CRISIL RESEARCH

Independent Equity Research

Enhancing investment decisions

In-depth analysis of the fundamentals and valuation

Orient Ceramics and Industries Limited

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.

Disclaimer:

Independent Research Report
Orient Ceramics and Industries Limited

Poised for growth through retail expansion and capacity additions

Industry: Construction materials
Date: August 17, 2010

Delhi-based Orient Ceramics and Industries Ltd (Orient) manufactures ceramic and vitrified tiles. We assign Orient a fundamental grade of '3/5', indicating that its fundamentals are 'good' relative to other listed securities in India. We also assign a valuation grade of '5/5', indicating that the market price has 'strong upside' from the current levels.

Healthy growth prospects in tiles industry, shift in consumer preference bode well

The tiles industry is expected to grow at a healthy rate driven by huge investments in the end-user segments such as housing, hospitality and infrastructure. CRISIL Research expects the tiles industry to grow at 12-14% to ~Rs 155 bn over the next two years. Also, a change in consumer preference from mosaic and natural stones to ceramic tiles along with an increase in disposable income and urbanisation spell good tidings for the industry.

Established player in the organised market; steady growth in the past

Orient is an established player in the organised market with a manufacturing capacity of 14 mn sq. meters (sq. mt). It has a market share of 3.1% in the highly fragmented tiles industry compared to the leader, Kajaria Ceramics, who has a market share of 5.1%. Orient has a strong presence in the Northern and Eastern markets with a network of ~900 exclusive dealers. The company had witnessed steady revenue growth of 10.2% through FY07-10. However, this was lower compared to industry growth of ~12%, mainly due to limited retail presence and less focus on advertising and marketing.

New launches, retail expansion and capacity additions to augment growth

In December 2009, Orient launched two brands – Europa, a high-end product in ceramic tiles, and Stiler, a wall highlighter. These products have been received well in the market. The company also plans to improve its retail presence by opening ~100 stores in FY11. It has significantly increased its focus on marketing, advertising and branding. The company also plans to enhance its capacity over the next two-three years to meet the growing demand. We believe these initiatives position Orient for a strong growth going ahead.

Revenues to grow at a two-year CAGR of ~18%, RoE to increase to 22% in FY12

We expect revenues to grow at a two-year CAGR of 17.8% to Rs 3.5 bn in FY12 supported by strong growth in the ceramic tiles segment on account of new product launches. EBITDA margins are expected to improve to 14.4% in FY12 from 13.9% in FY10 driven by increase in realisations from the launch of high-end brands. EPS is expected to increase from Rs 10.9 in FY10 to Rs 17.4 in FY12. RoE is expected to improve from 20.1% in FY10 to 22.2% in FY12.

Larger presence of unorganised players leads to high competition in the industry

The tiles industry is highly fragmented. The unorganised players have a 55% market share. This coupled with the growing capacities of organised players will lead to high competition in the industry as they all fight for a larger share of the market pie. We believe Orient will have limited flexibility to increase realisations as a result of high competition.

Valuation - the current market price has strong upside

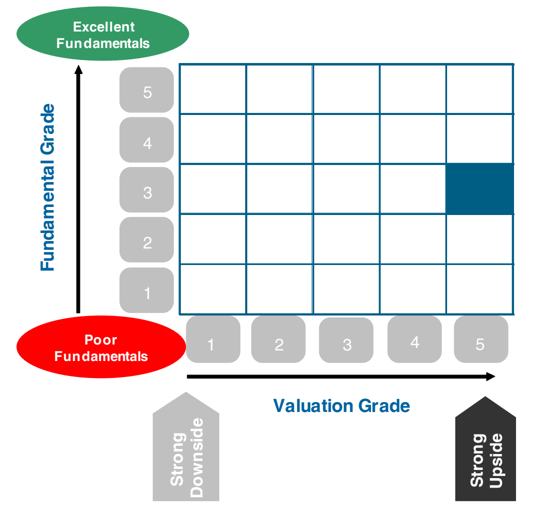
We have used the discounted cash flow method to value Orient. Based on this method, the fair value is Rs 132 per share. At this fair value, the stock trades at multiples of 9.1x FY11 and 7.6x FY12 earnings. We initiate coverage on Orient with a valuation grade of '5/5', indicating that the market price has 'strong upside' from the current levels.

Key forecast (standalone)

Rs mn	FY08	FY09	FY10	FY11E	FY12E
Operating income	2,142	2,264	2,524	3,068	3,501
EBITDA	239	308	350	422	504
Adj Net income	25	67	115	152	183
EPS-Rs	2.4	6.4	10.9	14.5	17.4
EPS growth (%)	(77.4)	146.6	80.1	32.8	20.2
PE (x)	17.1	4.2	3.9	6.3	5.2
P/BV (x)	0.9	0.5	0.7	1.3	1.1
RoCE (%)	11.8	15.6	19.9	22.9	22.3
RoE (%)	5.4	13.3	20.1	22.3	22.2
EV/EBITDA (x)	5.6	3.1	2.9	3.7	3.7

Source: Company, CRISIL Equities estimate

CFV matrix



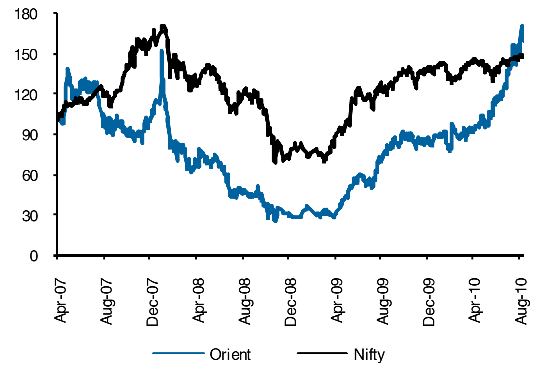
- Fundamental grade of '3/5' indicates good fundamentals
- Valuation grade of '5/5' indicates strong upside

Key stock statistics

BSE/NSE Ticker	ORIENTCE
Fair value (FV – Rs 10)	132
Current market price*	91
Shares outstanding (mn)	10.5
Market cap (Rs mn)	958
Enterprise value (Rs mn)	1,538
52-week range (Rs) (H/L)	98 / 42
P/E on EPS estimate (FY11E)	6.3
Beta	0.9
Free float (%)	25.3
Average daily volumes	6,229

**as on August 16, 2010*

Share price movement



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Orient: Business environment

Parameter	Manufactured goods		Traded goods
	Ceramic tiles*	Vitrified tiles#	
Revenue contribution (FY10)	68.8%	17.1%	14.1%
Revenue contribution (FY12)	68.1%	15.0%	16.9%
Product / service offering	Wide range of ceramic wall tiles in varied colours and designs. In the ceramic category, the company recently launched Europa and Stiler, which are high-end brands	Wide range of vitrified floor and wall tiles. Started production and sales in FY08	As, the company does not have a capacity in Western and Southern India, it relies on traded goods to meet demand in these regions
Geographic presence	Domestic markets. Nearly 75% of revenues comes from the Northern and Eastern markets		
Market position	• The industry is highly fragmented - 55% unorganised market, 45% organised. The organised market has various players with Orient having the fifth largest capacity in the organised segment • All-India market share of ~ 4% in the ceramic tiles segment and ~ 1.3% in the vitrified segment		• Orient relies less on the traded goods segment which comparatively has low margins. Contribution to revenues is ~11% (past three years) compared to the industry average of 15%
End market	• Residential, retail and commercial real estate markets, hotels, healthcare and airports		
Key competitors	• Asian Granito, Kajaria, Nitco Tiles, Somany Ceramics and unorganised players		
Sales growth (FY08-FY10 – 2-yr CAGR)	-4.3%	200.3%	33.2%
Sales forecast (FY10-FY12 – 2-yr CAGR) – (organic growth)	16.9% (driven by launch of high-end products – Europa and Stiler); launched in Q4FY10	10.0%	28.7%
Demand drivers	• Positive outlook of the real estate sector – high investment in the residential, commercial, retail and hospitality segments • Increase in replacement demand of ceramic tiles given a varied choice in colours and designs • Changing preference from marble and mosaic tiles to vitrified tiles in the flooring segment		
Margin drivers	• Increasing retail presence and growing brand visibility are expected to improve realisations • Recently launched Europa and Stiler brands have higher profitability compared to other ceramic tiles • Competition from peers and unorganised players to restrict realisation growth, which may impact margins		

Source: Company, CRISIL Equities

*__Ceramic tiles:__ Have water absorption capacity of 0.5-5%. They are mostly used in kitchens and bathrooms. They are mostly available in a glossy finish. Ceramic tiles constitute 60% of the tiles market in India.

#**Vitrified tiles:** Have very low water absorption capacity of 0.05% making them stain-resistant and strong. They can be used as an alternative to marble and granite flooring. They constitute ~35% of the tiles market in India. These are suitable for places with heavy wear and tear like industrial and chemical plants, hotel lobbies, banks and special pavements.

Grading Rationale

Tiles industry has healthy growth prospects

The tiles industry is expected to grow at 12-14% over the next two years

The tiles industry is expected to grow at a healthy rate driven by huge investments in the end-user segments such as housing, hospitality and infrastructure. CRISIL Research expects the tiles industry to grow at 12-14% to ~Rs 155 bn over the next two years.

Table 1: Investments and demand in the end-user segments

Particulars	
Housing	***mn units***
Urban housing shortages by FY14	21.7
Rural housing shortages by FY14	53.8
Hospitals	
Additional beds needed by FY13	349,321
Investments by FY13 (Rs bn)	873
Hotels	
Expected room additions by FY12	7,045
Investments by FY12 (Rs bn)	42.3
Airport modernisation	***Rs bn***
Expansion & upgradation in metros	147
Greenfield & upgradation in non-metros	98

Source: CRISIL Research

Historically, the ceramic industry has grown at a four-year CAGR of 13.5% to ~Rs 120 bn in FY10 due to continuous growth in the end-user segments such as housing and commercial real estate. Industry growth was above 15% in the past three-four years except in FY09, wherein it grew 5.8% due to the economic slowdown that led to a cold housing and commercial real estate market. However, with the economy back on track, the real estate sector is witnessing a strong traction. Moreover, an increase in the government's thrust and spending on infrastructure is expected to result in strong investments in verticals such as airports and hospitality creating additional demand for tiles.

India has per capita tiles consumption of 0.4 sq. mt

India’s per capita consumption of tiles is low

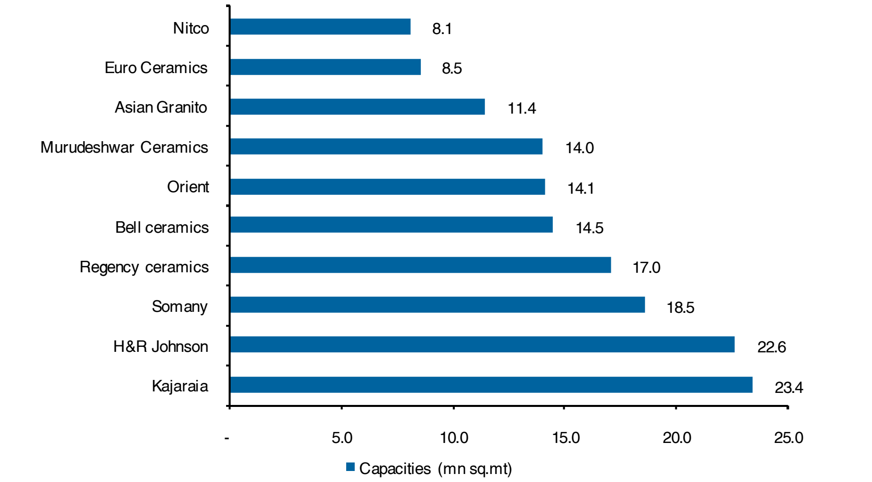
India’s per capita tiles’ consumption of ~0.4 sq. meters (sq.mt) as of FY10 is one of the lowest in the world. China’s is two sq.mt, while for some European countries such as Spain and Italy it is more than five sq.mt. However, an increase in disposable income and urbanisation is expected to boost the consumption of tiles in India in the near future. Moreover, replacement demand is also expected to increase as people replace traditional low-end tiles with tiles of better quality and design. Demand from the replacement market, which is currently 10% in India (~30% in countries such as China, Spain and Italy), is expected to increase in future.

Orient is an established player in the organised market

Orient is an established player in the organised tile manufacturing market with a capacity of 220,000 tonnes (~14 mn sq.mt) as of end-FY10. The company manufactures both ceramic and vitrified tiles in various designs and colours.

The tiles market in India is divided into two segments - the organised, 45% of the market, and unorganised, 55%. The share of the organised players is gradually increasing as they have been registering a higher growth compared to the unorganised players. The top six players in the organised market logged a revenue growth of 16.3% through FY06-10, compared to the overall industry growth of 13.5%, on account of better designs and quality.

Figure 1: Capacity of various players in the organised market



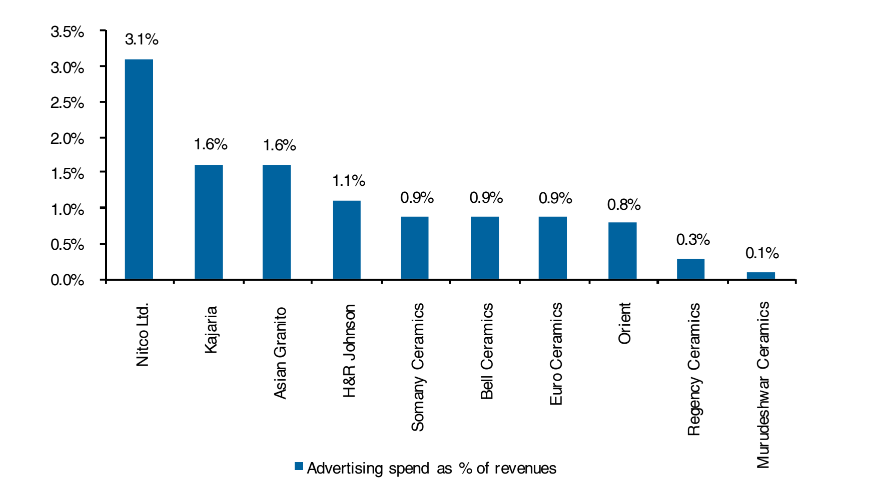
Source: CRISIL Equities

Steady run-up in the past…

Steady revenue growth in the past three years but was lower than the industry's growth

Orient has witnessed steady growth in the past. It registered a revenue growth of 10.2% over FY07-FY10. However, this growth was lower than the overall industry growth of ~12% because the company had limited retail presence and was focusing less on marketing and advertising.

Figure 2: Orient had low advertising spend compared to peers



Source: CRISIL Equities

… poised for a stronger growth now

Orient is taking various initiatives to gear for the next level of growth

The company has been taking various initiatives to gear up for the next level of growth. It plans to:

- Enhance its capacity over the next two-three years to meet the increasing demand for tiles.
- Plans to launch high-end product variants and roll out new collections every year.
- Also, plans to ramp up its retail presence and increase focus on marketing, advertising and branding.

With these initiatives, we expect Orient to register a revenue growth of 17.8% over the next two years, higher than the industry growth rate of 13-14%.

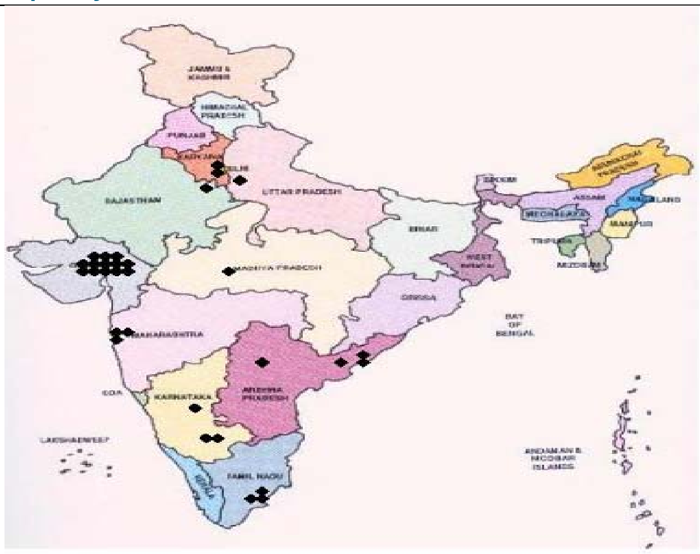
Second largest capacity in the Northern regions

North and Eastern markets contributed ~75% to the total revenues in FY10

The company is a dominant player in the Northern and Eastern markets along with Kajaria Ceramics - the leader in the organised space. Orient has a market share of 3.1% in the tile industry vs. Kajaria's 5.1%. Orient has the second largest manufacturing capacity (14 mn sq.mt.) in the Northern region after Kajaria who has a capacity of 23.4 mn sq.mt. Given that tiles are bulky and involve higher freight cost, Orient mainly caters to the Northern and Eastern regions where its manufacturing plant is located. These markets contributed ~75% of the total FY10 revenues.

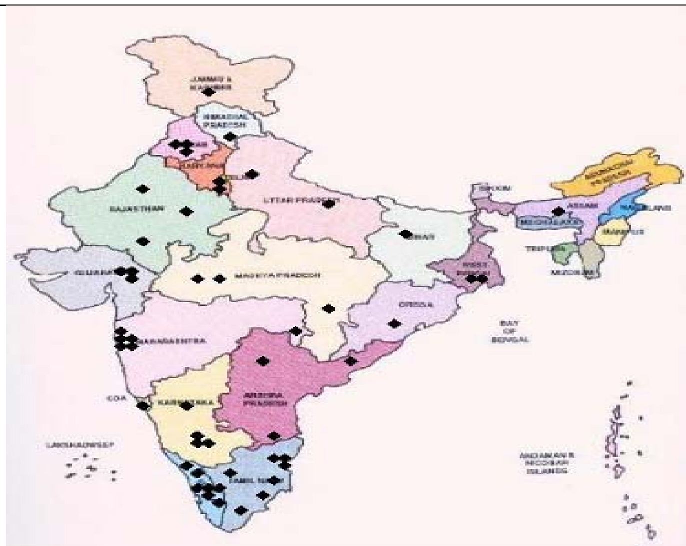
Manufacturing capacities are mainly concentrated in the Western region; Gujarat accounts for 70% of the total unorganised market. In terms of market segmentation, North and East have a 39% share in the Indian tiles market, while the South and West account for 23% and 38%, respectively.

Figure 3: Western region has highest production capacity



Source: Company

Figure 4: Consumption areas are scattered all over India



Source: Company

Sizeable capacity additions to tap the future growth

The company will continue to outsource products from unorganised players in the industry

Orient is planning to enhance its capacity to cater to the future growth in the industry. The company plans to increase capacity from ~14 mn sq.mt (utilisations at 81% in FY10) to ~19 mn sq.mt by FY12. The company will also continue to outsource products from other unorganised players depending on its requirements.

Though the company has a strong presence in the Northern and Eastern markets, it plans to expand its footprints in the Southern and Western regions too. We expect revenues from trading activities to grow at a faster pace as the company will resort to outsourcing activities (till its manufacturing capacity is operational) to meet the growing demand in the Western and Southern regions. Although the demand in these regions is currently met through traded goods, Orient is actively looking to acquire capacities from small unorganised players. The company had also bought a 40-acre land in Kakinada and is evaluating options to set up a greenfield plant there.

Planning to tie-up with Spanish or Italian player

Moreover, the company is looking to tie-up with a Spanish or Italian tile maker which will enable it to get access to latest technology and help improve quality and designs of its products.

Table 2: Capacity expansion

Segment	Existing capacity (mn sq.mt)	Expansion plans (mn sq.mt)
Ceramic tiles	12.2	3.7
Vitrified tiles	1.8	0.8
Total	**14.0**	**4.5**

Source: Company, CRISIL Equities

Strong distribution network

Orient has 900 exclusive dealers in the North and East

Orient has a strong India-wide distribution network. It has nearly 4,000 dealers including 900 exclusive dealers in the North and East. The company also owns 18 stock depots across the country which enables it to have a wide reach. Currently, it has two self-owned showrooms, four franchisee showrooms and 10 shop-in-shops (SIS). The company plans to increase its retail presence by opening four self-owned showrooms, 20 franchisee showrooms and nearly 60 SIS.

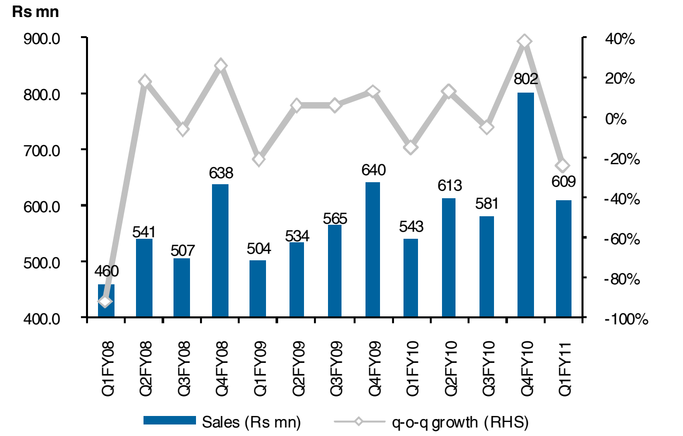
New brand launches to augment growth

In December 2009, Orient launched two new brands, viz. Europa and Stiler. Europa is a high-end product variant in ceramic tiles with better designs, superior quality (low water absorption) and is available in large sizes compared to the normal tiles. Stiler is a wall highlighter which mainly supports Europa tiles and provides an attractive look to the interiors. These products are comparable to Italian and Spanish tiles.

The company has roped in a product designer from Spain - Maria Castillo, to introduce world-class designs and products. Maria holds a Bachelor's degree in ceramics and has spent about nine years as chief designer and manager of Blau Estil's, a boutique design firm in Spain.

These products have met with reasonable success. Following their launch, Q4FY10 revenues increased 38% q-o-q to Rs 802 mn, highest ever quarterly revenues in Orient's history. Also, EBITDA and PAT margins were 280 and 390 bps higher at 14.5% and 3.9%, respectively, in Q4FY10 compared to Q4FY09 due to higher realisations from these brands.

Figure 5: Q4FY10 registered high revenue growth supported by launch of new brands



Source: Company, CRISIL Equities

Table 3: Europa and Stiler commands significant premium compared to other tiles

	FY08	FY09	FY10
Ceramic tiles (Rs per sq. mt)			
Europa	-	356	344
Stiler	-	-	1,503
Normal ceramic	179	191	183
Vitrified tiles (Rs per sq. mt)			
Polished vitrified	364	344	302
Ultra vitrified	-	-	621

Source: Company, CRISIL Equities

We expect Europa and Stiler brands to contribute 15.7% in FY12 vs. 7.4% in FY10. Due to increasing share from these high-margin products, we anticipate EBITDA margins to increase by 50 bps to 14.4% in FY12.

Structural budge in consumer preference spells good tidings

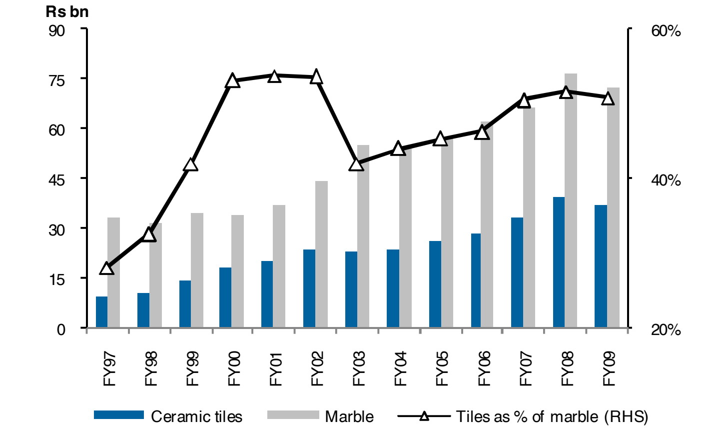
Budge in preference for ceramic tiles spells good tidings

There is an evident shift in preference for ceramic tiles from mosaic and natural stones such as marble and granite due to the following factors:

- Tiles are available in varied colours, designs and surface effects providing ample choices compared to natural stones
- High-end tiles are priced nearly 50% lower to marble and granite
- Relative ease in laying, versatility and lower maintenance

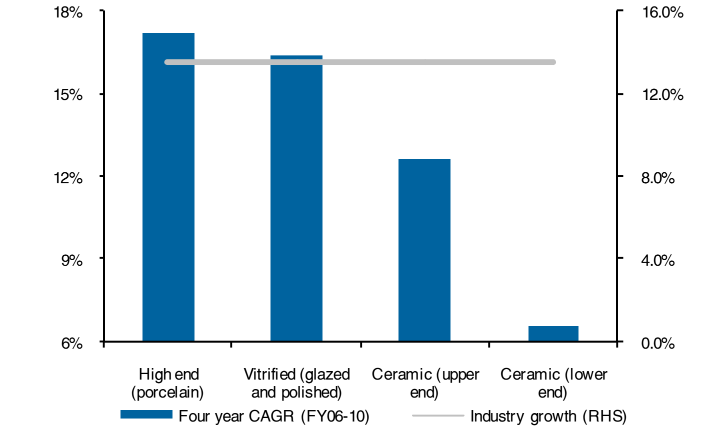
In India, ceramic tiles cover 20% of the floor, while mosaic tiles and natural stones cover the remaining 80%. However, the latter's share is gradually declining. Also, wall tiles were earlier used only in bathrooms and kitchens, but now they are being used in living rooms and bedrooms too. During FY06-10, the growth in the vitrified and high-end tiles was higher at 17% and 16%, respectively, compared to 13% growth for upper-end ceramic tiles during the same period. If this is any indication, we expect healthy growth in the tiles industry, particularly for high-end tiles.

Figure 6: Ceramic tiles segment has grown faster than marble



Source: Indiastat, CRISIL Equities

Figure 7: High-end and vitrified tiles registered above industry growth



Source: Industry sources, CRISIL Equities

Retail expansion and increased marketing focus to enhance brand visibility

The company plans to open ~100 stores in FY11

Orient is looking to expand its retail presence in order to tap future growth and enhance brand visibility. The company currently has two showrooms - one at its manufacturing unit in Sikandarabad, UP and another at its corporate office in Delhi. The company plans to open ~100 stores in FY11. However, the company is taking calculated risks and plans to focus more on the franchisee model rather than owning all the stores. Orient is looking to foray into the retail space through different models:

- Company-owned, company-operated (COCO): The company plans to open four COCO showrooms in GK-II, New Delhi, Faridabad, Chandigarh and Kolkata in FY11.
- Franchisee showroom: Under this model, the stores will be managed by a franchisee, who will also own the premises. The stores will have a minimum display area of 1,500 sq.ft. and will exclusively showcase Orient products.
- Shops-in-shops (SIS): Under this arrangement, the company will have a dedicated area of ~400 sq.ft. in the retailers' premises.

The company is also taking various marketing initiatives to enhance brand visibility. It had started participating in major tradeshows like Acetech (annual exhibition where builders, architects and building material suppliers display their products) to assess market moods and display their products to a wide range of customers. It has also increased its overall spend on advertising and ramped up its sales force.

Larger presence of unorganised players leads to high competition

The tiles industry is highly fragmented

The tiles industry is highly fragmented; unorganised players have a market share of 55%. Morbi, a small town in Gujarat, has many unorganised players catering to the local demand in the Western region. This coupled with the growing capacities of organised players will lead to high competition in the industry as they fight for a larger pie in different regions.

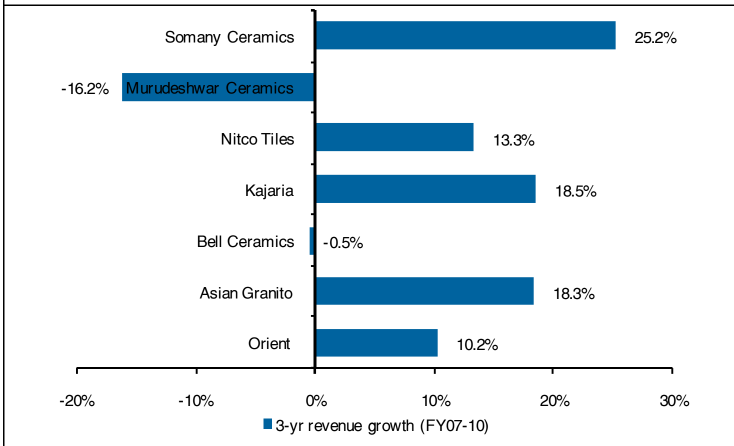
Established brands will have limited flexibility to increase realisations

Since the final choice of tiles depends on the availability of desired designs and colours, brands will have a limited impact amongst retail consumers. Also, consumers are faced with ample choice to select from the available brands leading to strong competition. In addition, availability of low-end tiles in the same colours and designs at a relatively competitive price makes it difficult for organised players. Hence, we believe established brands too will have limited flexibility to increase their realisations.

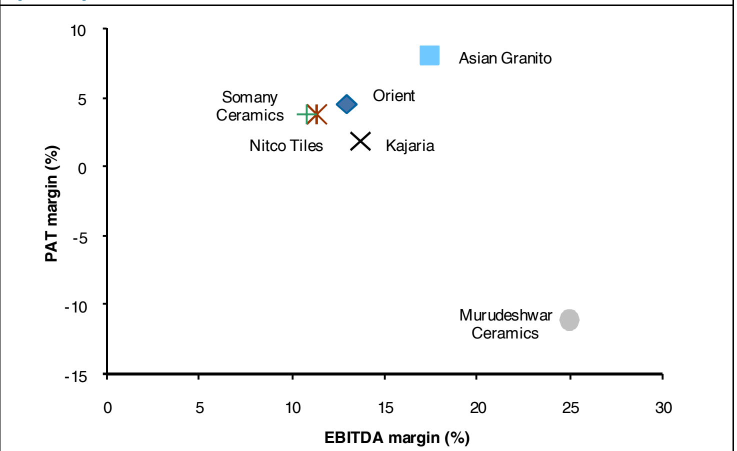
Orient – competitively placed amongst other organised players

Orient is competitively placed amongst other organised players in the industry. Although it witnessed lower revenue growth in the past three years as against other organised players, its margins and return ratios (RoE) are amongst the best.

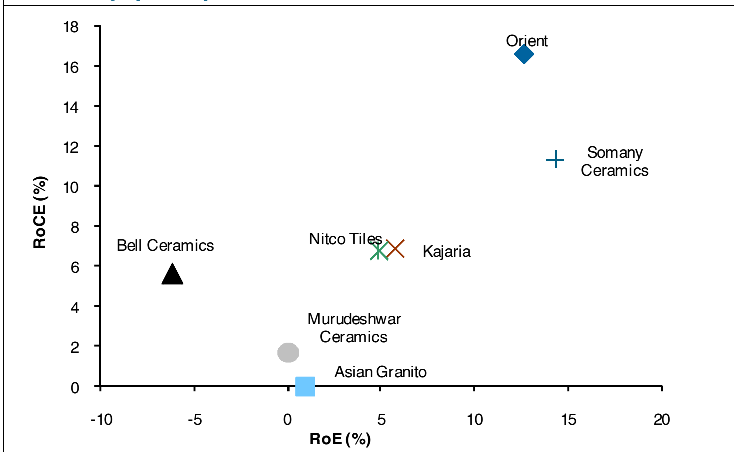
Orient had comparatively lower revenue growth



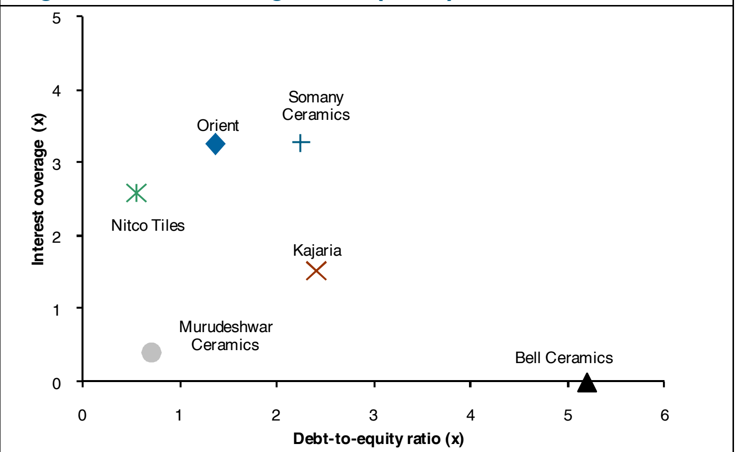
...but only second to Asian Granito in margin terms (FY10)



Orient has one of the best RoE and RoCE in the industry (FY09)



Financial profile: Orient has low debt-to-equity and high interest coverage ratio (FY09)



Source: CRISIL Equities

Source: CRISIL Equities

Key risks

Slowdown in the real estate market

Slowdown in the real estate market to have a direct impact on the tiles industry

Growth in the tiles industry is primarily driven by growth in the real estate market and the economic scenario. In FY09, the tiles industry witnessed lower growth of 5.8% compared to an average growth of 15% in the past three-four years due to slowdown in the real estate market. Although we expect growth in the tiles industry to remain buoyant over the next two-three years, any slowdown in the real estate market might have a significant impact on Orient's growth prospects.

Competition from Chinese imports

The Indian ceramic industry faces strong competition from Chinese players. To limit the competition and to restrict imports from China, the Government of India has levied an anti-dumping duty of Rs 137 per sq.mt in 2009. In the event of withdrawal of the duty, competition from Chinese players may increase.

Delay in capacity additions

Orient plans to enhance its manufacturing capacity to tap future growth. Although we believe the company will be able to achieve revenue growth of ~18% in the next two years, any delay in capacity addition might impact the financials of the company.

Inability to pass on hike in raw material prices

Inability to pass on hike in raw material costs might impact margins

Raw material costs constitute ~40% of the total operating costs in the tiles industry. Since Orient operates in a fragmented market with high competition from unorganised players, increase in raw material prices may have an impact on its margins in case the company is not able to pass this on to its customers.

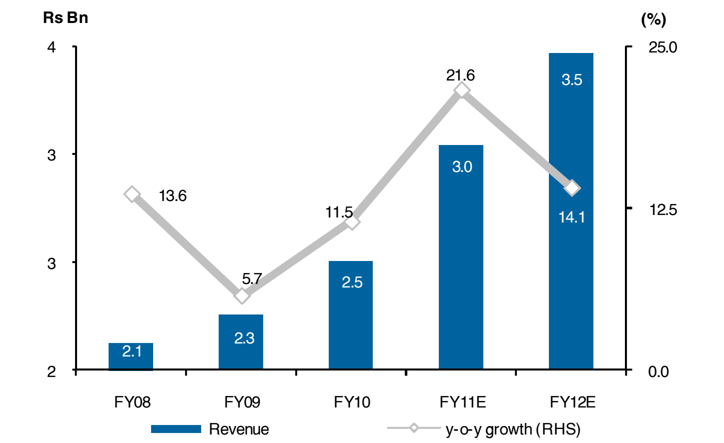
Financial Outlook

We expect revenues to grow at a two-year CAGR of 17.8% in FY12

Revenues to grow at two-year CAGR of ~18% to Rs 3.5 bn in FY12

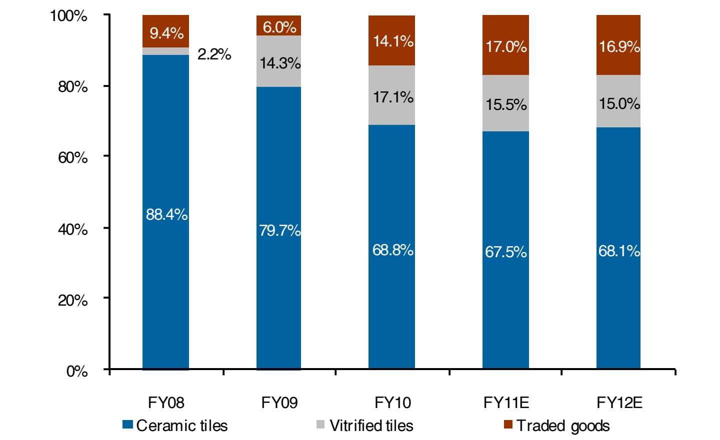
We expect Orient's revenues to grow at a two-year CAGR of 17.8% to Rs 3.5 bn in FY12 primarily driven by volume growth. The volume growth will be supported by launch of high-end brands - Europa and Stiler. We expect their contribution to revenues to increase from 7.4% in FY10 to 15.7% in FY12.

Figure 8: Revenue and revenue growth



Source: Company, CRISIL Equities estimate

Figure 9: Contribution of different product categories



Source: Company, CRISIL Equities estimate

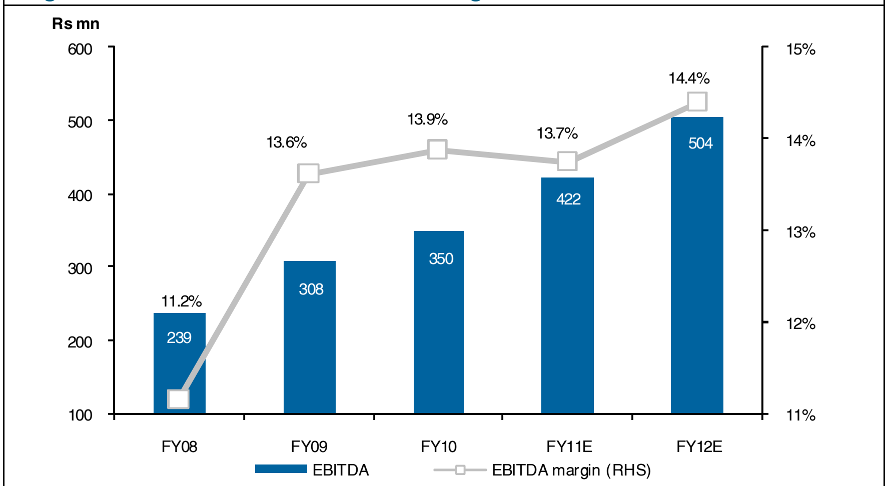
EBITDA margins to improve in FY12

We expect EBITDA margins to remain stable at 13.7% in FY11 (13.9% in FY10) as an increase in realisations is expected to be offset by higher advertising expenses incurred to enhance brand visibility. Although Q1FY11 EBITDA margin was lower at 9.7%, we expect the company to report higher margins in the subsequent quarters due to benefits from advertising and marketing activities.

We expect EBITDA margins to improve by 65 bps y-o-y to 14.4% in FY12 due to an increase in contribution from Europa and Stiler sales, leading to higher realisations.

EBITDA margins are expected to improve to 14.4% in FY12

Figure 10: EBITDA and EBITDA margins



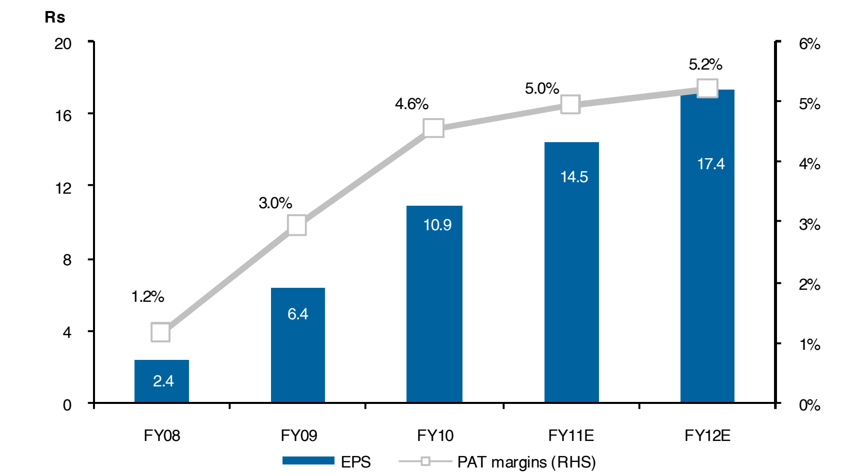
Source: Company, CRISIL Equities estimate

PAT to grow at a CAGR of 26%; EPS expected to increase from Rs 10.9 in FY10 to Rs 17.4 in FY12

EPS is expected to increase from Rs 10.9 in FY10 to Rs 17.4 in FY12

Orients's PAT is expected to grow from Rs 115 mn in FY10 to Rs 183 mn in FY12, driven by a healthy revenue growth as well as an expansion in margins. Orient's net margins are expected to improve from 4.6% in FY10 to 5.2% in FY12 while EPS is expected to increase from Rs 10.9 in FY10 to Rs 17.4 in FY12.

Figure 11: EPS and PAT margins



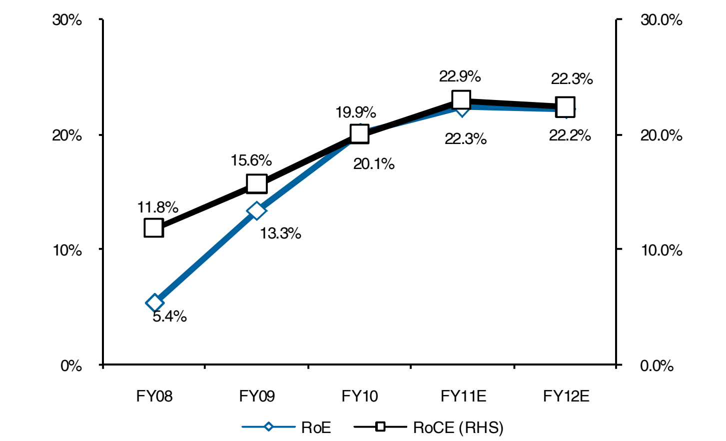
Source: Company, CRISIL Equities estimate

RoE to improve to 22%; asset turnover to increase in next two years

RoE is expected to improve from 20.1% in FY10 to 22% in FY12

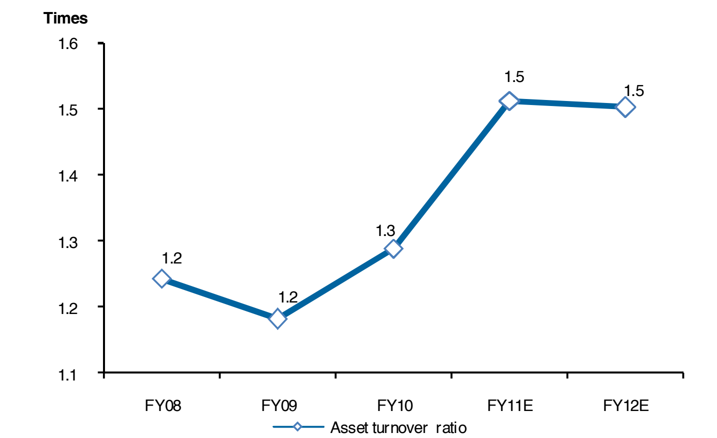
RoE is expected to improve from 20.1% in FY10 to 22.3% in FY11 and 22.2% in FY12 mainly due to an improvement in margins and higher asset turnover ratio. With the addition in capacities, we expect the average asset turnover ratio to increase to 1.5x over the next two years compared to 1.2x for the FY06-10 period. The increase in asset turnover is primarily on account of a change in product mix with increasing share of Europa and Stiler brands, which will command higher realisations.

Figure 12: RoE and RoCE to improve from current levels



Source: Company, CRISIL Equities estimate

Figure 13: Asset turnover ratio to increase



Source: Company, CRISIL Equities estimate

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 feel that the management has strong domain expertise and will drive the company's growth in the near future.

Management has sector expertise and domain proficiency

Orient's management has more than 30 years of experience in the ceramic industry

Orient has an experienced management team led by Mr Mahendra Daga, Chairman and Managing Director, who has more than 30 years of experience in the ceramic industry. He is a founder member of the Indian Council of Ceramic Tiles & Sanitaryware (ICCTAS), the apex body in India representing the ceramic tile Industry. Mr Mahendra Daga is supported by his son, Mr Madhur Daga, who is responsible for the overall management of the company. Mr Madhur has more than 15 years of experience and spends most of his time overseeing Orient's product innovation and marketing efforts.

Promoters shed conservative cloak, gear up to grow aggressively

Over the past three years, Orient's revenue growth was lower than that of the industry, mainly due to low retail spends and limited focus on marketing and advertising. However, Mr Madhur Daga has increased the focus on marketing and advertising activities. The company launched two new high-end brands. It also plans to increase retail presence and enhance capacities. Mr Madhur Daga has also brought in experienced professionals from the industry to ramp up the management team. The company appointed a Chief Product Designer from Spain, Ms Maria Castillo, who has the requisite experience in designing and product innovation in the ceramic industry. Mr Vijay Shankar Sharma, with strong domain expertise in finance and strategy, has been appointed as CFO in May 2008.

Strong second line of management

Company has a well-experienced second line of management

Based on our interactions with various business heads - production, marketing and product design - we believe that Orient has a strong second line with a strong experience of 15-20 years in their respective domains.

Mr Vijay Shankar Sharma (CFO) has approximately 20 years of experience in leading MNCs such as ICI India, Ranbaxy Laboratories, Idea Celluar and Vodafone India. He has played an important role in implementing best practices and processes in the company, which has helped the company deliver higher profitability. Mr Anil Agarwal (President – Manufacturing operations) has close to two decades of experience in the ceramic industry. Mr Sanjay Monga (VP – Sales and Marketing) has previously worked with Nerolac Paints and Shalimar Paints. Other key managerial personnel have been in the company on an average for more than four years.

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. In this context, CRISIL Equities analyses shareholding structure, board composition, typical board processes, disclosure standards and related-party transactions. Any qualifications by regulators or auditors also serve as useful inputs while assessing a company's corporate governance.

Overall, corporate governance at Orient presents good practices supported by a strong and fairly independent board. Further, the current board has good and relevant experience in the industry. We feel that the company's corporate governance practices are adequate and meet the minimum required levels.

Board composition

Board comprises five members, of whom three are independent directors

Orient's board comprises five members, of whom three are independent, exceeding stipulated SEBI listing guidelines. Given the background of directors, we believe that the board at Orient is fairly diversified.

Board's processes

The company has various committees – audit, remuneration and investors' grievance - in place to support corporate governance practices. The company's disclosures are sufficient to analyse various business aspects of the company. CRISIL Equities assesses from its interactions with independent directors of the company that the quality of agenda papers and the level of discussions at the board meetings are good.

The company's quality of disclosure can be considered good, judged by the level of information and details furnished in annual reports, website and other publicly available data. We feel that the independent directors are well aware of the business of the company and are fairly engaged in all the major decisions, reflecting well on the company's corporate governance practices. The audit committee is chaired by an independent director, Mr R. N. Bansal, and it meets at timely and regular intervals.

Valuation Grade: 5/5

We initiate coverage on Orient with a valuation grade of 5/5

We have used the discounted cash flow (DCF) method to value Orient. Based on this method, the fair value is Rs 132 per share. At this fair value, the implied P/E is 9.1x FY11 and 7.6x FY12 earnings. Consequently, we initiate coverage on Orient with a valuation grade of '**5/5**', indicating a strong upside from the current market price of Rs 91.

Key components of our valuations

- We have considered the discounted value of the firm's estimated free cash flow from FY11 to FY16.
- We have assumed cost of equity at 16.5%, factoring in the small size of the company and low liquidity in the stock.
- Terminal growth rate of 3%.
- Based on the above, we have arrived at a fair value of Rs 132.

Table 4: Sensitivity analysis

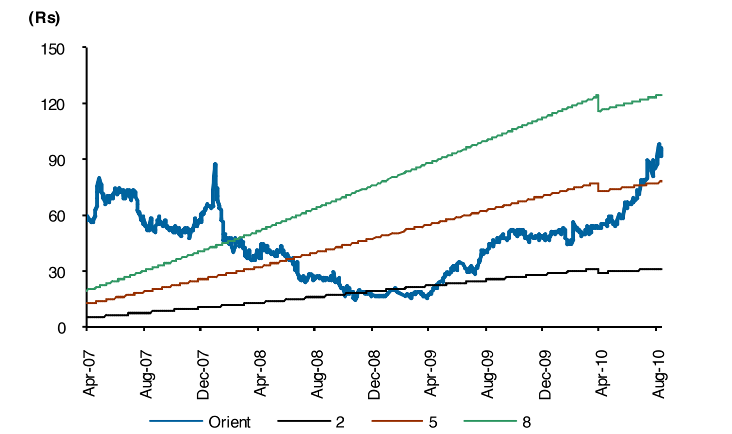
		Terminal growth rate				
		1.0%	2.0%	3.0%	4.0%	5.0%
Terminal WACC	12.9%	140	154	171	191	217
	13.9%	125	136	149	165	185
	14.9%	112	121	**132**	144	160
	15.9%	100	108	117	128	140
	16.9%	91	97	105	113	124

Source: CRISIL Equities estimate

At Rs 132, implied P/E is 9.1x FY11 and 7.6x FY12 earnings

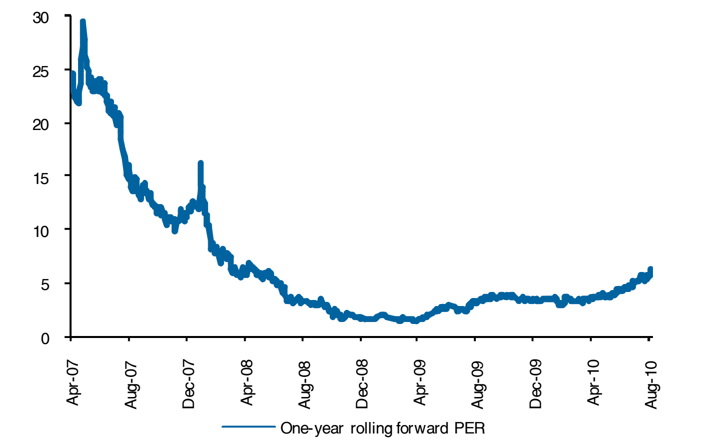
At our fair value of Rs 132, the stock would trade at an implied P/E of 9.1x FY11 and 7.6x FY12 earnings. Since April 2007, Orient has traded at an average one-year rolling forward P/E of 7x. However, since April 2009 the stock has traded at an average one-year rolling forward P/E of 3.5x. Given the expected improvement in realisations and margins along with an increase in asset turnover ratio, we expect the stock to get re-rated in the medium term and trace back to its historical average historical multiple of 7x.

Figure 14: Orient has traded at an average one-year rolling PER of 7x



Source: CRISIL Equities

Figure 15: One-year rolling forward PER is currently at historical low levels



Source: CRISIL Equities

Table 5: Peer comparison

	M.cap	EPS (Rs)			Price/Earnings (x)			Price/Book (x)			EV/EBITDA (x)			RoE (%)		
Companies	(Rs Mn)	FY10	FY11E	FY12E	FY10	FY11E	FY12E	FY10	FY11E	FY12E	FY10	FY11E	FY12E	FY10	FY11E	FY12E
Orient Ceramics	958	10.9	14.5	17.4	3.9	6.3	5.2	0.7	1.3	1.1	2.9	3.7	3.7	20.1	22.3	22.2
Asian Granito	1,297	12.0	-	-	5.1	-	-	0.8	-	-	3.3	-	-	24.8		
Bell Ceramics	186	(10.8)	-	-	(0.8)	-	-	0.4	-	-	5.5	-	-	na	-	-
Kajaria Ceramics	4,930	4.9	6.7	9.1	13.8	10.0	7.4	3.5	2.2	1.7	na	5.9	4.9	na	23.8	26.3
Nitco Tiles	1,900	7.8	-	-	7.6	-	-	0.4			6.3	-	-	4.9	-	-
Murudeshwar Ceramics	594	(8.7)	-	-	(3.9)	-	-	0.2			6.7	-	-	(5.9)	-	-
Somany Ceramics	1,691	29.6	-	-	8.3	-	-	2.6	-	-	5.1	-	-	14.3	-	-
Regency Ceramics	228	(5.3)	-	-	(1.6)	-	-	-	-	-	-	-	-	-	-	-

Source: CRISIL Equities estimate, industry estimates

Company Overview

Incorporated in May 1977, Orient is a well known player in the organised domestic tiles market. The company started manufacturing of ceramic tiles with an installed capacity of 5,000 tonnes per annum (TPA) at Sikandarabad, UP. Till 1993, the company was run by IFCI, who took over the charge from Somany's. The company got listed on the BSE in 1993 when Mr M. K. Daga, CMD, took over the management of the company from IFCI.

Orient has manufacturing capacity of 220,000 TPA in FY10

Today, Orient is an established player with an installed capacity of 220,000 TPA (14 mn sq.mt). The company initially manufactured only ceramic tiles, it started manufacturing vitrified tiles in FY08. Orient manufactures a wide range of non-vitrified, vitrified, ultra vitrified and decorative tiles for walls, floors and facades.

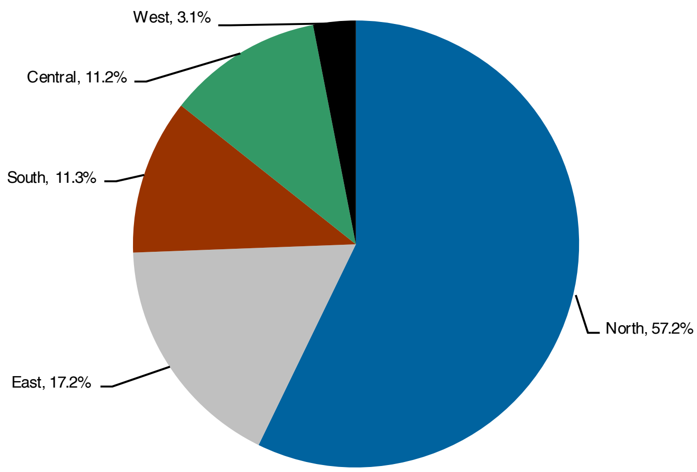
The company is one of the leading players in the Northern and Eastern regions along with Kajaria Ceramics. The demand from Southern and Western regions is met through trading activities.

Table 6: Orient's history

Year	Milestones
1977	Incorporated with an installed capacity of 5,000 TPA in UP
1993	Mr M. K. Daga took over the management of the company from IFCI
1994	New manufacturing facility of 25,000 TPA adjacent to the existing site
1996	Installed capacity enhanced to 52,000 TPA
2002-04	Received ISO 14001:2004, accredited ISO 9001:2000 and OHSAS 18000:1999
2007	Issued bonus share of 5:4. Installed roto colour machine and achieved turnover of Rs 2,000 mn
2008	Capex of Rs 350 mn for polished and glazed vitrified tiles. Implemented uniform credit policy with requirement of blank security cheques
2009	Hired European chief product designer and launched Europa and Stiler brands
2009	Opened five depots, totaling 17 across India
2010	Started exporting to Sri Lanka, Maldives, Oman, and Abu Dhabi. Implemented manufacturing module of ERP
2010	Plans to open more than 100 retail stores by December 2010

Source: Company

Figure 16: Northern region is a major contributor to the top line



Source: Company, CRISIL Equities

Orient earns revenues from ceramic, vitrified tiles and traded goods:

Europa and Stiler brands are expected to drive realisations and revenues in the near term

Ceramic tiles

Since 1977, Orient has been manufacturing ceramic tiles. The segment had a revenue contribution of 100% in FY05, which declined to 69% in FY10 due to diversification into the vitrified segment and trading activities.

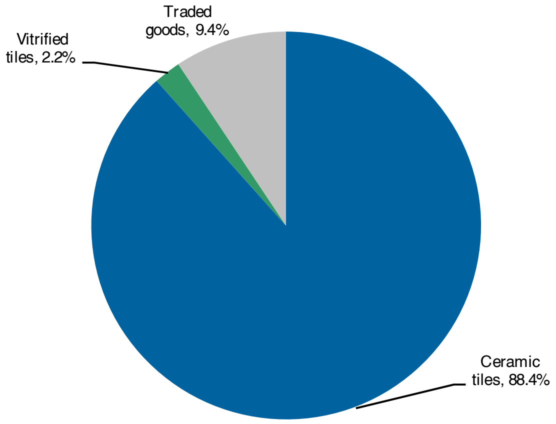
Vitrified tiles

In FY08, Orient started production of vitrified tiles. These tiles possess water absorption up to 0.05%, making them attractive for high footfall areas. The segment accounted for 17.1% of FY10 revenues.

Traded goods

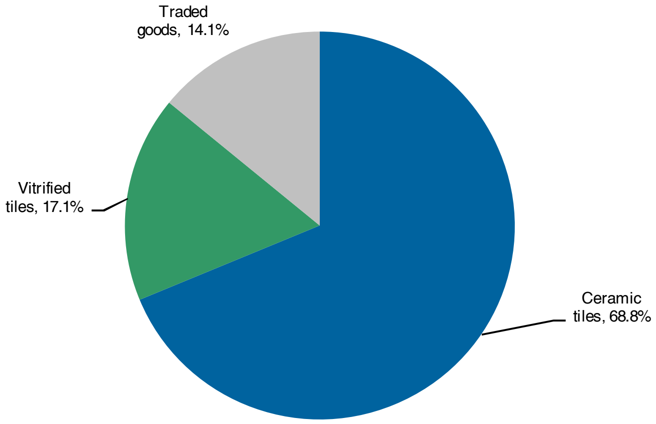
In FY08, Orient started relying on traded goods to cater to the Southern and Western markets. The company purchases the products from small manufacturers and sells them under its own brand.

Figure 17: Segmental contribution in FY08



Source: Company, CRISIL Equities

Figure 18: Segmental contribution in FY10



Source: Company, CRISIL Equities

Raw material sourcing

Clay is the basic raw material required for tiles manufacturing and is sourced mainly from Rajasthan (~500 km from the plant). The company has recently identified small clay manufactures at a distance of 250-300 km from the plant, which will help them save on the freight costs. Majority of the chemicals required are sourced locally, while 20% are imported.

Annexure: Financials

Income Statement

(Rs Mn)	FY08	FY09	FY10	FY11E	FY12E
Net sales	2,131	2,251	2,505	3,038	3,467
Operating Income	**2,142**	**2,264**	**2,524**	**3,068**	**3,501**
EBITDA	**239**	**308**	**350**	**422**	**504**
Depreciation	96	106	108	123	139
Interest	99	98	72	69	91
Other Income	1	1	4	1	3
PBT	**44**	**106**	**174**	**231**	**277**
PAT	**25**	**67**	**115**	**152**	**183**
No. of shares (mn)	11	11	11	11	11
Earnings per share (EPS)	2.4	6.4	10.9	14.5	17.4

Balance Sheet

(Rs Mn)	FY08	FY09	FY10	FY11E	FY12E
Equity capital (FV - Rs 10)	105	105	105	105	105
Reserves and surplus	375	420	516	642	794
Debt	906	685	596	646	981
Current Liabilities and Provisions	472	414	562	597	681
Deferred Tax Liability/(Asset)	71	67	56	66	78
Capital Employed	**1,929**	**1,690**	**1,835**	**2,056**	**2,640**
Net Fixed Assets	931	874	807	787	1,147
Capital WIP	13	7	3	0	0
Intangible assets	0	2	1	1	1
Investments	-	-	-	-	-
Loans and advances	150	119	112	169	201
Inventory	424	414	578	672	777
Receivables	404	263	318	378	441
Cash & Bank Balance	7	12	16	49	72
Applications of Funds	**1,929**	**1,690**	**1,835**	**2,056**	**2,640**

Source: Company, CRISIL Equities estimate

Cash Flow

(Rs Mn)	FY08	FY09	FY10	FY11E	FY12E
Pre-tax profit	44	106	174	231	277
Total tax paid	(10)	(43)	(70)	(68)	(82)
Depreciation	96	106	108	123	139
Change in working capital	(129)	122	(64)	(176)	(116)
Cash flow from operating activities	**1**	**291**	**148**	**109**	**219**
Capital expenditure	(346)	(43)	(37)	(100)	(500)
Investments and others	-	-	-	-	-
Cash flow from investing activities	**(346)**	**(43)**	**(37)**	**(100)**	**(500)**
Equity raised/(repaid)	-	-	-	-	-
Debt raised/(repaid)	338	(222)	(89)	50	335
Dividend (incl. tax)	(6)	(18)	(18)	(26)	(31)
Others (incl extraordinaries)	1	(3)	(0)	-	0
Cash flow from financing activities	**332**	**(243)**	**(108)**	**24**	**304**
Change in cash position	**(13)**	**5**	**4**	**33**	**23**
Opening Cash	20	7	12	16	49
Closing Cash	7	12	16	49	72

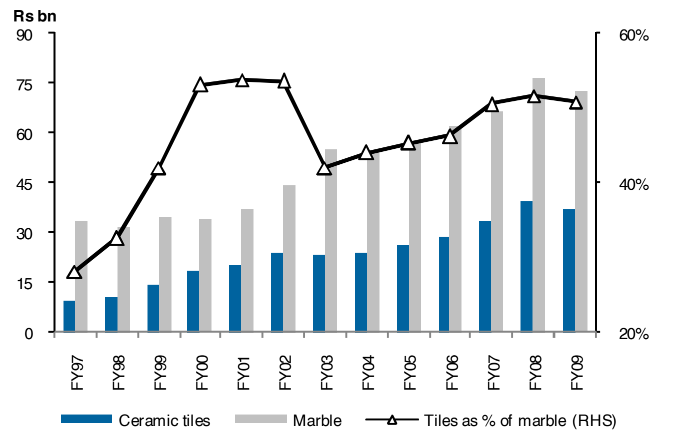
Ratios

	FY08	FY09	FY10	FY11E	FY12E
Growth ratios					
Sales growth (%)	13.6	5.7	11.5	21.6	14.1
EBITDA growth (%)	(22.5)	29.1	13.5	20.4	19.5
EPS growth (%)	(77.4)	146.6	80.1	32.8	20.2
Profitability Ratios					
EBITDA Margin (%)	11.2	13.6	13.9	13.7	14.4
PAT Margin (%)	1.2	3.0	4.6	5.0	5.2
Return on Capital Employed (RoCE) (%)	11.8	15.6	19.9	22.9	22.3
Return on equity (RoE) (%)	5.4	13.3	20.1	22.3	22.2
Dividend and Earnings					
Dividend per share (Rs)	0.6	1.8	1.8	2.1	2.5
Dividend payout ratio (%)	23.9	29.0	16.1	17.0	17.0
Dividend yield (%)	1.4	6.5	4.1	2.3	2.8
Earnings Per Share (Rs)	2.4	6.4	10.9	14.5	17.4
Efficiency ratios					
Asset Turnover (Sales/GFA)	1.2x	1.2x	1.3x	1.5x	1.5x
Asset Turnover (Sales/NFA)	2.7x	2.5x	3.0x	3.8x	3.6x
Sales/Working Capital	4.9x	5.1x	6.1x	5.7x	5.1x
Financial stability					
Net Debt-equity	1.9	1.3	0.9	0.8	1.0
Interest Coverage	1.4	2.1	3.4	4.3	4.0
Current Ratio	2.1	2.0	1.8	2.1	2.2
Valuation Multiples					
Price-earnings	17.1x	4.2x	3.9x	6.3x	5.2x
Price-book	0.9x	0.5x	0.7x	1.3x	1.1x
EV/EBITDA	5.6x	3.1x	2.9x	3.7x	3.7x

Source: Company, CRISIL Equities estimate

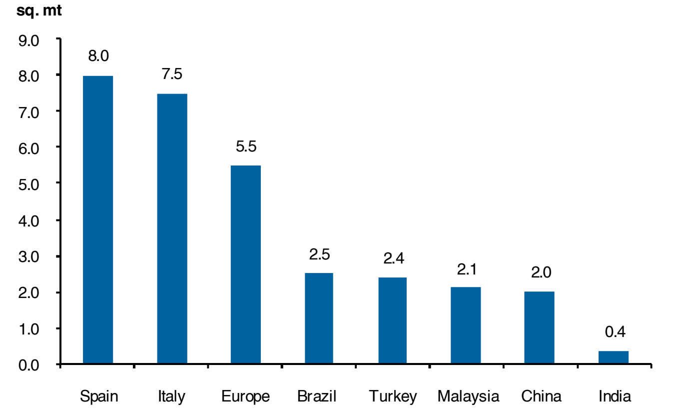
Focus Charts

Ceramic tiles segment has grown faster than marble



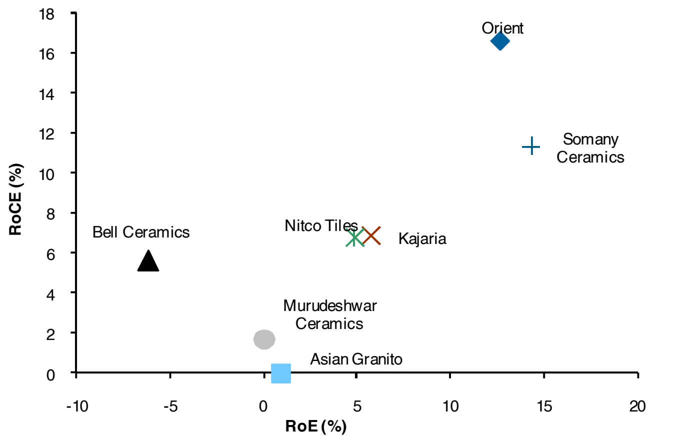
Source: NSE

India has low per capita tiles consumption



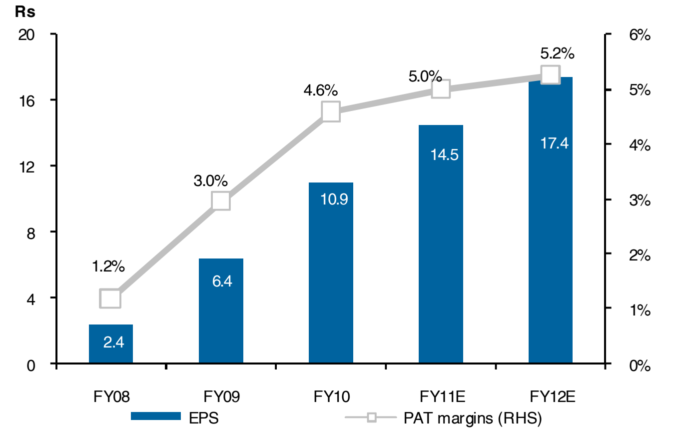
Source: Indiastats, CRISIL Equities

Orient has one of the best RoE and RoCE in the industry (FY09)



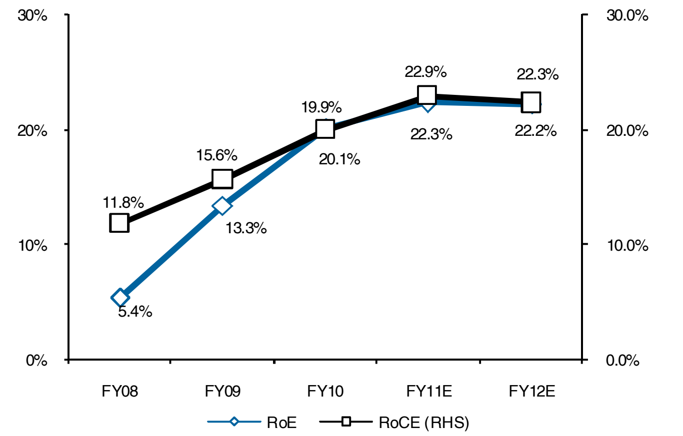
Source: ICCTAS, CRISIL Equities

EPS and PAT margins to improve in FY12



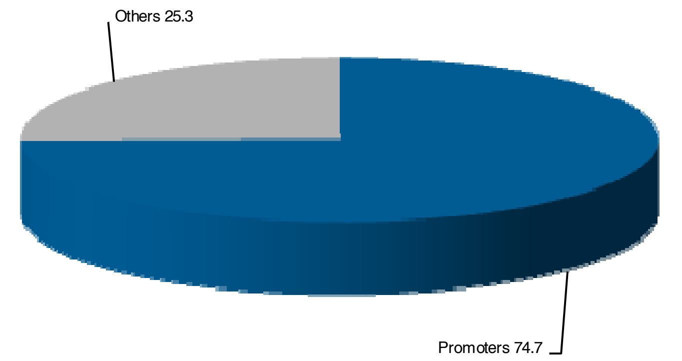
Source: CRISIL Equities

RoE and RoCE to improve from current levels



Source: Company, CRISIL Equities estimate

Shareholding pattern



Source: Company, CRISIL Equities estimate

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CRISIL is India's leading Ratings, Research, Risk and Policy Advisory Company

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