the production of plastic lenses stabilises and rejection rates reduce. EPS is expected to decline from Rs 8.8 in FY09 to Rs 8.2 in FY12E due to decreasing profitability of its associate GKB Vision on account of higher tax impact from FY12.

Valuations aligned; No upside from these levels

We have valued GKB based on the sum of the parts (SOTP) approach. We have used the discounted cash flow method to value both GKB (standalone) and GKB's 38% stake in GKB Vision. We have taken a higher cost of equity of 18.4% factoring in the liquidity risk due to low volumes of stock traded. Based on SOTP, we arrive at a fair value of Rs 52 per share for GKB. We initiate coverage on GKB with a valuation grade of '3/5' indicating that the valuations of GKB are 'aligned' to the current market price of Rs 48 (as on May 10, 2010).

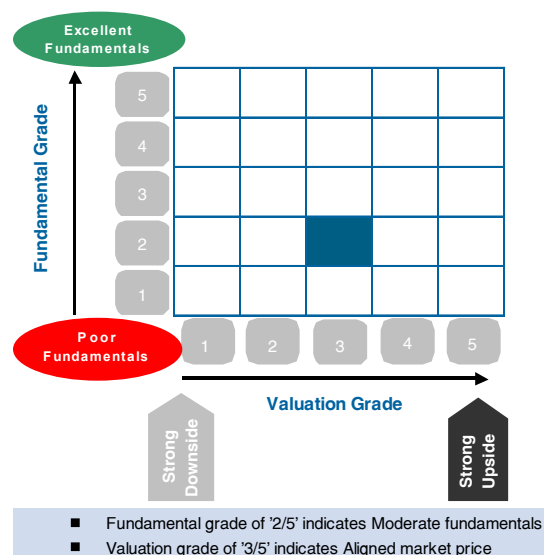
Key forecast (Consolidated financials)

(Rs mn)	FY08	FY09	FY10E	FY11E	FY12E
Operating income	189	285	378	397	432
EBITDA	30	36	36	49	59
Adj net income*	24	36	35	36	34
EPS-Rs*	5.7	8.8	8.5	8.6	8.2
EPS growth(%)	18.7	93.0	(6.6)	1.1	(4.2)
PE (x)	16.9	5.5	5.6	5.6	5.8
P/BV (x)	2.7	1.3	1.1	0.9	0.8
RoCE (%)	9.6	10.2	9.8	11.1	11.9
RoE (%)	16.0	23.6	20.3	17.5	14.8
EV/EBITDA (x)	16.1	7.6	8.7	6.6	5.5

*Adjusted net income and EPS includes share of profit from associates. Company follows the practise of including dividend from its associate in 'Other Income'. We have adjusted the net income by including the profit from the share of associates instead of taking dividend in 'Other Income'.

Source: Company, CRISIL Equities

CFV Matrix

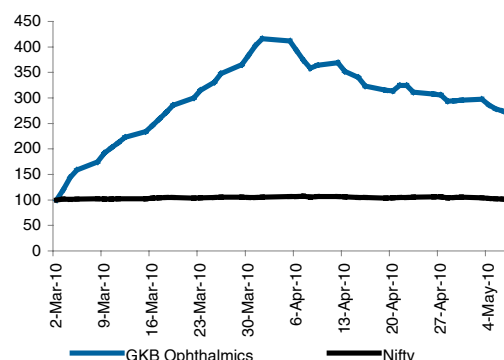


Key stock statistics

Stat	GKB-EQ
NSE Ticker	GKB-EQ
Fair value (face value Rs10)	52
Current market price (Rs per share)*	48
Shares outstanding (mn)	4.2
Market cap (Rs mn)	199
Enterprise value (Rs mn)	271
52-week range (Rs) (H/L)	80.8 / 10.3
P/E on EPS estimate (FY11E)	5.6
Beta	1.9
Free float (%)	34.1%
Average daily volumes (30-day average)	3998

* as on the report date

Share price movement



-Indexed to 100

-Came under the NSE 'permitted to trade category' on March 2, 2010

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Table 1: Business Environment

Parameter	GKB Ophthalmics Ltd.		GKB Vision Ltd. (GKB Ophthalmics holds 38% share in GKB Vision) *	
Overall sales break-up (Q3FY10)	Export: 90% / Domestic:10%		Export:95% / Domestic:5%	
	Glass Lenses	Plastic Lenses	Glass Lenses	Glass Moulds
% Revenue contribution (FY09)	93	7	94	6
% Revenue contribution (FY12)	62	38	92	8
Product offering	Basic category i) Single vision glass lenses	Basic category i) Single vision plastic lenses Value-added category ii) Bifocal lenses iii) Progressive lenses iv) Photochromic lenses v) High index lenses	Value-added category i) Bifocal lenses ii) Progressive lenses iii) Photochromic lenses	Glass moulds which are used in the production of plastic lenses
Capacity (Q3FY10)	12,000 lenses per day	4,000 lenses per day; plans to increase the capacity to 10,000 lenses per day by FY12	3,280 pieces per day on a single shift basis. However, the company is currently operating on a double-shift basis	
Major export destinations	Germany, California, Arizona, Muscat, Saudi Arabia	Same as glass lenses	Germany, Spain, France, Korea	Same as glass lenses
Key clients	LENSCO, Swiss Lens, TIC Optics, Lenstech	Same as glass lenses	LENSCO, TIC Optics, Optical Supplies of Asia, Essilor France	Same as glass lenses
Industry scenario	<ul style="list-style-type: none"> Global market size: Approximately 1 bn lenses at the end of 2009 Growth of 3-4% in volume terms for the past two-three years Of the world population of 6 bn, 4 bn require eye correction, but currently only 1 bn wear lenses; lack of awareness and ignorance is the main reason Plastic lenses constitute ~80% of the global ophthalmic lens industry Indian market – size : Approximately 90 mn lenses; glass lenses constitute approximately 80% of the market, however demand for plastic lens has been growing by ~20% for the past two-three years 			

* GKB Vision – 38% is held by GKB while the remaining 62% is held by the promoters of GKB

Parameter	GKB Ophthalmics Ltd.		GKB Vision Ltd.	
	Glass Lenses	Plastic Lenses	Glass Lenses	Glass Moulds
Sales CAGR forecast (FY09-12)	1%	106%	-3%	11%
Demand drivers	<p>i) A preferred choice amongst the ageing population; World population is expected to reach 8 bn by 2025; with percentage of people aged more than 45 to increase from 23% to 32%</p> <p>ii) Sometimes glass lenses are prescribed by the doctors specifically as they offer better clarity of vision</p>	<p>i) Closure of several unviable manufacturing units in Europe due to their high cost structure. As a result, lenses are increasingly being outsourced from India and China</p> <p>ii) Replacement demand for plastic lenses; Europe and Japan's replacement rate is moving close to the replacement rate of the US of 2.5 years from current 3.5 and 4 years respectively</p>	Same as glass lenses under GKB Ophthalmics	As glass moulds are the raw material for manufacturing plastic lenses, they will grow in proportion to the demand for plastic lenses
Margin drivers		<p>i) Reduction in rejection rates will help translate into higher sales with the same amount of raw materials, thereby improving EBITDA margins. ii) Higher realisations of value-added plastic lenses</p>	i) Demand for high indexed glass lenses which command high realisations to drive margins	i) Reduction in rejection rates will help translate into higher sales with the same amount of raw materials, thereby improving EBITDA margins

Grading Rationale

Global ophthalmic lens industry growing at a steady pace...

The global ophthalmic lens industry was sized at 1 bn lenses in 2009, of which America and Asia were the largest markets at 315 mn lenses each, accounting for 63% of the total market. The industry has evolved significantly from the use of spectacles purely for vision correction to fashion-cum-function accessory. The growth in world population, increasing thrust on eye awareness, changing lifestyles and an increase in the replacement demand of glasses have helped the industry clock 3-4% volume growth over the past two-three years. Further, there is a percentage of population, especially in Asia, which needs vision correction but is unable to do so due to poverty and lack of awareness.

Global ophthalmic lens industry has been growing at 3-4% over the past two-three years

Table 2 : Global ophthalmic lens industry: 1 bn lens market

Market	Market size (in units)	Growth rates (1996-2005)	Growth drivers
America	315 mn	North America: 3% Latin America: 13%	i) Eyeglass replacement rate is 2.5 years, lowest in the world ii) Latest trend of stocking multiple pairs of glasses for different occasions iii) High demand for value-added plastic lenses
Asia	315 mn	12%	i) High growth potential as a large proportion of population requires vision correction, but ignores their visual needs ii) Rapid shift from glass lenses to plastic lenses
Europe	250 mn	4%	i) Eyeglass replacement rate is 3.5 years; expected to reduce to 2.5 years ii) Western Europe: 85% plastic lenses; Eastern Europe: 52% plastic lenses. Hence, there is a huge potential to penetrate the Eastern European plastic lenses market
Africa and Middle-East	61 mn	6%	i) Gradual shift from glass lenses to plastic lenses
Japan, Australia and New Zealand	59 mn	8%	i) Eyeglass replacement rate is four years; expected to reduce to 2.5 years. Europe's and Japan's replacement rate moving to 2.5 years would increase the market by 50 mn lenses ii) Close to 100% of the market dominated by plastic lens. iii) High demand for value-added plastic lenses

Source: Essilor Presentation, 2009

...However basic needs still remain unsatisfied; growth potential in lens industry is high

Of the total world population of 6 bn people, only about 1 bn people are estimated to have eyesight correction. However, the number of people that need correction is estimated at 4 bn, which is 65% of the total population, and the reasons for this are lack of awareness, poverty and ignorance. With lenses being the main means of correction (three out of four people wear lenses for correction) there is a huge potential for growth.

Number of persons needing eyesight correction is 4 bn which is 65% of the total population

The other potential customer base is the ageing population. The number of people above the age of 45, who account for 23% of the global population, is expected to reach 32% of the total expected population of 8 bn by 2025.

Table 3: Vision correction needs worldwide

Region	% of people that need eye correction
Asia	81
Africa	84
South America	77
Europe	66
North America	41

Source: Essilor Presentation, 2009

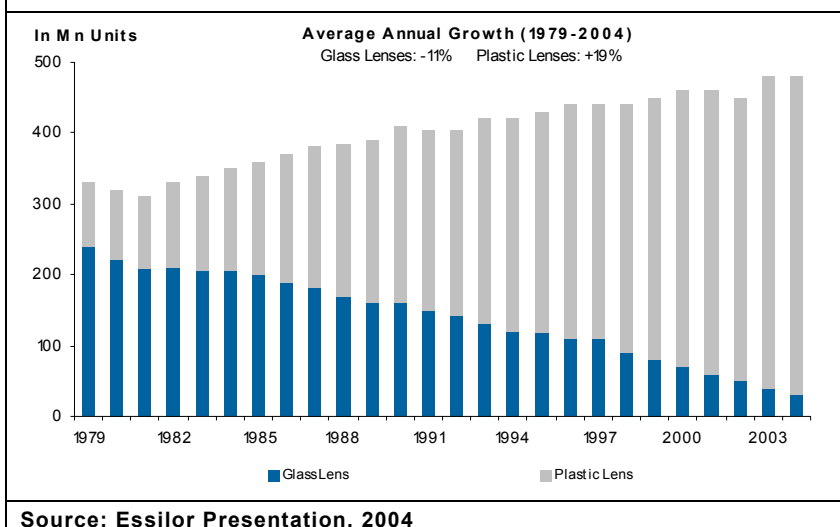
Plastic lenses dominate the global ophthalmic lens industry...

Currently, plastic lenses dominate the world ophthalmic lens industry, accounting for almost 80% of the total lens market. Plastic lenses are light-weight, more comfortable and stylised, hence are preferred by the fashion conscious people. Glass lenses are cheaper and have a higher shelf life than plastic lenses, but are heavy. Evolving fashion trends have gradually phased out glass lenses from most of the global markets. The transition from glass lens to plastic lens occurred in the period from 1996 to 2001, when the sales of glass lenses declined by an aggregate of 5.7% each year and the sales of plastic lenses increased by an aggregate 12% each year. Today, plastic lenses dominate the global ophthalmic lens industry. Glass lenses still prevail in the Indian ophthalmic lens industry, although the preference is steadily shifting towards the plastic variety.

Plastic lenses account for 80% of the total lens market

Chart 1: Glass lens vs. plastic lens

Factor	Glass Lenses	Plastic Lenses
Penetration	In developing countries: Glass lenses: 80% of spectacles In developed countries: Glass lenses: 5% of spectacles	In developing countries: Plastic lenses: 20% of spectacles In developed countries: Plastic lenses: 95% of spectacles
Qualitative difference	- Better clarity of vision -Glass lenses are scratch-free and sturdy and, hence, more durable -Brittle and heavier than plastic lenses	-Lighter than glass lenses -a fashion-cum-function product -Susceptible to scratches, hence lesser shelf-life and needs more sensitive handling
Price	- The cost of basic glass lenses and basic plastic lenses is similar	
	- Progressive glass lenses command high realisations	-High indexed plastic lenses command high realisations
Source: Industry sources		

Chart 2: Declining share of glass lenses in the world market

Ageing population prefer glass lenses

... However glass lenses will not disappear completely

Though plastic lens dominate the ophthalmic lens industry, a certain segment of population still prefers glass lens due to low cost and high durability. People in developing economies, especially in India, prefer the cheaper and long-lasting glass lens over plastic lens. This is validated by the fact that the share of glass lens is ~80% and plastic lens is ~20% in India. Majority of the ageing population prefer glass lenses due to better clarity of vision. Sometimes glass lenses are specifically prescribed by the doctors. Thus, even though there is a shift in demand toward plastic lenses, the demand for glass lenses will remain.

GKB Ophthalmics - an established player

GKB Ophthalmics is one of the established players in the organised ophthalmic lens manufacturing industry in India. The company manufactures basic single vision glass lens and has an installed capacity of 12,000 glass lenses per day. The company mainly exports (90%) since the Indian market is dominated by unorganised players (accounting for 75%) which supply low quality, cheap lenses to the price-sensitive Indian market. Besides the basic single vision glass lenses, the company also manufactures various value-added glass lenses – bifocal, progressive, photo chromic and high index lenses under a separate company called GKB Vision where it holds a 38% stake (the remaining 62% is held by the promoters of GKB).

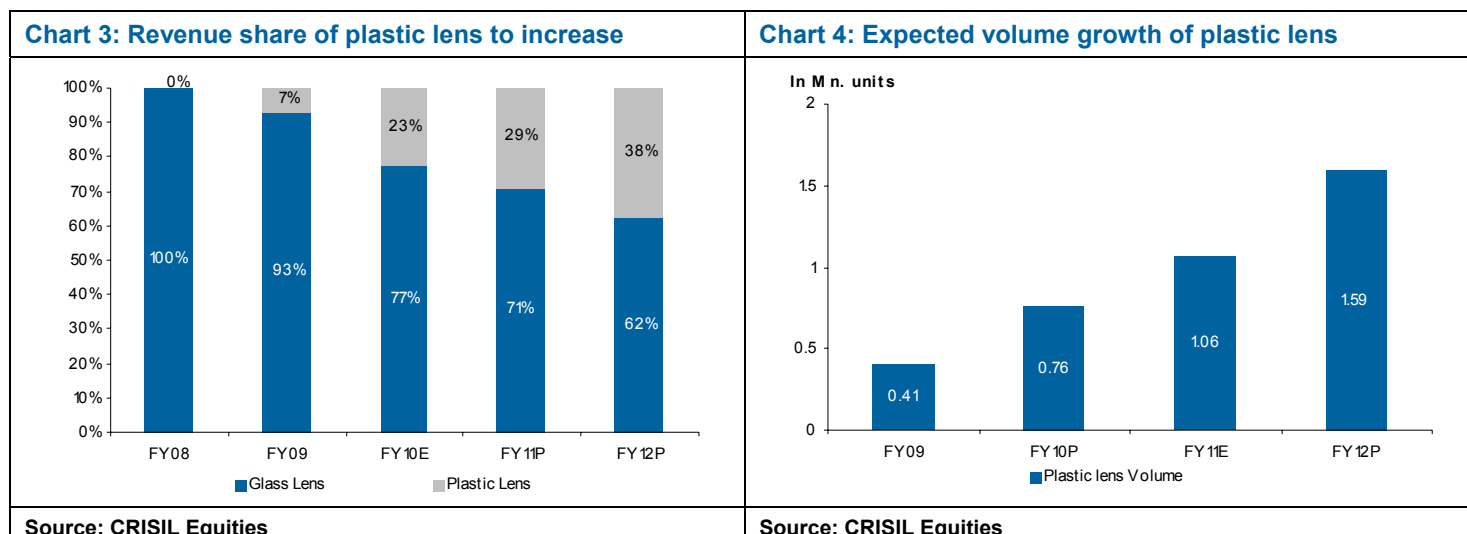
The company forayed into the manufacturing of plastic lenses in FY09. It currently has an installed capacity of 4,000 lenses per day which it plans to ramp up to 10,000 lenses by FY12 with a capital expenditure of ~Rs 9 mn. It is one of the two companies in India manufacturing plastic lenses; the other is Hyderabad-based Techtran Polylenses Ltd, which has a manufacturing capacity of ~12000 lenses per day.

Foray into plastic lens augurs well for GKB – better late than never

With the worldwide ophthalmic lens industry being dominated by plastic lenses, the company has realised, though late, that it can no longer remain restricted to producing glass lenses. Hence, the company forayed into the manufacturing of plastic lenses in 2009. The company initially started with a capacity of 2,000 lenses per day and increased it to 4,000 lenses per day. It plans to expand the capacity to 10,000 pieces

Foray into plastic lens to provide future growth

per day by FY12.



Closure of manufacturing units in Europe has led to increased outsourcing from India and China

Although the company faced teething problems in the production process leading to high rejection rates, things seem to be settling down.

Increased outsourcing from India & China

The closure of several unviable manufacturing units in Europe during the 2008 recession (as they had higher cost structures) has resulted in plastic lenses being outsourced from India and China, where the cost of production is relatively cheaper. With China mainly producing the basic variety of plastic lenses there is a huge market for high value-added products in the plastic segment that can be outsourced from India given the cost advantage compared to other European players.

GKB faces limited competition from other players in India. Apart from GKB, Techtran Polylenes Ltd is the only Indian player that manufactures plastic lenses. Hence, GKB is well poised to tap the opportunity in the plastic lenses market.

The closure of units in Europe has also helped the company source second-hand machines from them at a cheaper cost. For increasing its capacity from the current 4,000 plastic lens pieces per day to 10,000 pieces per day, the company has acquired an almost brand-new machine from one of the sick units in Europe at half the cost. This is expected to result in substantial cost savings for the company.

Agreement with Mitsui, a renowned player in chemicals, to ensure supply of high quality raw material

The company has also entered into an agreement with a Japanese firm, Mitsui Chemicals Inc, for the supply of raw materials required in the production of high-indexed plastic lenses. GKB is the only company in India to have signed a contract with Mitsui Chemicals, which is Asia's largest and the world's fifth ranked global chemical company in the world. High-indexed plastic lenses command high realisations and are expected to drive the revenue growth in the plastic lens segment of the company going ahead.

GKB lacks any unique value proposition which has hindered its ability to retain clients in the past

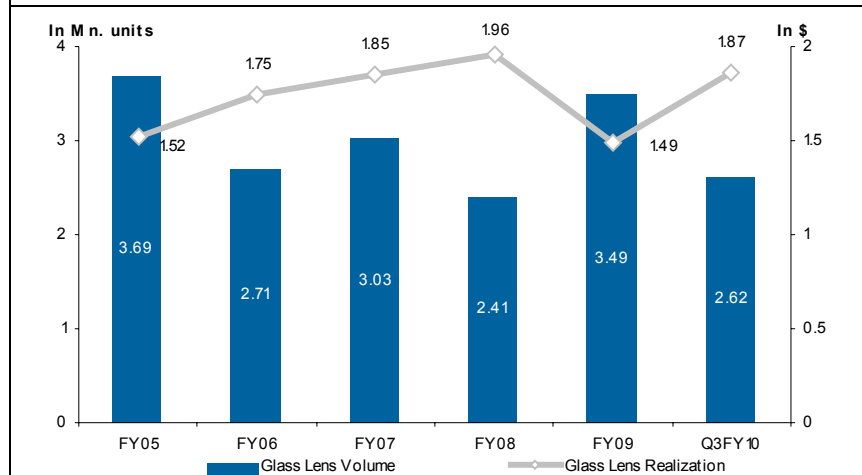
Constraints - competitive industry, no unique value propositions

The ophthalmic lens industry is competitive with many ophthalmic lens suppliers operating globally. GKB has a capacity of 4.5 mn lenses (per annum) in a market of 1 bn lenses globally and, hence, does not have any advantage in terms of size or volume

of operations, which can bring in client dependence. Also, the company has no unique value proposition compared to other players in the industry. Hence, the company has limited ability to retain its clients.

Due to the competitive nature of industry and lack of any unique value proposition, the company has failed to retain clients in the past, as a result of which its earnings are marked by a great degree of volatility. For instance, in FY07, the company lost a major client - Essilor AG, one of the largest manufacturers of ophthalmic lens globally. Essilor AG acquired a company in Italy from where it started to directly source its lens requirements.

Chart 5: Glass lens volume and realisations



Source: Company, CRISIL Equities

Key risks

Absence of hedging exposes the company to risks of currency fluctuation

Adverse impact due to foreign exchange currency fluctuations

GKB Ophthalmics earns a major proportion of its revenues from exports, mainly to America. Further, it sources its raw material requirements from France and Germany. As a result, it earns its revenues primarily in USD and incurs costs in Euros. As a result, the company is exposed to currency fluctuations both on revenues and costs. The company does not adopt any hedging practices, leading to the risk of adverse impact on its profitability due to fluctuations in these currencies.

Low cost exports from China

The company faces competition from the ophthalmic lens manufacturers in China who mainly supply to the export market at low prices. However, China mainly supplies the low-cost, basic finished lenses and, hence, is not a major competitor in value-added lenses.

Client concentration

The top three clients of the company contributed more than 60% of the company's revenues in FY09. The client base of the company is marked by a degree of instability due to the inherent fragmented nature of the ophthalmic lens industry. There are many small suppliers of ophthalmic lenses globally. Hence, the company does not enjoy much bargaining power with its clients. As a result, there is always a risk of losing a client which has contributed to volatility in revenues in the past and continues to remain a risk going forward.

Financial Outlook

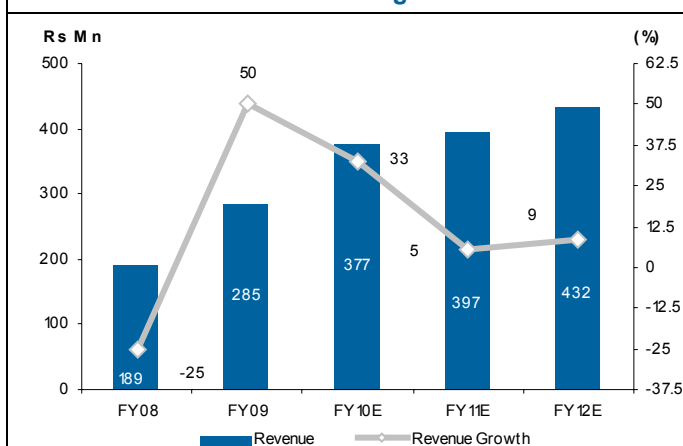
Revenues to grow to Rs 432 mn by FY12 at three-year CAGR of 15%

We expect GKB Ophthalmics' revenues to register a three-year CAGR of 15% to reach Rs 432 mn in FY12 from Rs 284.6 in FY09.

Revenues to post a three-year CAGR of 15% to Rs 432 mn in FY12

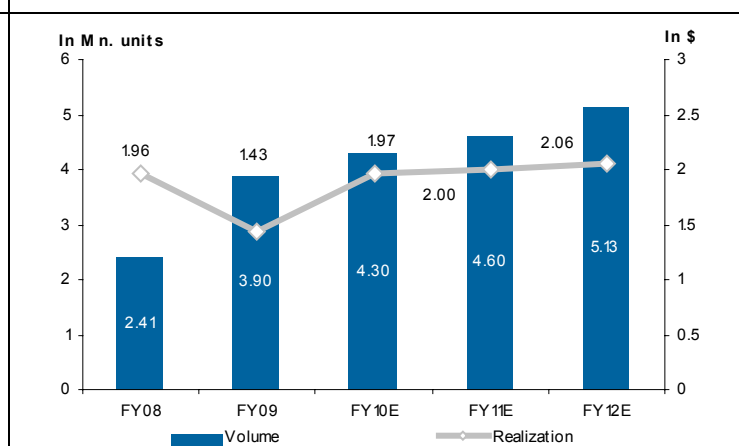
The revenue growth forecast during the FY09-12 period is much higher compared to 3% CAGR registered over FY05-09. During this period, the revenue growth was muted as the company was mainly in the production of glass lenses, which was experiencing a declining demand trend the world over. The production of plastic lenses will definitely give a boost to the company's revenues. Revenues from the plastic segment are expected to grow from ~Rs 19 mn in FY09 to ~Rs 166 mn in FY12E, translating into a contribution of 38% in FY12E compared to 7% in FY09.

Chart 6: Revenue and revenue growth trend



Source: CRISIL Equities

Chart 7: Volume and realisation trend



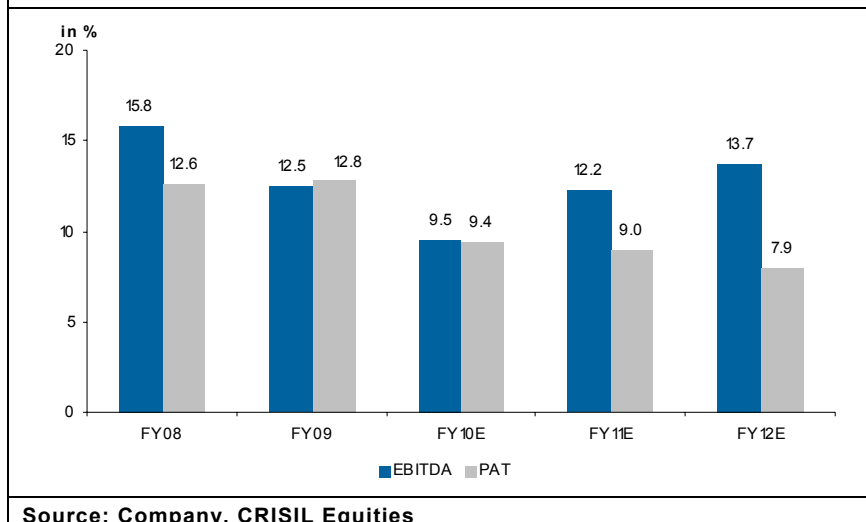
Source: CRISIL Equities

EBITDA margin to increase to 13.7% by FY12

GKB's EBITDA margin declined from 15.8% in FY08 to 12.5% in FY09. As FY09 was the first year of production of plastic lenses, the rejection rates for lenses were high. As a result, the increase in raw material did not translate into actual sales thereby impacting EBITDA margin. We believe with capacity additions in FY10, stabilisation in production will take a while. Hence, we expect EBITDA margin to dip further to 9.5% in FY10E. The company has so far reported an EBITDA margin of 9.2% for the period ending nine months to December FY10. Going forward, as the plastic lens production process stabilises and the rejection rates reduce, we expect EBITDA margin to increase to 12.2% in FY11 and 13.7% in FY12.

EBITDA margin to improve to 13.7% in FY12 with the stabilisation of production of plastic lenses

Chart 8: EBITDA and PAT margins



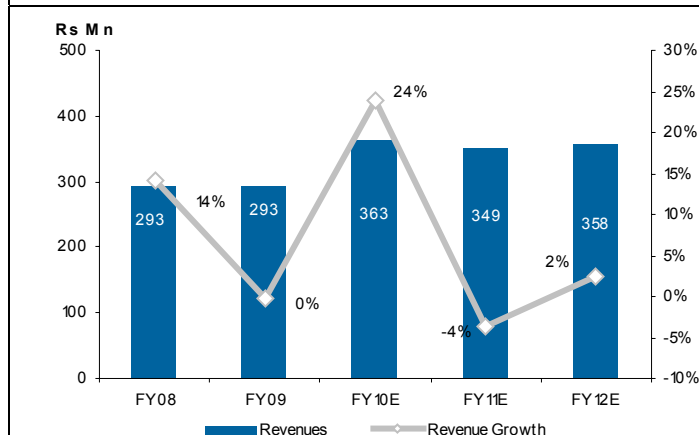
GKB Vision's growth expected to be flat; low profitability due to higher tax impact

GKB Vision's revenues are expected to increase from Rs 293 mn in FY09 to Rs 358 mn in FY12E backed by increase in volume and realisations. The realisations in value-added glass lenses manufactured under GKB Vision increased substantially in FY09 and nine months ending December, FY10 due to higher demand for photo chromic lenses. We expect GKB Vision's EBITDA margin to slip from 28% in FY09 to 21.8% in FY12E due to higher raw material costs and rejection rates with the commencement of production of glass moulds in 2009.

GKB Vision's revenues to increase on account of marginal increase in volume and realisations

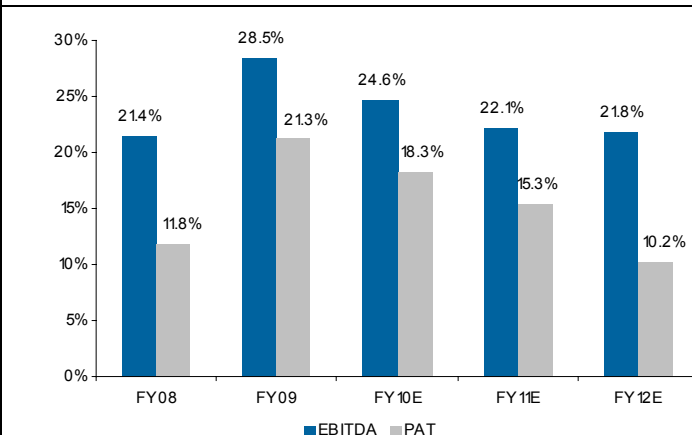
Driven by flat growth and declining margins, we expect GKB Vision's PAT to decline from Rs 60 mn in FY09 to Rs 37 mn in FY12. The company will also have to bear the impact of higher taxes in FY12 once the tax exemption expires. GKB Vision is a 100% export oriented unit and enjoys 100% tax exemption till FY11.

Chart 9: GKB Vision's revenue and revenue trend



Source: CRISIL Equities

Chart 10: EBITDA and PAT margins



Source: CRISIL Equities

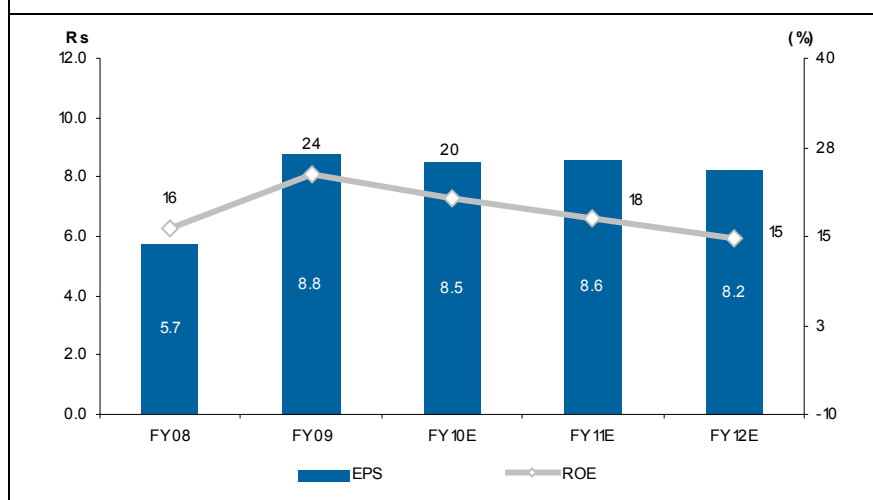
EPS expected to decline due to lower profitability of GKB Vision

GKB's consolidated PAT (after adding 38% share of profit from its associate GKB Vision) is expected to decline from Rs 36 mn in FY09 to Rs 34 mn in FY12. Although we expect GKB's standalone profit to register a healthy CAGR growth of 16% during FY09-FY12E, driven by increasing volumes as well as margins (mentioned above), the profitability of GKB Vision is expected to decline. GKB Vision's PAT is expected to decrease from Rs 60 mn in FY09 to Rs 37 mn in FY12E due to higher tax impact in FY12.

In line with the profitability, we expect GKB's EPS to decline to Rs 8.2 per share (after adding 38% share of profit from GKB Vision) in FY12 from Rs 8.8 in FY09.

We expect GKB to earn an EPS of Rs 7.1 in FY12

Chart 11: EPS and ROE



Source: Company, CRISIL Equities

Management Overview

CRISIL's fundamental grading methodology includes a broad assessment of management quality, apart from other key factors such as industry and business prospects, and financial performance. Overall, we believe that the management is experienced and well versed with the dynamics of the ophthalmic industry.

GKB has a reasonably good and experienced management

Experienced management

Mr K.G. Gupta, the Chairman and Managing Director, has an experience of close to five decades in the ophthalmic lens industry. He has been instrumental in positioning GKB as an established organised player in this industry in India. Mr Gupta has previously served as the Chairman of Confederation of Indian Industry in Goa and is currently a member of the Western Regional Council.

Mr Gupta is supported by his two sons Mr Guarav Gupta and Mr Vikram Gupta, who are now actively involved in chalking out the growth plans for the company and new initiatives. Under the increasing involvement of the two sons, the company has diversified into the manufacturing of plastic lenses and struck a deal with Mitsui Chemicals for raw material supply.

GKB has been late in entering the plastic lens segment, which has hurt its growth in the past

Not been proactive in reacting to changing industry dynamics

The company entered into the manufacturing of plastic lens in 2009, whereas the transition from glass lens to plastic lens globally took place during 1996-2001. We believe that the management has not been proactive in gauging the change in industry dynamics and adopting to it, which has hurt the growth of GKB Ophthalmics. In case the company had moved into the manufacturing of plastic lenses when the transition took place globally, it would have reaped the benefits of high growth in the plastic lenses segment then.

Reasonably experienced second line of management

The company has a reasonably experienced second line of management in place. We believe that the second line of management has sound technical know-how, is reasonably well experienced in their respective functional areas and have been with the company long enough to ensure smooth operations of the company.

Corporate Governance

CRISIL's fundamental grading methodology includes a broad assessment of corporate governance and management quality, apart from other key factors such as industry and business prospects, and financial performance. CRISIL Equities also analysed the company's shareholding structure, board composition, typical board processes, disclosure standards and related-party transactions. Any qualifications by regulators or auditors also served as useful inputs while assessing corporate governance.

GKB's board comprises of five directors, of whom one is an executive director and four are non-executive directors including one independent director. The company does not comply with Clause 49 of the listing agreement as there is only one independent director on the board. Also, interaction with the independent director revealed that his level of engagement with the company's affairs is below the required level.

Board composition

The board comprises professional individuals with varied experience. Mr Somnath Priolkar is the sole independent director on the board. He is 77 years old and has worked in the company previously as the head of accounts and finance for about 13 years.

As there is only one independent director on board, GKB Ophthalmic's board does not meet the SEBI guidelines on board composition. We discussed this with the management, and they recognize this as a shortcoming. They plan to induct more independent directors on the board.

Board processes

The balance sheet disclosures indicate that all the processes relating to committees are in place. The audit committee, chaired by the independent director, consists of two other non-executive directors. However, the company does not have a remuneration committee in place and the HR manager assists the board in fulfilling the remuneration policy.

GKB's board comprises five directors, of whom only one is independent

Valuation Grading

Grade:3/5

We have used the sum-of-parts approach to value GKB. We have used the discounted cash flow (DCF) method to value both GKB Ophthalmics (standalone) and GKB's 38% stake in GKB Vision.

Fair value estimate of Rs 52 based on DCF

Based on the DCF method, we arrive at the fair value of Rs 52 per share for GKB. We have valued GKB (standalone) at Rs 26 per share and GKB's 38% stake in GKB Vision is valued at Rs 26 per share. At our fair value of Rs 52 for GKB, the implied P/E is 6.04x for FY11 and 6.34x for FY12 earnings (including the share of profit from GKB Vision). We initiate coverage on GKB with a valuation grade of '3/5'. This grade indicates that GKB's valuations are 'aligned' to the current market price of Rs 48 as on May 10, 2010.

Key components to our valuation

We have considered discounted free cash flows from FY11 to FY15.

- i) Cost of Equity of 18.4% for both GKB Ophthalmics and GKB Vision factoring in higher risks due to fragmented nature of the industry, small size of the business and low liquidity of the stock.
- ii) Terminal Growth rate of 2% in line with the expected growth rate in the global ophthalmic lenses industry.
- iii) Cost of Debt (post tax) of 8% for both GKB Ophthalmics and GKB Vision.
- iv) Capex assumption of Rs. 9.5 mn in a phased manner till FY12 to fund the increase in plastic lens manufacturing capacity from 4000 lenses per day currently to 10,000 lenses per day by FY12.

Chart 12 : Sensitivity analysis: GKB Ophthalmics						Chart 13: Sensitivity analysis: GKB Vision					
	Terminal growth rate						Terminal growth rate				
	1.0%	1.5%	2.0%	2.5%	3.0%		1.0%	1.5%	2.0%	2.5%	3.0%
14.3%	32	34	36	38	41	15.6%	28	29	29	30	31
15.3%	27	29	30	32	34	16.6%	26	27	28	28	29
16.3%	23	24	26	27	29	17.6%	25	26	26	27	27
17.3%	19	20	22	23	24	18.6%	24	24	25	25	26
18.3%	16	17	18	19	20	19.6%	23	23	24	24	24

Source: CRISIL Equities

Source: CRISIL Equities

Company Overview

GKB Ophthalmics is a manufacturer and exporter of ophthalmic lenses. The company's manufacturing facilities are located at Tivim Industrial Estate, Goa. It manufactures single vision glass lenses and plastic lenses with a capacity of 12,000 glass lenses per day and 4,000 plastic lenses per day as on Q3FY10. The company earns most of its revenues through exports to Europe, America, Africa, Middle-East and Far East.

The glass lens segment of the company contributed 77% of the total revenues as on Q3FY10. The company commenced commercial production of plastic lens in 2009 with a capacity of 2,000 pieces per day which has increased to 4,000 pieces per day. The company plans to further increase its capacity in plastic lens to 10,000 pieces per day by FY12. However, the company has no capacity addition plans in the glass lens segment.

Chart 14: Company structure

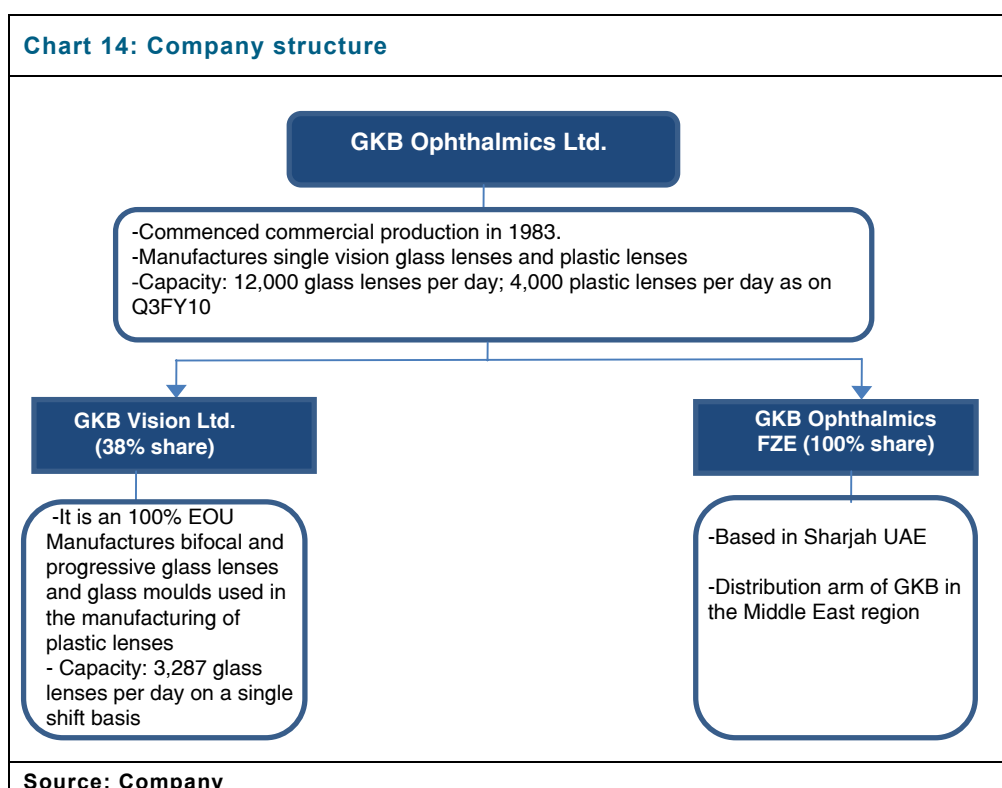


Table 4: Timeline

Timeline Details

1983	GKB Ophthalmics Ltd. commenced commercial production of ophthalmic glass lenses
2008	Diversified into the manufacturing of glass moulds and photo chromatic plastic lenses
2008	Entered into a joint venture agreement with Indo Internacional, S.A.Spain, to import and sell optical equipments manufactured by foreign JV partner in India
2009	Entered into an agreement with Japanese firm Mitsui Corporation for the supply of raw materials to produce the high-indexed variety of plastic lenses

Source: Company

Annexure: Financials

Income Statement					
(Rs Mn)	FY08	FY09	FY10E	FY11E	FY12E
Net sales	189	285	377	397	432
Operating Income	189	285	378	397	432
EBITDA	30	36	36	49	59
Depreciation	8	12	9	11	12
Interest	16	10	12	16	19
Other Income	9	8	0	1	2
PBT	15	23	15	23	30
PAT (before share in profit from associates)	11	13	10	15	20
Share in profit from associates	13	24	25	20	14
PAT (after share in profit from associates)	24	36	35	36	34
No. of shares	4.2	4.2	4.2	4.2	4.2
Earnings per share (EPS)	5.7	8.8	8.5	8.6	8.2

Balance Sheet					
(Rs Mn)	FY08	FY09	FY10E	FY11E	FY12E
Equity (FV Rs 10 per share)	42	42	42	42	42
Reserves and Surplus	108	117	148	176	201
Debt	85	80	122	152	182
Current Liabilities and Provisions	83	134	176	176	188
Deferred Tax Liability/(Asset)	14	11	11	11	11
Capital Employed	331	384	498	557	624
Net Fixed Assets	93	84	100	119	137
Investments	42	44	44	44	44
Loans and advances	10	12	16	17	18
Inventory	131	159	228	240	255
Receivables	50	77	100	106	115
Cash & Bank Balance	6	8	10	32	55
Applications of Funds	331	384	498	557	624

*Adjusted net income and EPS includes share of profit from associates. Company follows the practise of including dividend from its associate in 'Other Income'. We have adjusted the net income by including the profit from the share of associates instead of taking dividend in 'Other Income'.

Cash Flow

(Rs Mn)	FY08	FY09	FY10E	FY11E	FY12E
Pre-tax profit	15	23	15	23	30
Total tax paid	(3)	(12)	(5)	(8)	(10)
Depreciation	8	12	9	11	12
Change in working capital	(13)	(7)	(54)	(18)	(14)
Cash flow from operating activities	7	15	(35)	8	19
Capital expenditure	(10)	(2)	(25)	(30)	(30)
Investments and others	17	22	25	20	14
Cash flow from investing activities	7	20	0	(10)	(16)
Equity raised/(repaid)	0	0	0	0	0
Debt raised/(repaid)	6	(5)	42	30	30
Dividend (incl. tax)	(4)	(6)	(5)	(7)	(9)
Others (incl extraordinary)	(17)	(22)	-	-	-
Cash flow from financing activities	(16)	(33)	37	23	21
Change in cash position	(2)	2	2	21	24
Opening Cash	8	6	8	10	32
Closing Cash	6	8	10	32	55

Ratios

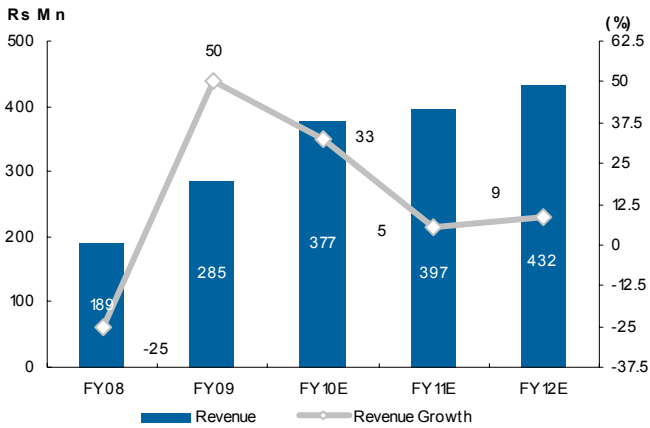
	FY08	FY09	FY10E	FY11E	FY12E
Growth ratios					
Sales growth (%)	(25.3)	50.4	32.6	5.2	8.8
EBITDA growth (%)	(13.3)	18.8	0.7	35.7	22.1
EPS growth (%)	18.7	93.0	(6.6)	1.1	(4.2)
Profitability Ratios					
EBITDA Margin (%)	15.8	12.5	9.5	12.2	13.7
PAT Margin (%)	12.6	12.8	9.4	9.0	7.9
Return on Capital Employed (RoCE) (%)	9.6	10.2	9.8	11.1	11.9
Return on equity (RoE) (%)	16.0	23.6	20.3	17.5	14.8
Dividend and Earnings					
Dividend per share (Rs)	0.9	1.4	1.1	1.7	2.2
Dividend payout ratio (%)	36.4	45.8	45.0	45.0	45.0
Dividend yield (%)	1.0	2.8	2.2	3.3	4.4
Earnings Per Share (Rs)	5.7	8.8	8.5	8.6	8.2
Efficiency ratios					
Asset Turnover (Sales/GFA)	1.2x	1.7x	2.1x	1.9x	1.8x
Asset Turnover (Sales/NFA)	2.1x	3.2x	4.1x	3.6x	3.4x
Sales/Working Capital	1.9x	2.6x	2.7x	2.2x	2.2x
Financial stability					
Net Debt-equity	0.5	0.5	0.6	0.5	0.5
Interest Coverage	1.4	2.5	2.2	2.4	2.5
Current Ratio	2.4	1.9	2.0	2.2	2.4
Valuation Multiples					
Price-earnings	16.9x	5.5x	5.6x	5.6x	5.8x
Price-book	2.7x	1.3x	1.1x	0.9x	0.8x
EV/EBITDA	16.1x	7.6x	8.7x	6.6x	5.5x

Source: Company, CRISIL Estimates



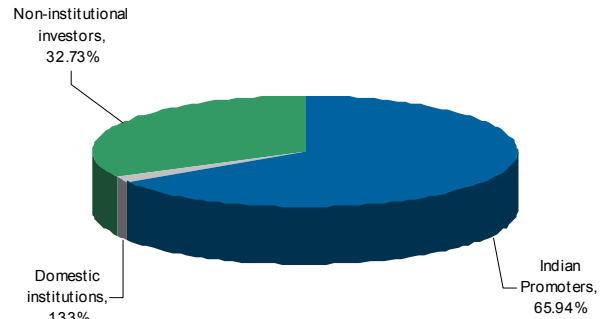
Focus Charts

GKB: Revenue and revenue growth trend



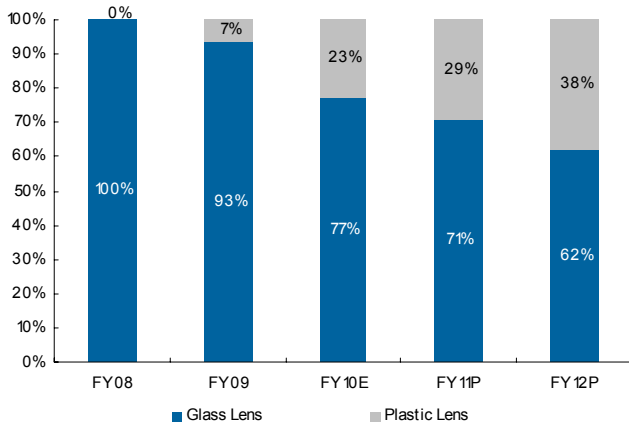
Source: CRISIL Equities

Shareholding as on March 2010



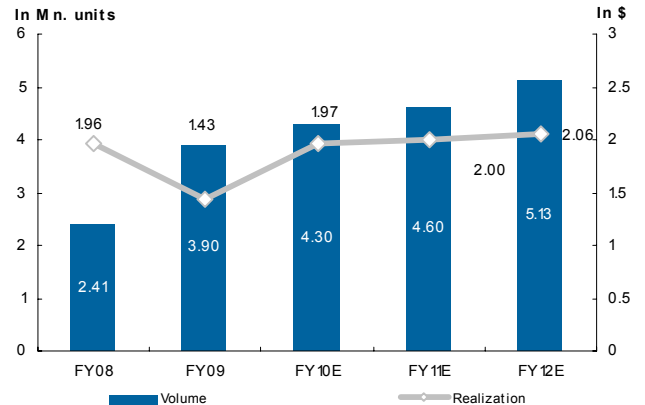
Source: Company

Share of plastic lens to increase



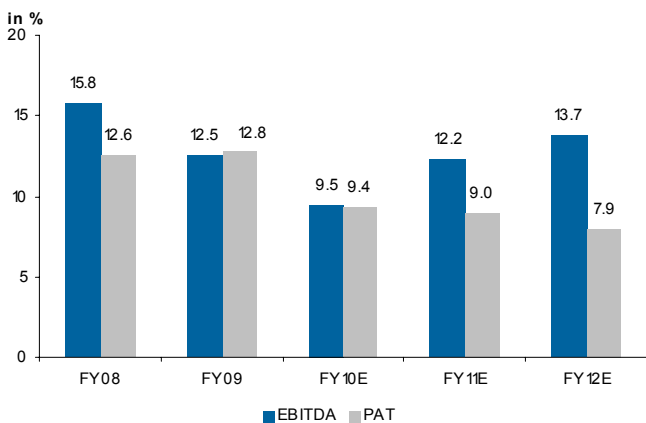
Source: Company, CRISIL Equities

GKB: Lenses volume and realisation trend



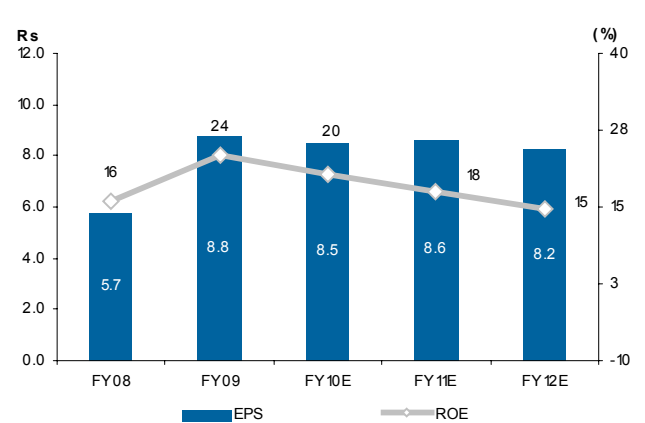
Source: Company, CRISIL Equities

GKB: EBITDA and PAT margins



Source: Company, CRISIL Equities

GKB: EPS and ROE



Source: Company, CRISIL Equities

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