INTERNACIONAL DE CERAMICA SA DE CV
Form 20-F
June 30, 2004

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

G

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

:

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2003.

OR

G

TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ___ to

___

Commission file number: 82-2873

Internacional de Cerámica, S.A. de C.V.

(Exact name of Registrant as specified in its charter)

Ceramics International, Inc.

(Translation of Registrant's name into English)

United Mexican States

(Jurisdiction of incorporation or organization)

Ave. Carlos Pacheco 7200

Chihuahua, Chih., Mexico

(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each Class	Name of each exchange on which registered
American Depositary Shares, each representing five Limited Voting Units	New York Stock Exchange
Limited Voting Units, which consists of one Series D and one Series L Share	New York Stock Exchange*
Series D Shares, without par value	New York Stock Exchange*
Series L Shares, without par value	New York Stock Exchange*

*Not for trading, but only in connection with the registration of American Depositary Shares pursuant to the requirements of the Securities and Exchange Commission.

Securities registered or to be registered pursuant to Section 12(g) of the Act: **None**

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: **None**

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report:

Series B Shares, without par value	57,906,632
Series D Shares, without par value	19,646,720

Series L Shares, without par value	19,646,720

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No___

Indicate by check mark which financial statement item the Registrant has elected to follow:

Item 17_____ Item 18 X

Table of Contents

Page

Unless otherwise specified or the context otherwise requires, references to “Interceramic” in this Annual Report on Form F-20 for the fiscal year ended December 31, 2003 (this “Annual Report”) shall mean *Internacional de Cerámica, S.A. de C.V.*, a limited liability company with variable capital (*sociedad anónima de capital variable*) organized under the laws of the United Mexican States (“Mexico”), and references to the “Company” shall mean Interceramic collectively with its subsidiaries.

The Company maintains its financial books and records in Mexican pesos (“Pesos,” “P.” or “Ps”) and presents its financial statements in conformity with generally accepted accounting principles in Mexico (“Mexican GAAP”). Pursuant to Mexican GAAP, financial data for all periods covered by the consolidated financial statements of the Company and other financial information presented in this Annual Report, unless otherwise indicated, have been restated in constant Pesos with purchasing power as of December 31, 2003.

This Annual Report contains translations of certain Peso amounts into dollars (“Dollars,” “US $” or “$”), the currency of the United States of America (the “United States”), at specified exchange rates solely for the convenience of the reader. These translations should not be construed as representations that the Peso amounts actually represent Dollar amounts or could be converted into Dollars at the rate or rates indicated. Unless otherwise indicated, Dollar amounts have been translated from Pesos at the exchange rate of Ps 11.235 to US $1.00, the exchange rate as quoted to the Company by *Wells Fargo Bank, N.A.* as the rate representing the interbank exchange rate (the “Interbank Rate”) at the close of business on December 31, 2003. There are several other commonly available rates of conversion of Pesos to Dollars and no representation can be made as to the accuracy of one rate as compared to any other, many of which may vary significantly from time to time from the Interbank Rate.

The manufacturing operations and the principal offices of the Company are based primarily in Mexico and the Company’s consolidated financial statements are expressed in Pesos; however, all of the Company’s indebtedness and a significant portion of the other liabilities of the Company are designated in Dollars, and the Company generates a material amount of Dollar denominated revenues and/or expenses payable in Dollars. Such Dollar amounts are translated into Pesos for financial statement purposes in accordance with Mexican GAAP.

The Company generally measures its ceramic floor tile production and sales in terms of square meters. For purposes of converting the Company’s production and sales information from square meters into square feet, the Company has used a convention of 11 square feet to each square meter rather than the actual numerical conversion of 10.762 square feet to each square meter. In Mexico, the Company’s measurement of product generally is based upon the actual surface area of the tile produced or sold. In the United States, the Company observes the convention of measuring product based upon the surface area covered by the applied ceramic tile, which includes standard one-quarter inch grout joints.

This Annual Report contains forward-looking statements, within the meaning of Section 27A of the United States Securities Act of 1933, as amended (the "1933 Act"), and Section 21E of the United States Securities Exchange Act of 1934, as amended (the "1934 Act"), which reflect the Company's views about future events and financial performance. Statements that are not historical facts, including without limitation statements about the Company's hopes, beliefs, strategies and expectations, are forward-looking statements and involve inherent risks and uncertainties. The Company's forward-looking statements are based on current plans, estimates and projections and, accordingly, undue reliance should not be placed upon them. Actual results could differ materially from those projected in forward looking statements for a variety of reasons that may be beyond the control of the Company, including without limitation effects on the Company from competition, economic, political and social events that might occur in Mexico, changes in circumstances that might adversely impact the Company's ability to access sources of financing on competitive terms, events that might impact the construction industry in Mexico generally, changes in Mexican GAAP, changes in law and other factors. In any event, the forward-looking statements contained in this Annual Report speak only as of their dates and the Company undertakes no obligation to update or revise any of them, whether as a result of new information, future events or otherwise. In preparing its financial statements, the Company makes estimates concerning a variety of matters. Some of these matters are highly uncertain, and the estimates involve judgments based on the information available to the Company. Certain discussions in this Annual Report concern matters for which the financial presentation would be materially affected if either (i) the Company relied on different estimates that it could reasonably use or (ii) in the future the Company changes its estimates in response to changes that are reasonably likely to occur.

Interceramic's registered office in Mexico, and principal executive office, is located at Ave. Carlos Pacheco 7200, Chihuahua, Mexico, and its telephone number is 011.52.614.429.1111. The address for the corporate offices of the Company's United States subsidiaries is 2333 South Jupiter Road, Garland, Texas 75041, telephone number 214.503.5500.

PART I

ITEM 1. Identity of Directors, Senior Management and Advisers

Not applicable.

ITEM 2. Offer Statistics and Expected Timetable

Not applicable.

ITEM 3. Key Information

A. Selected Financial Data

The table on the following page presents selected consolidated financial data of the Company. The data presented should be read in conjunction with, and are qualified in their entirety by reference to, the Financial Statements included under Item 18 in this Annual Report (the "Financial Statements"). The Financial Statements have been audited by Mancera, S.C., a member practice of Ernst & Young Global, independent auditors.

The Financial Statements have been prepared in accordance with Mexican GAAP, which differ in certain significant respects from generally accepted accounting principles in the United States ("US GAAP"). *See* Note 13 to the Financial Statements for a description of the principal differences between Mexican GAAP and US GAAP as they relate to the Company and reconciliation to US GAAP of net earnings and shareholders' equity.

Pursuant to Mexican GAAP, the Financial Statements and the selected consolidated financial data set forth below have been prepared giving effect to Bulletin B-10, Bulletin B-12 and Bulletin B-15 of the *Instituto Mexicano de Contadores Públicos*, the Mexican Institute of Public Accountants (the "IMCP"). Bulletin B-10, as amended, provides for the recognition of the effects of inflation on financial information. For years ending prior to January 1, 1997, Bulletin B-10 allowed the Company to restate non-monetary assets at current replacement cost, as determined by independent appraisers, to restate the components of shareholders' equity using the Consumer Price Index for Mexico (the "NCPI"), and to record gains or losses in purchasing power from holding monetary liabilities or assets. Bulletin B-10 also requires restatement of all financial statements to constant Pesos as of the date of the most recent balance sheet presented and, accordingly, all data in the Financial Statements and in the selected consolidated financial data set forth below have been restated in Pesos with purchasing power of December 31, 2003, unless otherwise indicated. *See* Note 1 to the Financial Statements. The effect of these inflation accounting principles has not been reversed in the reconciliation to US GAAP. *See* Note 13 to the Financial Statements.

The IMCP published the Fifth Amendment to Bulletin B-10, applicable to financial statements for periods beginning on or after January 1, 1997, which abandons the use of appraisals for the valuation of fixed assets and instead imposes a specific cost method. Under this method, certain fixed assets acquired in Mexico, such as machinery and equipment, are to be valued based on their historical cost. If an asset was acquired from outside of Mexico, the historical cost is restated using the consumer price index of the country of origin, converted into Pesos at the exchange rate prevailing at the time of valuation. For items acquired in Mexico, or for which the country or origin is uncertain, the historical cost is restated using the NCPI. The Company implemented this change commencing with the fiscal year ended December 31, 1997. *See* Note 1(h) to the Financial Statements.

Bulletin B-12 specifies the appropriate presentation of the statement of changes in financial position when financial statements have been restated in constant Pesos in accordance with Bulletin B-10 and prior years' presentations have been restated accordingly. Bulletin B-12 further requires (i) identification of the generation and application of resources representing differences between beginning and ending financial statement balances in constant Pesos and (ii) that monetary and foreign exchange gains and losses not be treated as nonmonetary items in the determination of resources provided by operations. Under Bulletin B-15, which became effective on January 1, 1998, prior period financial statements must be restated using an actualization factor determined by weighing the Company's respective operations in the United States and Mexico, each as effected by inflation in the applicable country and currency exchange rates in the applicable currencies. In this respect, Bulletin B-15 is inconsistent with the requirements of Rule 3-20(e) of Regulation S-X promulgated by the United States Securities and Exchange Commission (the "SEC") with respect to filings under the 1933 Act and the 1934 Act, and is treated as a difference between Mexican GAAP and US GAAP in the Financial Statements. *See* Note 1(a) and Note 13 to the Financial Statements.

Effective January 1, 2000, the Company adopted the requirements of the Accounting Principles Bulletin D-4, "Accounting for Income Tax, Asset Tax and Employee Profit Sharing," issued by the IMCP. Bulletin D-4 requires the recognition of deferred taxes on all temporary differences in balance sheet accounts for financial and tax reporting purposes, using the enacted income tax rate at the date the temporary differences are expected to reverse. Through December 31, 1999, deferred taxes were recognized only on temporary differences that were considered to be non-recurring and that had a known turnaround period.

The accumulated effect of these new requirements at the beginning of 2000 was applied to stockholders' equity, without restatement of prior years' financial statements. The cumulative effect of adopting this new bulletin increased deferred tax liabilities and decreased stockholders' equity by Ps 319,986.

AS OF AND FOR

	YEAR ENDED DECEMBER 31,					
	1999	2000	2001	2002	2003	2003
	(IN THOUSANDS OF PESOS AS OF December 31, 2003(1)					Thnds. of Dollars(9)
INCOME STATEMENT DATA:						
MEXICAN GAAP:						
Net sales	2,954,519	3,036,053	3,174,154	3,267,385	3,424,926	304,844
Cost of sales	(1,911,750)	(1,926,221)	(1,993,310)	(2,058,976)	(2,236,376)	(199,054)
Gross profit	1,042,769	1,112,832	1,180,844	1,208,409	1,188,550	105,790
Selling and administrative expenses	(779,952)	(797,177)	(819,259)	(898,570)	(959,388)	(85,392)
Operating income	262,817	315,656	361,585	309,839	229,162	20,398
Comprehensive financing (cost) income	26,722	(67,879)	(26,666)	(168,266)	(111,923)	(9,962)
Other income (expense), net	(26,887)	(30,565)	(5,358)	(12,830)	(8,690)	(773)
Equity in results of associated companies (2)	839	0	1,426	(450)	488	43
Write-off of assets	0	0	(48,152)	0	0	0
Income and asset tax	(17,282)	(16,750)	(18,244)	(20,852)	(21,105)	(1,879)
Deferred income tax	0-	(39,453)	(31,770)	9,024	(25,726)	(2,290)
Employee profit sharing (3)	(3,475)	(2,652)	(3,701)	(3,798)	0	0
Consolidated net income	242,284	158,357	229,120	112,667	62,206	5,537
Minority net income (loss)	5,996	(816)	24,940	19,660	29,989	2,669

Majority net income	236,287	159,173	204,180	93,007	32,217	2,868
Net income per Unit (4)	4.36	2.91	3.52	1.63	0.65	0.06
Weighted average Units outstanding (000's)(4)	54,175	54,625	57,928	57,184	49,555	49,555
US GAAP AMOUNTS(5):						
Majority net income	236,434	123,490	206,996	63,848	209,588	18,655
Net income per Unit (4)	4.46	2.32	3.65	1.14	4.31	0.38
Diluted net income per Unit (4)	4.42	2.31	3.65	1.14	4.31	0.38

	AS OF AND FOR YEAR ENDED DECEMBER 31,					
	1999	**2000**	**2001**	**2002**	**2003**	**2003**
	(IN THOUSANDS OF PESOS AS OF December 31, 2003(1)					**Thnds. of Dollars(9)**
BALANCE SHEET DATA:						
MEXICAN GAAP						
Current assets	1,298,426	1,329,777	1,324,119	1,349,488	1,385,920	123,357
Property, plant and equipment, net	2,021,267	1,915,973	1,747,954	1,847,975	1,966,173	175,004
Total assets	3,373,025	3,293,540	3,128,495	3,271,443	3,448,668	306,957
Current liabilities	633,647	598,776	1,427,315	744,636	786,601	70,013
Short term debt (6)	200,603	143,851	1,090,618	278,936	385,969	34,354

Long term debt	1,561,344	1,327,169	263,358	1,012,667	972,419	86,552
Total stockholders' equity	1,174,139	989,036	1,095,721	1,163,268	1,241,398	110,494
US GAAP AMOUNTS(5):						
Total stockholders' equity	63,171	260,768	361,168	439,491	562,059	50,028
Weighted average units outstanding(10)	5,100	6,367	7,000	7,000	7,000	7,000
CHANGE IN FINANCIAL POSITION:						
MEXICAN GAAP:						
Resources provided by operating activities	377,195	333,980	345,263	169,291	103,819	9,241
Resources (used in) received from financing activities	(263,465)	(156,158)	(140,812)	(131,519)	(12,269)	(1,092)
Resources used in investing activities	(141,951)	(100,337)	(116,226)	(181,793)	(133,936)	(11,921)
CASH FLOW DATA:						
US GAAP:						
Cash flow provided by operating activities	151,481	153,415	198,239	61,647	54,214	4,825
Cash flow used in investing activities	(142,858)	(96,441)	(108,884)	(176,959)	(133,936)	(11,921)
Cash flow (used in) provided by						

financing activities	(78,933)	53,875	(56,355)	(166,872)	(35,706)	(3,178)
Effect on inflation accounting	36,536	(37,449)	46,020	150,677	75,527	6,722
OTHER DATA:						
MEXICAN GAAP:						
Depreciation and amortization	166,051	153,515	152,430	160,054	175,645	15,634
Capital expenditures	(141,950)	(100,341)	(116,226)	(181,793)	(133,936)	(11,921)
Working capital	664,780	731,001	(103,196)	604,852	599,319	53,344
EBITDA (11)	428,867	469,170	514,016	469,893	404,807	36,032
OPERATING INFORMATION:						
Gross profit margin (7)	35.29%	36.62%	37.20%	36.98%	34.70%	34.70%
Operating profit margin (7)	8.90%	10.39%	11.39%	9.48%	6.69%	6.69%
EBITDA (7)	14.52%	15.44%	16.19%	14.38%	11.82%	11.82%
Personnel at period end	3,811	3,381	3,127	3,089	3,045	3,045
AVERAGE EXCHANGE RATES (8)	9.55	9.47	9.33	9.75	10.85	
YEAR END	9.50	9.61	9.19	10.39	11.235	
EXCHANGE RATE						

Notes:

(1) In thousands, except for net income per Unit and operating information.

(2) The equity in results of associated companies reflects the participation of the Company in the earnings of certain non-consolidated affiliates. *See* Note 1(g) to the Financial Statements.

(3) *See* Note 9 to the Financial Statements.

(4) Calculated by dividing majority net income by the weighted average Units outstanding for the respective period.

(5) *See* Note 13 to the Financial Statements.

(6) Includes bank loans and the current portion of long term debt. *See* Note 5 to the Financial Statements.

(7) Expressed as a percentage of net sales.

(8) Average Interbank Rate at the end of month during each period. At June 4, 2004, the Interbank Rate was Ps 11.42 to US $1.00. For the six months from December 2003 through May 2004, the high and low exchange rates were as follows:

Month	High	Low
December 2003	11.390	11.167
January 2004	11.235	10.817
February 2004	11.170	10.940
March 2004	11.225	10.930
April 2004	11.470	11.167
May 2004	11.710	11.415

(9) Solely for the convenience of the reader, figures as of December 31, 2003 have been translated into Dollars as the rate of Ps 11.235 to US $1.00, the Interbank Rate at December 31, 2003.

(10) The weighted average Units outstanding is calculated under US GAAP under which only the fixed portion of stockholders' equity is taken into account.

(11) EBITDA represents earnings before interest, taxes, depreciation and amortization. EBITDA is not a measure of performance under either US GAAP or Mexican GAAP and should not be considered a substitute for cash flow from operations, net earnings or other measures of performance as defined by US GAAP, or as a measure of profitability or liquidity. EBITDA does not give effect to the cash that must be used to service debt or to pay income taxes and thus does not reflect the funds actually available for capital expenditures or other discretionary uses. The presentation of EBITDA used by the Company may not be comparable to other similarly titled captions of other companies due to differences in the methods of calculation. It is included herein to provide additional information with respect to the Company's ability to meet its consolidated debt service obligations and its capital expenditure and working capital requirements. It is also included because it is used as a measure in a financial covenant contained in the Company's primary loan agreement. The calculation of EBITDA is as follows:

	YEAR ENDED DECEMBER 31,					
	1999	2000	2001	2002	2003	2003
	IN THOUSANDS OF PESOS AS OF December 31, 2003(1)					Thnds. of Dollars(9)
Majority net income	236,287	159,173	204,180	93,007	32,217	2,868
Reconciliation to EBITDA						
Comprehensive financing (cost) income	(26,722)	67,879	26,666	168,266	111,923	9,962
Other income, net	26,887	30,565	5,358	12,830	8,690	773
Equity in results of associated companies (2)	(389)	0	(1,426)	450	(488)	(43)
Income and asset tax	17,282	16,750	18,244	20,852	21,105	1,879
Deferred income tax	0	39,453	31,770	(9,024)	25,726	2,290
Employee profit sharing (3)	3,475	2,652	3,701	3,798	0	0
Minority net income (loss)	5,996	(816)	24,940	19,660	29,989	2,669
Depreciation and amortization	166,051	153,515	152,430	160,054	175,645	15,634
EBITDA	428,867	469,170	514,016	469,893	404,807	36,032

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for Offer and Use of Proceeds

Not applicable.

D. Risk Factors

There are certain risk factors that are specific to Interceramic, its industry and its business. These may include the following:

Risks Relating to Developments in Mexico and Other Emerging Market Countries

Mexican political, social, and economic conditions and might adversely impact our sales and profitability

Over 75 percent of our assets are located in Mexico, and on average about 50 percent of our sales each year are achieved in Mexico. As a result, demand for our products and our selling prices may decline as a result of adverse general economic and social conditions in Mexico, Mexican political developments, devaluation of the Peso and inflation and high interest rates in Mexico.

Mexico has experienced adverse economic conditions that make our profitability vulnerable to factors beyond our control

Since 2001, Mexico has experienced a prolonged period of slow-growth, with the gross domestic product or “GDP” growing at the rate of 0.3 percent, 0.9 percent and 1.16 percent in 2001, 2002 and 2003, respectively. If the Mexican economy falls into a recession, our business, financial condition and results of operations may suffer materially for a number of reasons, including lack of consumer demand for our products, declining selling prices and increased cost of the materials, supplies and services we need in Mexico to make our products.

Policies of the Mexican government could adversely effect the value of your investment in our company

The Mexican government has exercised and continues to exercise a significant influence over many aspects of the Mexican economy. With the improving economic stability in recent times, the government has materially loosened its control over the economy, however in deteriorating economic circumstances the government could be expected to reinsert itself into the economy which could result in governmental controls on prices, currency exchange rates and inflation. Accordingly, Mexican government actions concerning the economy could have a significant effect on us and other private sector entities and on market conditions and the prices and returns on Mexican equity securities, including our equity securities.

Political considerations in Mexico can adversely impact our operations and the value of your investment in our company

Political events in Mexico may significantly affect our business conditions, financial condition and results of operations as well as the price of our securities. In recent years, political and social unrest and disturbances have adversely impacted the Mexican securities markets. In 2000, the citizens of Mexico elected Vincente Fox President of Mexico, the first opposition candidate to win the Presidency since 1929. Mr. Fox, a member of the National Action Party, ran for office on a program advocating reform of the political process in Mexico. However, the Institutional Revolutionary Party, which had held the presidency since 1929, maintains a majority, together with the Partido de la Revolución Democrática in both houses of the Mexican Congress and conflict between the President and the Congress has made it very difficult for Mr. Fox to accomplish the reforms he had advocated during his campaign. Continued conflict between the two branches of government could lead to political paralysis in Mexico which could adversely effect operations and the price of our securities.

Depreciation or fluctuation of the Peso relative to the Dollar could adversely affect our financial condition and results of operations

All of our debt and a material amount of our revenues and expenses are denominated in Dollars. Accordingly, we are affected by fluctuations in the value of the Peso against the Dollar. During periods when the Peso devalues against the Dollar, we recognize foreign exchange losses on our financial statements, while exchange gains are recognized during periods that the Peso strengthens against the Dollar. For example, while in 2001 the Company recognized foreign exchange gains of Ps 52.8 million as the Peso appreciated against the Dollar, in 2002 the opposite was true and the Company recognized foreign exchange losses of Ps 115.8 million. In 2003 the Company registered a foreign exchange loss of Ps 91.5 million. Currency fluctuations are likely to continue to have an effect on our financial position, results of operations and cash flows in future periods.

Severe devaluation or depreciation of the Peso may also result in disruption of international foreign exchange markets and limit our ability to convert Pesos into Dollars for purposes of paying our debt as well as other obligations that we incur in Dollars. Although the Mexican government does not currently restrict the ability of persons to convert Pesos into Dollars or otherwise export currencies out of Mexico, it has done so in the past and it could institute restrictive policies which might adversely affect our ability to convert Pesos into Dollars in the future.

High levels of inflation and high interest rates in Mexico could adversely affect our financial condition and results of operations

Even though we are currently experiencing the lowest interest and inflation rates in decades, Mexico has historically experienced high interest rates and high levels of inflation. Measured by changes in the National Consumer Price Index, inflation in Mexico for 2001 was 4.40 percent, 5.70 percent for 2002 and 3.97 percent for 2003. High rates of inflation can adversely affect the Company's results of operations or a variety of reasons, including the inability to always match the pace of inflation in the prices of goods and services needed to make products with the price the Company can obtain in the markets for the sale of its products. During periods of high inflation in Mexico, domestic interest rates have increased significantly. During 2002, the interest rate of the 28-day Mexican government securities called "Cetes" averaged 7.08 percent. During 2003, the interest rate of the 28-day Mexican government securities called "Cetes" averaged 6.23 percent. While these recent interest rates represent a considerable change from interest rates in excess of ten percent less than a decade ago, these low levels may not be maintained. High interest rates not only would increase our cost of borrowing money in Mexico, but also might make it more difficult to borrow or acquire goods and services on credit, thereby impairing our ability to manufacture our products as and when needed to service consumer demand.

Adverse developments in other emerging market countries may lower the value of your investment in our company

The market value of the securities of Mexican companies is periodically subject to economic, social and political developments in other emerging market countries. Although economic conditions in other countries may differ materially from those in Mexico, and although many of these other countries may have immaterial connections to the Mexican economy, investors' reactions to developments in other countries, particularly in emerging market economies, may result in a decrease in the market value of our securities.

Risks relating to us and our business generally

The construction business is cyclical and a decrease in demand for tile products may lower our sales

A recession or decline in the construction industry in Mexico or in the United States could result in decreased demand for our products and lower price levels. The tile industry is highly dependent on construction activity—including new construction and remodeling—which is cyclical in nature and is significantly affected by changes in general and local economic conditions. These changes include employment levels, financing availability, interest rates, consumer confidence and housing demand. Further, material unanticipated fluctuations in the demand for ceramic tile products could result in increases in inventories which may not be readily saleable by us at profitable prices.

We use significant amounts of natural gas in our production process and increased natural gas prices will adversely effect our profitability

Energy accounts for on average around 15 percent of our production cost, the largest component of which is for purchases of natural gas. Increases in the price of natural gas cannot easily be recovered from the prices of our products, and thus a significant increase in the price of natural gas is likely to have a detrimental effect on our gross profit. With the current uncertainty in the Middle East and the protracted conflict in Iraq, natural gas prices have been increasing over recent months, currently is almost 25 percent more expensive than it was at this time in 2003. In the past, we have entered into fixed price contracts or other arrangements to limit our exposure to unfavorable fluctuations in energy prices, but we have none of these arrangements in place in 2004.

We are highly leveraged and disruptions in cash flow may impair our ability to fund operations

Although we have been decreasing our debt in recent years, we are still relatively highly leveraged, with consolidated indebtedness of US $99.4 million and a total debt to equity ratio of 0.65 to 1 as of March 31, 2004. Substantially all of our physical assets have been pledged to secure repayment of our debts. Because a substantial portion of our cash provided by operations is needed to pay our debts, funds available for operations and for needed capital expenditures have been reduced in recent periods, and our ability to generate sufficient cash flow to adequately fund operations and capital expenditures in future periods may be impaired. Additionally, our highly leveraged position makes us more vulnerable to adverse economic conditions than less leveraged competitors. Furthermore, the discretion of our management with respect to certain business matters is limited by covenants contained in some of our loan agreements.

We may not generate enough cash flow to pay substantial debt amortizations in coming periods

In June of 2002, we entered into a Credit Agreement with an international consortium of lenders, pursuant to which we borrowed US $100.0 million to refinance our then-maturing $90.0 million notes and for other general working capital purposes. Although the Credit Agreement is on generally favorable terms, it provides for significant amortization of principal, with US $13.1 million due in 2004, US $20.0 million due in 2005, US $22.5 million due in 2006 and the remaining US $25.0 million due in 2007. We also have US $6.1 million in short-term debt due in 2004. These significant debt service obligations may materially impact our cash flow and impede our ability to fund operations. In 2002 and 2003, our cash flow was substantially reduced over prior periods. In the event we are unable to generate sufficient cash flow to service debt obligations when due, we will be required to either renegotiate the terms of our debt obligations or replace them on conditions that are more favorable than currently. If we were unable to do so, it could impair our ability to fund operations and adversely impact our profitability.

We face significant competition in all markets and pricing pressures may decrease our profitability

Significant competition generally is reflected in lower prices for our products, and any further decreases in our selling prices could decrease our profitability and impair our cash flow. The markets for our products in both Mexico and the United States are highly competitive. In Mexico, we compete for market share primarily with domestic manufacturers and independent distributors of ceramic tile, many with greater resources than we possess. We dedicate significant resources to advertising, marketing and product presentation strategies in Mexico in order to generate and maintain consumer interest in our products. A failure of one or more of our strategies could result in decreased sales in Mexico. In the United States, we face significant competition, primarily from Italian and Spanish producers. Much of our competition in the United States is against products similar to ours and pricing pressures are significant. Although the recent weakness of the Dollar against the European common currency, or “Euro,” has increased the cost of products of many European competitors, most of these competitors still retain a pricing advantage over us due to generally lower costs of production.

Import tariffs in the United States provide some competitors with pricing advantages that put us at a competitive disadvantage

United States tile manufacturers can charge less for their products than we do because they are not subject to import tariffs, making our products less competitive and adversely effecting our sales revenues. Mexico, the United States and Canada are parties to the North American Free Trade Agreement, or NAFTA, created to establish a “free trade" zone and to eliminate import duties, tariffs and barriers among the three countries. However, under NAFTA tariffs on ceramic tile imported from Mexico into the United States were not eliminated and are to be phased out over a period of 15 years (the current NAFTA tariff rate for substantially all of our products is 5.00 percent). United States producers are not subject to any tariffs in the United States markets and thus enjoy a competitive advantage against importers like us. The benefits of NAFTA to us may only be realized gradually with increased access to the United States market and increased sales in the United States as the tariffs are reduced. It is also possible that European or United States manufacturers may locate or expand production facilities in Mexico to take advantage of reduced tariff levels, resulting in increased competition not only in the United States market but in the Mexican market as well.

The United States is also a party to the General Agreement on Tariffs and Trade, or GATT. Under GATT, the United States currently imposes a tariff on products like ours from non-NAFTA countries at a rate of 8.50 percent. The reduction of tariff rates under GATT may result in increased competition within the United States ceramic tile markets from European and other foreign producers of ceramic tile products.

Risks relating to our controlling shareholders and our capital structure

Our controlling shareholders may cause us to take actions that may not be in the best interest of other shareholders

Over half of our general voting securities are held or controlled by members or associates of the Oscar Almeida Chabre family of Chihuahua, Chihuahua, México. This controlling group may have objectives for our company that differ from those of minority shareholders on a variety of issues, including for example business strategies, product development and capital investment. Because of this, the value of your investment is subject in many respects to the decisions of management over which you are unable to exercise any control. By virtue of its ownership, this group has the effective power to designate a majority of the Board of Directors and to determine the outcome of other actions requiring a vote of the shareholders, except in very limited cases that require a vote of the holders of the Series D Shares and the Series L Shares. Further, under Mexican law, you may have less protection as a minority shareholder than you do under the laws of the United States. See the discussion under the heading "Item 10. Additional Information–B. Memorandum and Articles of Association" contained in this annual report.

A change in our control may result in management changes and defaults under loan agreements that could result in acceleration of significant debt obligations

As a result of shareholdings and certain agreements, the Almeida Family currently controls a majority of our general voting securities. The Almeida Family has controlled the senior management of our company since its inception, and a loss of control could result in a loss of experienced executive and other management personnel which might harm our ability to competitively operate our business. Also, most of our loan agreements contain provisions that would allow our lenders to accelerate our debts if the Almeida Family ceases to own a certain percentage of the Company. If all or even a portion of our debts were accelerated, we may be unable to pay or refinance them. The Almeida Family is not obligated to maintain their holdings in our securities, however, and if they chose to dispose of all or a portion of their Series B Shares the control of Interceramic could change.

On December 7, 2004, the then outstanding Series L Shares will automatically convert to Series B Shares. As a result, the Almeida Family will, based upon their current ownership, cease to own or control over 50 percent of our general voting securities.

Your ability to recover damages from or enforce a judgment against us may be limited

We are organized under the laws of Mexico and all of our officers and all but two of the members of our board of directors reside in Mexico. Also, more than 75 percent of our assets are located in Mexico. As a result, if you were to have a claim against us, whether predicated upon the civil liability provisions of the federal securities laws of the United States or otherwise, it may not be possible for you to effect service of process within the United States upon our management or to enforce the payment by us or our management of damages that might be awarded to you by courts in the United States.

ITEM 4. Information on the Company

A. History and Development of the Company

Interceramic was founded on February 17, 1978 as a closely held a limited liability company with variable capital (*sociedad anónima de capital variable*) by certain members and associates of the Almeida Family. Although Interceramic conducts business in Mexico under the "Interceramic" trade name, its charter name is "*Internacional de Cerámica, S.A. de C.V.*," which translates roughly as "Ceramics International." The current prescribed duration of Interceramic is to February 28, 2053. Interceramic became a publicly traded company in Mexico in 1987 and in 1994 completed an initial public offering of securities in the United States. American Depositary Receipts ("ADRs") evidencing five of Interceramic's "Limited Voting Units," which are securities comprised of one Series D Share and one Series L Share, are listed on the *New York Stock Exchange, Inc*. (the "NYSE"). Both Limited Voting Units and "Common Units," which are securities comprised of two Series B Shares, are listed on the *Bolsa Mexicana de Valores, S.A. de C.V.* (the "Mexican Stock Exchange").

Interceramic's registered office in Mexico, and principal executive office, is located at Ave. Carlos Pacheco 7200, Chihuahua, Mexico, and its telephone number is 011.52.614.429.1111. The address for the corporate offices of the Company's United States subsidiaries is 2333 South Jupiter Road, Garland, Texas 75041, telephone number 214.503.5500. The Company's registered agent in the United States for most purposes is Mark E. Mendel, Esq., Mendel • Blumenfeld, LLP, 5809 Acacia Circle, El Paso, Texas 79912, telephone number 915.587.7878.

In its early history, Interceramic manufactured glazed ceramic floor tile from one production facility located in Chihuahua, Mexico, primarily for sale in the Mexican markets through independent distribution. In 1989, it added another production facility in Mexico, which has almost since inception been owned as a "joint venture," initially of Interceramic and *Armstrong World Industries, Inc.* ("Armstrong"), but currently with *Dal-Tile International, Inc.* ("Dal-Tile"), as successor to Armstrong's interest in the venture. Also in the late 1980's, Interceramic commenced distribution of selected products in the United States. While its initial sales into the United States were through independent distributors, the Company has been steadily increasing a network of Company-owned distribution in the United States. The same holds true in Mexico, where independent distribution gave way in the 1994-1995 period to a mixed network of Company-owned distribution and an extensive, exclusive "Interceramic" franchise web throughout the country. The Company added a new production facility in Chihuahua in 1995, while also opening a manufacturing facility in the United States, in both cases for the production of glazed ceramic wall tile. The Company also manufactures for sale in Mexico grouts and certain adhesives for the installation of ceramic tile products. For the last several years, the Company has focused its efforts in Mexico and the United States on maximizing its profitability and market share through innovation, promotion and marketing. *See* the discussions under B, C and D below.

In late 2000, Interceramic concluded a private placement of 3,636,363 Common Units to *Kohler Co.* ("Kohler"), a leading international producer of bathroom and kitchen fixtures and related products. As a result, Kohler acquired a 6.28 percent stake in the then aggregate outstanding capital stock of the Company and an 11.06 percent ownership of the Series B Shares outstanding at that time, although as a result of subsequent stock issuances Kohler's stake in the Series B Shares has decreased to 7.50 percent. In the 2000 transaction, Kohler paid a price of US $3.30 for each new Common Unit, which was in excess of twice the then market price for a Common Unit on the Mexican Stock Exchange.

In connection with its investment in Interceramic, Kohler and Interceramic entered into a letter agreement (as amended, the "Kohler Agreement") setting forth the terms of the distribution relationship pursuant to which Interceramic would distribute Kohler products, primarily including sinks, bathtubs, sanitary fixtures, faucets and related accessories, in Mexico. Kohler also entered into certain agreements with the Controlling Group. *See* "–B.

Business Overview–The Kohler Agreement" below.

As was the case in both 2001 and 2002, during the course of 2003 the Company did not undertake any material capital projects, and most of its capital expenditures during the year were attributable to development and implementation of the Oracle supply chain management system, the installation of two new technologically advanced kilns in substitution of older kilns, the redisign and automation of the selection and packaging areas in all of the plants and the creation and implementation of a new image for the Company's wholly-owned stores in the United States, as well as for the routine upgrades of and improvements to existing equipment and facilities.

Aggregate capital expenditures during 2003 were Ps 133.9 million, while in 2002, the Company's capital expenditures were Ps 181.8 million and in 2001 capital expenditures were Ps 116.2 million. During the course of 2004, the Company expects to incur capital expenditures of approximately Ps 480.0 million, primarily in connection with the recently completed purchase from the Almeida Family of two franchisee distributors in Mexico and on the construction and equipment of a new state-of-the-art production facility to be located in the Mexican city of Chihuahua (the "New Plant").

B. Business Overview

General

The Company is engaged in the manufacture and distribution of glazed ceramic floor and wall tile and related products, primarily in Mexico and the United States. The Company produces a broad selection of high quality glazed ceramic floor and wall tile for residential and commercial uses. Products manufactured in its Mexican facilities are marketed by the Company throughout Mexico under the "Interceramic" brand name, using a national network of exclusive franchise stores as well as a number of Company-owned stores in the important Mexico City, Guadalajara, Monterrey and Chihuahua markets. In the United States, the Company effects sales under its own brand names, using its sales subsidiary, *Interceramic, Inc*. ("Interceramic USA"), which sells through independent distributors and a network of wholesale/retail stores owned and operated by Interceramic USA. Operated for many years under the name *Ceramic Tile International*, during the course of 1993 the Company changed the trade name for these stores to "*Interceramic Tile and Stone Galleries*" ("ITS"). Current ITS locations are in Anaheim, California; Dallas, San Antonio, Houston, Fort Worth, Plano, Austin and El Paso, Texas; the Atlanta, Georgia, area; Albuquerque, New Mexico; Las Vegas, Nevada; Phoenix and Scottsdale, Arizona; and Tulsa and Oklahoma City, Oklahoma. The Company also sells certain of its Mexican production to Dal-Tile for resale in the United States under Dal-Tile brand names. Through Interceramic USA, the Company also manufactures glazed ceramic wall tile in the United States and distributes the production in the United States using the independent distributors and the ITS network. In addition, the Company imports ceramic floor and wall tile, primarily from Italian and Spanish manufacturers, for distribution and sale in the United States and Mexico and manufactures and distributes grouts and adhesive materials in Mexico to complement the Company's ceramic tile product lines.

Interceramic commenced production in 1978 using the Italian, single-fired ("*monocottura*") tile production process. The Company was the first tile producer in North America to adopt this technique, which results in lower firing times and energy usage, allowing the production of high quality products at relatively low costs. Since starting operations to the present, the Company's annual production capacity has gone from 7.2 million to 264.0 million square feet.

Ceramic tile is currently produced by the Company in four facilities, three of which are located in the city of Chihuahua, Mexico, and the other of which is located in the Dallas-Fort Worth area suburb of Garland, Texas.

The Company's first production facility (the"ICSA Plant") is owned and operated by Interceramic and with a production capacity of 124.3 million square feet of glazed ceramic floor tile, currently accounts for 47.08 percent of the Company's installed capacity. The Company manufactures only glazed ceramic floor tile at the ICSA Plant.

The Company's second production facility (the "RISA Plant") is owned and operated by *Recubrimientos Interceramic, S.A. de C.V.* ("RISA"), a company owned 50.01 percent by the Company and 49.99 percent by Dal-Tile, and accounts for 25.00 percent of the Company's current installed capacity. The RISA Plant was constructed in 1989, and has a production capacity of 66.0 million square feet. All production of the RISA Plant is currently glazed ceramic floor tile. As successor to Armstrong under contracts entered into between the Company and Armstrong, Dal-Tile has the right to purchase up to 50 percent of the production of the RISA Plant, all in first quality, for sale in the United States.

The Company's third production facility (the "Azulejos Plant"), located adjacent to the RISA Plant, is owned and operated by Interceramic, and accounts for 15.00 percent of the Company's installed capacity. The Azulejos Plant is dedicated to the manufacture of large format wall tile, a popular product in Mexico, and has an annual capacity of 39.6 million square feet. Trim pieces, an important component of the ceramic wall tile markets, particularly in the United States, are also manufactured at the facility, primarily for export.

The Company's fourth production facility (the "Garland Plant"), located in Garland, Texas, is owned and operated by Interceramic USA, and accounts for 12.92 percent of the Company's installed capacity. At the Garland Plant, Interceramic USA is engaged in the manufacture and production of small and larger format glazed ceramic wall tile and related trim pieces, all of which is currently produced for the United States market. The annual capacity of the Garland Plant is 34.1 million square feet of 4¼" and 6" x 6" wall tile, together with related trim pieces.

In addition, at a facility (the "First ABISA Plant"), located adjacent to the ICSA Plant and owned and operated by a subsidiary of the Company, *Adhesivos y Boquillas Interceramic, S. de R.L. de C.V.* ("ABISA"), the Company manufactures and develops grouts and adhesive materials used in the installation of ceramic tile. In 2001 ABISA opened a second grout and adhesive facility (the "Second ABISA Plant") in the central Mexican town of Huichapan. The Second ABISA Plant more than doubled ABISA's capacity and allows the Company to reduce the shipping costs associated with these high-weight but low-cost products to franchisees in the southern part of Mexico. *Custom Building Products of California, Inc.* ("Custom"), a United States producer of similar products, owns 49.00 percent of ABISA's equity.

In 1998, the Company organized a wholly-owned subsidiary, *Distribución Interceramic, S.A. de C.V.* ("DISA"), to own and operate wholesale/retail locations throughout the Mexico City area. Additionally, in 1999, the Company organized *Interacabados de Occidente, S.A. de C.V.* ("Occidente"), another wholly-owned subsidiary, to acquire the operations of the Company's franchisee in the Guadalajara area. In March 2004, the Company purchased all of the issued and outstanding capital stock of *Grupo Comercial Interceramic, S.A. de C.V.* ("GISA") and *Materiales Arquitectónicos Decorativos, S.A. de C.V.* ("MASA"). GISA operates the Company's franchises in the city and state of Chihuahua, while MASA is the owner of the franchise stores in the Monterrey area. GISA was purchased from the Almeida Family and MASA was purchased from the Almeida Family and an associate of the family.

Production Capacity

At the end of 2003, the Company had a total annual installed capacity of 264.0 million square feet, of which 190.3 million square feet is allocated to the production of glazed ceramic floor tile and 73.7 million square feet is dedicated to the production of glazed ceramic wall tile. For the past four years, all of the Company's plants have been operating at full capacity. The New Plant is expected to increase the Company's production capacity by approximately 25 percent. The production capacities of the respective facilities, expressed in millions of square feet per annum, are:

ICSA Plant	124.3
RISA Plant	66.0

Azulejos Plant	39.6
Garland Plant	34.1

In addition to its core business of providing tile for the higher end of the market, the Company also manufactures limited amounts of strategic products for the lower end of the ceramic tile market in Mexico, primarily as a means of introducing potential customers to the higher-end offerings available in the franchise stores. Over the past couple of years, the Company has out-sourced the manufacture of certain of the more basic, or “commodity-type,” products in order to focus its own manufacturing efforts on higher end products, and during 2003 sold 6.4 million square meters of third party products compared to sales of 27.9 million square meters of its own products. The Company has adopted a strategy in Mexico to de-emphasize the distinctions between commodity and other tile products, instead focusing on a broad “Interceramic” product mix at its franchise stores in order to meet virtually every consumer demand for glazed ceramic tile products.

The Company also manufactures a variety of glazed ceramic wall tile products to complement its floor tile. In Mexico, the Company’s wall tile is directed at the medium- and high-end markets. The ceramic wall tile being produced at the Garland Plant is aimed primarily at the United States and Canadian markets, which favor smaller, 4¼” product. However, although it fluctuates during the course of the year, up to a third of the production of the Garland Plant may be at any one time dedicated to a larger format, 6” x 6” wall tile. A material part of the production of wall tile is the manufacture of the related trim pieces for borders, accents and decorative purposes, and both the Azulejos Plant and the Garland Plant are engaged in the production of trim pieces.

Ceramic Tile Markets in Mexico and the United States

Ceramic tile has been used for thousands of years as both functional and decorative veneers on floors and walls. Ceramic tile is just one of many available floor and wall coverings, competing with others such as concrete, carpet, wood, stone, laminates and vinyl. Relative demand for a particular material depends on various factors, and ceramic tiles generally hold a competitive advantage over other available wall and floor coverings in terms of aesthetic appeal, durability, ease of maintenance and fire resistance. Traditionally, their greatest advantage has been their beauty, and their greatest disadvantage has been cost. However, with recent advances in manufacturing and installation technology, the cost gap between ceramic tile and other coverings has narrowed, although installation cost for ceramic tile is typically significantly higher than in the case of alternative floor coverings such as concrete, carpet, laminates and vinyl.

Glazed ceramic tile consumption by product volume increased by a compounded average of 11.31 percent per year in Mexico between 1997 and 2003 and 10.60 percent per year in the United States over the same period. In Mexico, double-digit growth has been fueled by increased construction spending associated with economic recovery since the Peso devaluation in 1994 and by rising personal income levels. Growth in the United States reflects increased consumer preference of ceramic tile vis-à-vis other floor covering alternatives and economic expansion of the 1990’s. Furthermore, ceramic tile products have benefitted from declining prices associated with improvements in manufacturing technology resulting in a more competitively priced package and narrowing the price gap against other floor covering alternatives.

Mexico consumes considerably less ceramic tile per capita than other countries with similar climatic, cultural, architectural and income characteristics, such as Brazil. This disparity represents substantial potential for market growth in Mexico as the country continues to benefit from increased political and economic stability, proximity to the United States and NAFTA integration. Consumption per capita in the United States is even lower than in Mexico, indicating a large potential for market growth, as ceramic tile gains consumer preference over other floor covering alternatives. This is already evidenced by ceramic tile growth in the United States having outpaced growth of other floor covering formats in recent years due to decreasing prices and shifting architectural trends, which have increasingly emphasized ceramic tile products in construction and remodeling.

Markets

General

The Company markets its products throughout Mexico, as well as in the United States and Canada and in the past, to a very limited extent, Central America. The vast majority of its sales are in Mexico and the United States, which over the past five years have combined for 99.85 percent of the Company's consolidated sales. Sales in Mexico are made through an extensive franchise network, which includes Company-owned points of sale in the major markets of Mexico City, Guadalajara, Chihuahua and Monterrey, while in the United States, Interceramic USA effects sales through independent dealers and ITS stores. In Canada, most sales are made through one distributor located in Toronto who then makes further distribution throughout the country. The chart on the following page summarizes the Company's consolidated sales by markets.

[Chart on Following Page]

Historical Mix of Company Sales by Market

	2000	**2001**	**2002**	**2003**
Mexico				
Revenues*	1,729.5	1,880.1	1,842.0	1,920.5
Percent of Consolidated Sales	56.91	59.23	56.37	56.07
United States				
Revenues*	1,307.6	1,292.8	1,424.4	1,503.4
Percent of Consolidated Sales	43.02	40.73	43.60	43.91
Other (Primarily Canada and Latin America)				
Revenues*	2.0	1.3	1.0	1.0
Percent of Consolidated Sales	0.07	0.04	0.03	0.02
Totals				

Revenues*	3,039.1	3,174.2	3,267.4	3,424.9
Percent of Consolidated Sales	100.00	100.00	100.00	100.00

*Millions of Pesos

Although the respective percentages of (i) sales in Mexico and (ii) sales comprised of the aggregate of (A) sales of Company production exported from Mexico, (B) production from the Garland Plant and (C) products manufactured by non-affiliates sold outside Mexico (collectively, "International Sales") have varied from year to year, in order to maintain the presence required in both markets for long term penetration, the Company does not intend to materially change the mix between Mexican and International Sales from roughly 50 percent in each of the markets.

Mexico

The Company believes, based on industry sources, that Mexico's market for glazed ceramic tile in 2003 was at least 1,514 million square feet, divided into two main sectors: floor and wall tile. In 2003, floor tile represented approximately 1,141 million square feet and wall tile represented approximately 373 million square feet of the Mexican market. Total consumption of glazed ceramic tile products by volume in Mexico has increased at an estimated compound annual growth rate of 12.23 percent over the last eight years. The estimated 1,514 million square feet of sales for 2003 represents a modest increase of 3.92 percent over an estimated market of about 1,457 million square feet during 2002, a year which showed a much higher consumption increase of 10.00 percent over the preceding year. However, in 2001 growth over 2000 was just 3.47 percent.

The chart on the following page indicates growth in ceramic tile consumption, the construction industry in general and the Mexican gross domestic product, indexed to 1993 as the base year:

[Chart on Following Page]

Index of Ceramic Tile Consumption,

Construction and GDP in Mexico(1)

Year	Ceramic Tile Growth Index(2)	Construction Growth Index(3)	GDP Growth Index(3)
1993	100.00%	100.00%	100.00%
1994	104.64	108.43	104.46
1995	79.58	82.99	97.96

1996	91.18	91.10	103.00
1997	108.32	99.55	109.98
1998	128.65	103.76	115.37
1999	138.10	108.94	119.69
2000	151.48	113.51	127.56
2001	143.49	107.07	127.40
2002	144.54	108.41	128.33
2003	150.69	112.09	130.00
CAGR(4)	4.19	1.15	2.66

(1) Constant Pesos.

(2) Source: *Mexican Association of Ceramic Tile Producers*.

(3) Source: *Instituto Nacional de Estadistica, Geografía e Informática*.

(4) Compounded Annual Growth Rate.

Steady improvement in the Mexican economy since the economic crisis of the mid 1990's has resulted in increased spending on construction of residential and infrastructure projects and corresponding increased demand for construction materials. Further, recovering personal income levels have enabled certain consumers to upgrade or remodel their homes, replacing cement or earthen floors with ceramic tile. Industry studies have indicated that a material percentage of residences in Mexico lack floor coverings of any kind, and the Company believes that remodeling and improvement of existing structures is an important growth area for ceramic tile products. With further improvement in personal income levels and continued political and economic stability in Mexico generally, the Company believes there is significant potential for further growth in ceramic tile consumption.

Prices for glazed ceramic tile in Mexico have generally been decreasing over the past several years for a number of reasons, including increased competition, initially from imports but increasingly from large capacity additions by domestic producers and the savings generated by technological advances in the production process. Despite the industry trend of declining prices, the Company has over the same period been able to increase its selling prices modestly in the extremely competitive market.

Prior to the last major economic crisis in Mexico, a significant share of the ceramic tile market in Mexico, estimated by the Company to be approximately 10.37 percent during 1994, was held by imports, primarily from Spain and Italy. The Peso devaluation had a significant adverse effect on ceramic tile imports in Mexico, decreasing import participation in the domestic markets by almost 90 percent. Since the Mexican economy stabilized late in the 1990's imports have slowly regained market share and at an estimated nine percent of the market in 2003 have virtually recovered their pre-devaluation market share. Prior to the devaluation the Company had imported a substantial amount of product for resale in Mexico, but for a number of years the Company imported no foreign tile products for sale in Mexico. Starting late in 2002, the Company resumed imports of foreign product, substantially all of which is aimed at the lower-end of the markets to enable the Company to focus its limited production capacity on higher-end products while offering the consumer a broad spectrum of products.

In Mexico, sales are made to contractors, builders and architects for residential and commercial new construction and renovation. In addition, a substantial amount of the sales in Mexico are made directly to the end consumer, with homeowners purchasing tile directly and contracting with an installer to lay the tile. Particularly in the home building and renovation markets, in Mexico consumers are much more likely to be involved in the selection of ceramic tile for their homes than are consumers in the United States. As a result of the Company's strategy to direct most of its product mix among the high and middle ends of the market, the Company considers its customer base to be increasingly influenced by the middle class consumer, particularly those involved in the remodeling or improvement of existing properties.

United States

Based on statistics compiled by the United States Department of Commerce (the "Commerce Department") and estimates and projections reported in a 2003 study of the United States ceramic tile industry by *Economic Industry Reports, Inc.* (the "2003 Study"), the ceramic tile industry in the United States was relatively flat for a number of year until the last decade. Consumption in the United States increased dramatically over the period, increasing by 211.40 percent over 1992 to an estimated market in 2003 of 2,595.5 million square feet compared to 833.4 million square feet in 1992. Similar to Mexico, 2000 saw substantial growth of 11.66 percent over the preceding year while 2001 saw much slower growth, with the market increasing by only 3.47 percent over 2000–in the latter case most likely greatly attributable to the uncertainty sparked by the events of September 11, 2001. The market rebounded considerably in 2002, increasing by 10.00 percent over 2001, an increase of more than 133 million square feet. In 2003, growth slowed again, and ceramic tile consumption increased by only 3.92 percent over 2002. The Company believes that the key to growth in ceramic tile consumption in the United States has been and will continue to be ceramic tile gaining market share over other types of floor and wall coverings. According to the publication "*Specialists in Business Information*," in the period 1993 through 1998 the market for ceramic tile grew at a compound annual rate of 10.7 percent while carpet grew at 2.4 percent, hardwood at 6.2 percent, resilient sheet and tile at 4.1 percent and rubber flooring at 5.8 percent. While somewhat dated, and while the study also did not include the figures for "laminate" flooring, a fairly recent and fast growing entrant into the flooring markets, the Company considers the trends identified in this study to remain generally sound and confirms the Company's belief that ceramic tile demand is increasing faster than demand for most other types of floor products.

Although the overall market for glazed ceramic floor and wall tile in the United States, according to the 2003 Study, increased during the time period from 1990 to 2003 at an average annual rate of 9.16 percent, during the same period, however, the price obtained per unit has been generally decreasing. The average price per unit for glazed ceramic tile products of domestic producers dipped $0.07 per square foot in 2001 over 2000, and declined further by $0.02 to an estimated $1.10 per square foot in 2002. The trend continued in 2003 as prices decreased by $0.05 per square foot over 2002. Imports continue to lag behind domestic production in pricing however–having reached a peak of $0.96 per square foot in 1989, the average price for imported glazed ceramic tile products stood at $0.79 per square foot at the end of 2003. Imported products in the United States thus trade at an average 28.18 percent discount over domestic products. While glazed ceramic tile prices have slipped, other types of ceramic floor and wall tile have achieved modest price gains over the same periods. For both domestic and foreign producers, the reduction in price per unit is primarily due to competition and reduced production costs. As manufacturers have realized cost savings through technological advances and as a result of competitive pressures in the marketplace, the savings have tended to be passed on to the consumers. Because over half of the United States market is composed of imports, the Company believes that the United States ceramic tile market is representative of global ceramic tile markets. As most of the competitive and technological pressures and advances have already occurred at global pricing levels, the Company expects that prices of glazed ceramic tile in the United States will be substantially the same for the foreseeable future.

In the United States, the Company competes with several domestic producers, as well as imports from Italy, Spain, Mexico and other countries. However, the Company's sales in the glazed ceramic floor and wall tile market in the United States have grown significantly, from approximately US $14.8 million in 1989 to US $134.6 million in 2003. Based upon information contained in the 2003 Study, the Company estimates that its share of the glazed ceramic floor tile market in the United States was 6.33 percent at the end of 2003, slightly less than an estimated market share of 6.78 percent in 2002. This reflects not only the burgeoning growth of the ceramic tile markets in the United States over the years but also a slight erosion in the Company’s market share from around eight percent in the late 1990's.

Although the Company sells its products in other Central and Latin American countries, as well as in Canada, 99.93 percent of International Sales are to the United States. Of the total International Sales by volume during 2003, 57.58 percent consisted of sales of glazed ceramic floor and wall tile manufactured by the Company and the remaining 42.42 percent consisted of tile imported by the Company or purchased by Interceramic USA from United States or foreign producers. The significant increase in sales of non-Company products–they accounted for only 17.76 percent of sales in 2002–resulted from the Company’s decision to purchase substantial amounts of product from third-party suppliers in order to allow the Company to dedicate more of its own production capacity to higher margin products. Of the total International Sales for 2003, 25.69 percent consisted of sales through independent distributors and 68.62 percent consisted of sales through ITS stores, with the remainder being sold through Dal-Tile and customers in Central and Latin America.

In the United States, the Company sells to ITS, as well as to independent distributors, usually one for each major metropolitan area in the United States other than those in which an ITS store is located. The distributors then sell to floor covering dealers, builders, general contractors, floor covering contractors and the installer trade located in their respective sales areas. The usual customers for the Company’s products in the United States are contractors for new residential and commercial construction and, to a lesser degree, industrial construction. In addition, a significant percentage of sales is made in connection with home and office remodeling and renovation, both to the professional contractor, architect and interior decorator, as well as, to a much more limited extent than in Mexico, to the retail consumer.

Strategy

General

For a variety of reasons, including vastly differing economic conditions and income levels, differences in consumer and cultural preferences and disparate climatic conditions, the ceramic tile markets in Mexico and the United States differ from each other in many material respects. Accordingly, the Company has developed focused business strategies for each market. However, with all of the Company’s production facilities currently running at full capacity, the Company is pursuing a basic strategy in both markets to increase its gross margins by focusing its product mix on the higher end segments of the market and gaining market share in these segments. In order to do so, the Company is concentrating on the development of new, innovative and first-class products for sale in both Mexico and the United States. For example, during 2003 the Company introduced 40 new product lines, including a number of highly-sought “porcelain” products. At the same time, the Company believes it extremely important to maintain a full array of product offerings for the complete range of consumer tastes and budgets. To avoid erosion of its market share by producing insufficient quantities of products, during the course of 2002, the Company established a number of “private label” programs with third party manufacturers in order to be able to meet product demand as well as to focus its own manufacturing capacity on higher end products. The products developed under the private label programs are aimed at the lower, less expensive segments of the market in order to provide a full-line of ceramic tile product offerings to its customers as well as to enable the Company to dedicate all of its own production capacity to the more innovative, more expensive products.

The New Plant, a new production facility located in Chihuahua, Mexico, is currently under construction and slated to open early in the second quarter of 2005. The New Plant will increase the Company’s overall capacity by about 25 percent and should reduce need for some of the third party production.

The Company also continues to pursue strict control over operating expenses and further efficiencies in the production process in order to increase margins as much as possible within the limits imposed by current production capacity.

Mexico

Since the substantial recovery of the Mexican economy in the later years of the 1990's, the Company's central strategy has been increasing market share, primarily through the improvement of the selling prices for its products. This strategy has continued with the Company concentrating on improving its product mix to obtain higher margins on virtually the same volume of product by square meter. The Company has focused on improving its margins by obtaining a better product mix in its franchise stores and is directing its efforts towards obtaining real price increases. This has been achieved to a great extent over the past few years, and will continue to be the Company's prime strategy. The existence of the exclusive franchise stores makes it easier for the Company to introduce new products into the market, without having to develop entirely new distribution systems and networks. Further, with Company-owned distribution in the two dominant domestic markets of Mexico City and Guadalajara, joined in March 2004 by the acquisition of the Company's franchisees in Chihuahua and Monterrey, the Company is able to obtain additional margin on sales–a strategy that has proven valuable through the ITS distribution network in the United States.

In 1994, the Company terminated its relationships with poorer distributors and converted the remaining core of its existing distributors into exclusive, franchise distributors. This conversion resulted in several benefits for the Company, including increased time and sales efforts of distributor personnel with respect to the Company's products, increasing the level of promotions and advertising for the Company's products and improving the exhibition of the Company's products in ceramic tile showrooms. The Company believes that presentation of its wide mix of products at exclusive stores prominently bearing the "Interceramic" name has been a major factor in its ability to increase market share since the devaluation. By the end of 1994, all distributors had been either terminated or converted into franchises and at the end of 1995, the Company had 126 franchise stores operating in 73 different Mexican cities. Additional franchises have been opened since then and the entire network consolidated, reviewed and strengthened, and at December 31, 2003, the Company had 200 franchise stores operating in more than 114 Mexican cities.

Since 1997, the Company has owned its own distribution in the Mexico City area and has devoted considerable energies towards establishing its presence in Mexico City through advertising campaigns and opening of new, "Interceramic" stores. At the end of 2003, the Company owned 21 stores in Mexico City. In keeping with the Company's desire to own distribution directly in important markets, in 1999 the Company acquired the operations of its franchisee in the city of Guadalajara, one of the largest markets in Mexico, and was operating 13 stores in the area at the end of 2003. In 2002, the Company increased its presence in both the Mexico City and Guadalajara area markets by purchasing the operations of two existing franchisees, resulting in the acquisition of four stores in Toluca, near Mexico City, and three more stores in Morelia, a center on the main route between Mexico City and Guadalajara. By the end of 2003, the Company had five stores each in the Toluca and Morelia areas. By the acquisition of MASA and GISA at the end of March 2004, the Company further expanded its Company-owned network in Mexico into the major markets of Chihuahua and Monterrey. The acquisition resulted in the Company owning 19 stores throughout the northern Mexican state and city of Chihuahua and nine stores in the Monterrey area, a heavily industrialized city in northeastern Mexico.

The Company continually supports each of its exclusive franchises with consulting services covering a variety of operational matters, including inventory maintenance, implementation of inventory systems, marketing and training of sales and management personnel. The Company is strongly committed to the franchise concept in Mexico, and believes that it has reinforced brand recognition with trade customers, architects and other consumers of ceramic tile products.

In keeping with its position in the Mexican markets as a supplier of a complete line of ceramic tile products, the Company also manufactures glazed ceramic wall tile in a number of formats. In Mexico the Company has focused on the high end wall tile market, which for years had been dominated by European imports; and the Company has been able to stay largely out of the extremely price-sensitive commodity wall tile segment. With its distribution network and its ability to outperform imports in price, product offering and service, the Company believes it has made a material impact on the Mexican ceramic wall tile market, estimating that its share of the Mexican glazed ceramic wall tile market has gone from about three percent in 1992 to approximately 19 percent at the end of 2003.

The Company also markets products complementary to ceramic tile, such as plumbing fixtures and grouts and adhesives. Promoting package formats consisting of ceramic floor and wall tile, sanitary fixtures and grouts and adhesives increases customer convenience and is in keeping with the usual Mexican practice of providing a complete line of ceramic tile products, sanitary and other bathroom and kitchen fixtures and related products in the same store. This strategy is particularly important to the Company in light of its conversion from independent distributors in Mexico to exclusive franchises. By entering into the production of wall tile, expanding its grout and adhesive production, marketing sanitary fixtures, faucets and kitchen and bathroom accessories and related products the Company provides a full scope of products in the franchise stores. Sanitary fixtures and related products directed toward the high-end market are purchased by the Company from Kohler and resold to the Company's franchisees throughout Mexico. Middle and lower end products are purchased by the franchisees directly from *Ideal Standard, S.A. de C.V.*, a Mexican affiliate of *American Standard, Inc.* (collectively, "American Standard") under the terms of an agreement between the Company and American Standard (the "American Standard Agreement"). *See* "–The Kohler Agreement" and "–The American Standard Agreement" below.

The Company considers it an important strategic step to develop and market grouts and adhesives for the installation of ceramic tile products. The Company's relationship with Custom was entered into in order to avail the Company of the technical expertise necessary to produce high quality grouts and adhesives. *See* "–The Custom Agreement" below. Although its capacity has been expanded over the years, the production capacity of the First ABISA Plant is well behind the ceramic tile production of the Company. In 2001, ABISA placed the Second ABISA Plant into production, not only more than doubling the production capacity of ABISA, but also allowing the Company to reduce the costs associated with shipping these products to its franchise locations in the southern part of Mexico. As grouts and adhesives are relatively low priced products but heavy and bulky, minimizing transportation costs is important in keeping them competitively priced.

United States

The fundamental strategy of the Company in the United States has been to increase its market share, initially by taking market share from other producers in a relatively flat ceramic floor tile market, but with the recent growth in ceramic tile consumption in the United States, also by taking advantage of this growth. The Company believes that ceramic floor tile continues to gain market share in the United States against carpeting and vinyl covering in residential and commercial applications, and that the Company can best exploit this trend by producing innovative, high-design floor and wall tile. Carpeting is currently the overwhelming floor covering of choice in the United States, and in recent years easy to install "laminates"–or synthetic wood or other patterned flooring–has made material gains in the overall flooring industry. Although ceramic tile is generally much more expensive, both in cost and installation, than carpet, laminates and many other alternative floor coverings, the Company believes that as consumer awareness grows and new and innovative product lines are marketed, ceramic tile should gain further market share against other floor coverings.

Management believes that there is substantial demand for quality, competitively priced wall tile in the United States. The Garland Plant was developed to respond to this perceived demand. The Garland Plant was designed as a state-of-the-art wall tile facility, with aggregate annual production capacity of 34.1 million square feet of primarily 4¼" wall tile and related trim pieces such as borders, corners and accents, although the Garland Plant also produces material amounts of 6" x 6", larger format wall tile. The Company's focus continues to be on marketing and developing a strong, distinctive line of products and related trim to take advantage of the sales opportunities it believes to be available in the expanding ceramic tile markets in the United States. Further, the Company is focusing on improving prices obtained on products manufactured in the Garland Plant to enable the Company to achieve better margins.

The Company's penetration of the United States glazed ceramic floor tile market is attributed by management to several factors. Primary among these has been the role of Interceramic USA in coordinating distribution and sales in the United States and providing an ability to furnish distributors and consumers with rapid, consistent and excellent service from the Company's United States employees. Further, the Company believes that its aggressive introductions of new and innovative products into the United States market, together with related marketing campaigns, have also been beneficial.

A pillar of the Company's United States strategy has been to develop and expand its distribution network, not only through independent distributors, but in particular through the expansion of the ITS store network. At the beginning of 1993, Interceramic USA operated a total of three stores, and by the end of 2003, it operated 19. Focusing on the southern United States, where ceramic tile is more in demand, at December 31, 2003, ITS stores were located in Dallas, Fort Worth, Plano, Houston, San Antonio, Austin, Spring and El Paso, Texas; the Atlanta, Georgia area; Las Vegas, Nevada; Phoenix and Scottsdale, Arizona; Albuquerque, New Mexico; Anaheim, California and Tulsa and Oklahoma City, Oklahoma. A new store is to open in the second quarter of 2004 in San Diego, California. The Company consistently records higher sales volumes and better profit margins in the United States through ITS sales as opposed to independent distributors, and will continue to add new ITS stores in the United States when opportunities present themselves, including the possible acquisition of existing ceramic tile stores owned by other parties.

Under the joint venture arrangement with Dal-Tile, RISA sells glazed ceramic floor tile to Dal-Tile for resale under the Dal-Tile and American Olean names in its company-owned outlets and through the American Olean network of independent distributors. The ability to sell RISA production to the large Dal-Tile/American Olean network in the United States provides the Company with the ability to achieve further material, if less direct, sales in the United States.

Competition

General

In addition to the competition that the Company faces from other ceramic tile producers, the Company's products compete with numerous other floor coverings for residential, commercial and industrial uses. Among such coverings are carpet, the popular laminates, vinyl, stone products (such as marble, granite, slate and limestone tile) and unglazed tile (such as terra cotta and porcelain). Ceramic tile products are typically more expensive than carpeting, laminate and vinyl coverings, and are generally cheaper than stone products. The cost of installation of tile products, including ceramic tile, is significantly higher than the cost of laying carpet, laminates or vinyl. In general, however, glazed ceramic tile products offer longer wear-time periods and superior resistance to corrosives then do other coverings.

In both Mexico and the United States, it is difficult for the Company to accurately determine its position in the market compared to other competitors due to the lack of reliable production and sales data from companies not under reporting requirements such as those imposed on Interceramic under the 1934 Act. Accordingly, although sufficient information exists both in Mexico and the United States for the Company to judge its position in the overall market, it is unable to accurately fix the market share of most of its major competitors.

Mexico

The Company's production capacity expanded significantly over its first 15 years of operation. However, the Company has not increased production capacity since 1996, other than a trim line added at the Garland Plant and periodic increases in production capacity achieved through improved efficiencies in its existing production processes. For example, during 2000 the Company's ability to increase its percentage of first class production added almost two million square feet of salable production capacity. The Company estimates its current market share of glazed ceramic floor and wall tile to be approximately 19 percent by Dollar sales volume. The Company believes that it is the premier cost-efficient producer of first quality ceramic floor and wall tile in Mexico and that ceramic tile sold under the "Interceramic" name may be sold at premium prices because of its reputation for quality and high brand-name loyalty. The Company believes that its tightly-knit, national network of exclusive Interceramic franchises is a major competitive advantage. In addition, the Company believes that its ownership of the stores in the Mexico City and Guadalajara markets is materially beneficial to the Company's penetration of and presence in those important markets. The recent acquisition of the franchises in Chihuahua and Monterrey should also prove very beneficial to the Company, as these franchises were among the most successful in the country-wide network.

In Mexico, the Company competes with a limited number domestic manufacturers of ceramic tile, including Porcelanite, Vitromex, Lamosa and, to a lesser extent, a Mexican affiliate of Dal-Tile. Although there are other domestic producers as well as foreign manufacturers which import tile in the Mexican market, the market is dominated by the four largest producers (including the Company), who collectively account for almost 80 percent of the market. The Company believes that the Mexican market for ceramic tile can be broken down into two broad segments, high quality tile (which comprises approximately one-third of the market) and commodity tile (which comprises approximately two-thirds of the market). High quality tile is distinguished from commodity tile on the basis of strength, durability, innovation and aesthetic design. Selection is also greater at the higher end, with a wider variety of colors, styles and sizes. In the high end segments, quality, selection, innovation and customer service are important aspects of a product's position in the market. Historically, the Company has focused on the medium to high end of the tile market, where initially it faced competition mainly from European imports, and in more recent years, Vitromex and Porcelanite. While following the Peso devaluation competition from imports decreased materially, imports have recovered most of their pre-devaluation market share and may prove to be more of a factor in coming years if the Mexican economy continues to grow and stabilize.

As a result of the Company's belief that it needs to supply lower-end, strategic products to provide a complete product offering to effectively compete against other domestic producers and attract all types of potential consumers to its stores, the Company also manufactures lower-end products. At the lower-end market segment, however, profit margins are smaller and competition is almost totally based on price. Particularly in light of its current capacity constraints, the Company redirected its strategy to out-source the production of strategic products as well as to present them as part of a comprehensive Interceramic line available at its exclusive franchise stores, rather than directing sales at specific low-end markets. This has assisted the Company in concentrating its production on higher margin products as the Company has pursued a strategy of developing more innovative, high design products in order to take advantage of the higher selling prices and margins available to the higher quality products. This strategy has proven valuable for several reasons, including helping the Company differentiate its products from the competition as well as keeping the Company largely out of the price wars that have been waged in the low end market segments. The success of the strategy has been demonstrated by the fact that the Company's prices are on balance about 20 percent higher than those of the Mexican ceramic tile industry in general.

Although the Company believes it is the only glazed ceramic tile producer in Mexico with 100 percent of its installed capacity being state of the art, certain of its competitors have invested significantly in modernization and renovation in recent years as well as completing significant capacity expansions. While the Company is fourth among the domestic producers in production capacity, it possesses the highest market share in the high end markets. There are material barriers to entry in the high end markets, and management believes that its current position in the market and, in particular, its strong domestic franchise distribution, are significant competitive advantages.

United States

The United States floor covering market in general, and the ceramic tile industry in particular, is highly competitive in terms of price, service and quality of products. The Company, through Interceramic USA, competes with several domestic manufacturers, such as the domestic market leader Dal-Tile, as well as numerous foreign producers of ceramic tile whose products are sold in the United States at very competitive prices. According to the 2003 Study, there were 33 companies manufacturing glazed ceramic floor and wall tile in the United States at the end of 2003–a dozen more than at the end of 1998–yet 79.4 percent by product volume and 73.7 percent by sales volume of the glazed ceramic floor and wall tile market in 2003 was held by imports. Management believes that Interceramic USA has been successful in penetrating the more mature, highly competitive United States glazed ceramic floor tile market. Innovative products, strong distribution, aggressive marketing and competitive pricing have all contributed significantly to the Company's market penetration in the United States. *See* "–Markets" above.

In the glazed ceramic wall tile industry, the Company faces greater competitive obstacles, due primarily to the relative simplicity of the small format wall tile and the long-term dominance of a handful of domestic producers. The Company continues to work to improve its competitive position in this market by concentrating on the production and marketing of interesting and innovative trim pieces that will better distinguish its products from those of competitors.

The Production of Glazed Ceramic Tile

The ceramic tile production process begins with the excavation of clays to be used in the manufacturing process and the transportation of the clays to the production facilities from mine sites. Upon arrival at the facilities, clay is kept in open storage bins while awaiting processing. Depending on the type of tile being produced, any number from two to more than six different types and colors of clays may be blended together.

The selected clays and water are mixed and pumped into large, rotating cylindrical mills, where the grinding action of thousands of baseball-sized crushing balls made of high density alumina pulverizes pebbles, granules and clumps of clay into a uniform substrate. The resultant mixture, or "body slip," is then pumped out of the ball mills and pumped into holding tanks, called slip tanks, before being pumped into a silo-like structure, called a spray-dryer, where the body slip is subjected to blown hot air to evaporate the water. The result, after each evaporating cycle of the spray-dryer, is a very fine, uniform, powder-like substance similar to exceedingly fine sand. This material is carried by conveyor belt to a separate holding bin. The production method to this point is batched, so that loading unit batches and hoses carry computer programmed amounts of clay and water from slip tanks to the spray drier, to powder storage bins and, finally, to tile presses in a continuous, automated process adjusted to production targets and timing. Spray-drying, for example, can be calibrated to adjust for red-bodied tile or white-bodied tile.

The powder is then fed into molds within a hydraulic press, one press for each production line, where the powder is molded into the selected geometric shape and size for the tile being produced and is subjected to extreme pressures, producing a molded ceramic tile. These presses can produce in excess of 10,000 square feet of tile per production line per eight-hour shift during an ordinary production shift. The efficiency of the pressing phase is critical to the production process to reduce the presence of gaseous materials which could weaken the tile body.

At this point the tile, which is hard but brittle, is subject to an initial drying stage, and is fed automatically along a conveyor belt where glazes and designs are administered through automated washing, brushing and silk-screening equipment. The glazed tile is then fed into a long, high temperature kiln, accommodating four or more lines of tile, depending on the size of the tile being fired and the type of kiln being used, with ceramic rollers inside the kiln moving the tile along the approximately 260 foot-length of the kiln, depending on the type of kiln used. The single-firing lasts from 45 to 50 minutes from the time the tile is delivered to the kiln door, via continuous feeding conveyor belts, until the tile emerges, fired, at the opposite end. The internal temperature rises steadily from the loading aperture through the length of the enclosed kiln to temperatures as high as 2200° Fahrenheit. The tile that emerges is extremely hard, durable and impact resistant.

Finally, the fired tile, automatically stacked in multiple layer loading trays, is moved by robotic machinery through the quality control inspection points where the tile is magnetically scanned for defects and visually examined for sorting according to variations in the color of the glaze, chipping or other surface defects. Once identified as first, or second quality, the tile is sorted mechanically and then stacked, boxed, sealed and labeled for shipping, all by specialized equipment. The major difference between first quality and second quality tile is in the uniformity of the shading of the products, with some minor surface defects being permitted for second quality tile.

The Company believes that its manufacturing facilities and state of the art technology have resulted in increased efficiencies and high quality products at relatively lower costs as compared to older technology. The adoption of the Italian developed monocottura technology using single-firing of ceramic tile through rapid-cycle kilns revolutionized the production of ceramic tile, resulting in dramatic reductions in the firing times associated with older processes. In addition, the single-fired process permits a better integration with other production cycles required for the manufacture of glazed ceramic tile, such as pressing and glazing, allowing for increased automation and partial robotization. High quality, extremely durable ceramic tile, measured by low porosity, low absorption and impact resistance, is economically achieved by the single-fired process.

The Research and Development Center

Adjacent to the ICSA Plant in Chihuahua, the Company has a specialized Research and Development Center which serves several purposes. The Company is continuously engaged in research and development of harder and more wear-resistant tile, improved combinations of clays, scratch and chip resistant glazes and enamels, and different combinations of colors, designs and surface textures for glazes. In addition, the Research and Development Center has instruments to measure specifications of tile and glaze and to quality control-test production line tile. The facility includes all the machinery and equipment necessary to replicate the entire full scale production process, to several different scales, in order to test and improve production techniques and to subject newly developed products to normal production conditions. It is particularly well-suited for turning out runs of glazed ceramic floor or wall tile to order. The Research and Development Center also enables the Company to develop new products quickly and to be timely in its response to changes in the market for ceramic tile.

Raw Materials and Supplies

The Company is not dependent on any one outside supplier for any of the raw materials used in its business, although it may from time to time purchase supplies (for example, alumina grinding balls) from only one supplier because of price and/or quality considerations.

Generally, making ceramic floor tile requires three types of high quality clay–including green body, red body and grey body clays. Substantially all supplies of clay for floor tile production used in the Mexico operations are obtained from the Company’s own mines, which are estimated to have sufficient reserves to supply the Company’s projected needs for manufacture of ceramic floor tile for at least the next 60 years. These mines are located approximately 20 miles from the Company’s production facilities in Chihuahua.

Depending on the specific type of wall tile being manufactured, that process may involve the mixing of four to six different types of white body clay. The Company currently owns sources of two types of the white body clays which are used in the production of the large format wall tile at the Azulejos Plant as well as in the production of small format wall tile at the Garland Plant. Although the Company is investigating the possibility of purchasing sources of other white body clays in both the United States and Mexico, it currently is purchasing supplies of these other white body clays from unrelated parties in Mexico and the United States, and has not had nor does it anticipate any difficulties in obtaining and maintaining supplies of these clays.

Although the Company believes that most of its competitors have access to sufficient sources of raw materials, the Company believes that its clays are of generally higher quality than that of most competitors, resulting in the production of a clay body with lower porosity and water absorption than bodies formed from many other clays. Further, with the exception of the white clays needed for wall tile production, the Company owns the full range of clays needed for all types and grades of ceramic tile produced by it.

Clay in Mexico is delivered to the production facilities by truck, although some white clays are imported from the United States and delivered by train. In the United States, clay for production at the Garland Plant is transported by train to a location in the Dallas area, where it is loaded in trucks and delivered to the Garland Plant.

Other raw materials, such as enamels, coloring agents, corundum, oxides, various chemicals and reagents and packaging material are commercially available from Mexican, European or United States suppliers. Management believes that adequate quantities of raw materials and supplies required for the manufacture of ceramic tile are and will continue to be readily available from suppliers in the United States, Europe and Mexico.

Product Lines

The Company manufactures and sells glazed ceramic and porcelain floor and wall tile, as well as grouts and adhesives for applying these products. Additionally, under the Kohler Agreement and the American Standard Agreement, in Mexico the Company markets various sanitary fixtures, faucets, bathroom accessories and related products and hardware in its franchise stores. Kohler products are directed at the high-end market while the American Standard products are geared more towards the mid- and low-end markets. The Company believes that providing a broad product mix is important, particularly in Mexico where customers traditionally expect it and where some of the Company’s significant competitors maintain full product lines. See “–Strategy” above.

The Company’s products are manufactured according to various use specifications and are marketed accordingly. Residential Light grade tile covers ceramic tile intended to be used in applications where the likely incidence of wear and corrosion is low, such as in bathrooms and kitchens, while Commercial Moderate and Commercial Heavy grade tile is used for different applications in restaurants, shopping malls and public buildings and is sold for commercial (including exterior) application where wear and corrosive conditions are likely to be higher. In between the Residential Light and Commercial Moderate grades, different types of tile range from Residential Moderate and Heavy to Commercial Light.

The Company currently features over 100 different product lines. In Mexico, the Company markets all of its ceramic tile under the “Interceramic” name, with different styles, types, colors and grades being given distinct style names. The Company also markets sanitary and bathroom fixtures, faucets and accessories manufactured by American Standard exclusively in Mexico under the Interceramic brand name and similar products manufactured by Kohler under the Kohler name. In the United States, the Company markets its manufactured products under the Interceramic name only, but American Olean and Dal-Tile products produced by RISA are sold in the United States by Dal-Tile. Particularly in Mexico, the Company’s product mix covers most market segments, encompassing all segments under the “Interceramic” brand with different product names, depending on the type of product and the market segment to which it is directed. This provides distributors with a complete line of ceramic tile and related products, strengthening the exclusive distributorship concept. Regardless of the segment, however, the Company’s products are all generally priced higher than competitors’ products and are distinguished by higher quality and design. All of the Company’s products meet or exceed American National Standards Institute minimum specifications for the various tolerances of ceramic tile, such as water absorption, abrasive hardness, breaking strength, thermal shock, scratch hardness of glaze, frost resistance, warpage and bonding strength.

Each product line is offered in a variety of colors and sizes, and many products are offered in square as well as smaller rectangular shapes for contrast. Each product line features a characteristic surface glaze, depending on the intended use as well as on the style and appearance sought to be achieved. Glazes range from shiny, smooth and vitreous, with uniformity of color, to smooth, matted finishes with the color variations characteristic of marble or porcelain, to surfaces with a grainy texture and mottled appearance. Some of the Company’s more popular products have rugged, multi-colored, -shaded or -tinted surfaces with the appearance of hewn stone.

In 1999, the Company launched new products using a “rectified” technique which produces ceramic tile with marble- and granite-like patterns and textures. These relatively expensive products have been very well received in the markets, particularly in Mexico. During 2000 the Company launched a coordinated series of floor and wall tile, manufactured in Mexico and in Garland, which provides wall and floor tile in larger formats and with similar features giving the appearance of natural stone. This series is complemented by trim wall and floor pieces produced to match with the exact same design, making perfect match coordinates. Also in 2000, the Company introduced a new line of marbled tile with fine design and high definition, resulting in a look practically like natural marble.

In 2002, the Company began sales of porcelain tile products manufactured in its Mexican facilities, initially in the United States but by the end of the year the Company was selling these products in Mexico as well. A very strong, innovative and attractive product, porcelain tile currently represents the pinnacle of the glazed ceramic tile offerings in the market. By moving into production of these upscale products the Company has effectively responded to a competitive threat led by primarily European manufacturers.

Interceramic USA also imports, primarily from Spain, Italy and Brazil, and purchases from other United States manufacturers, other ceramic tile products such as glazed ceramic wall tile in a variety of styles, shapes, colors and glazes, as well as glazed and unglazed ceramic floor tile, stone and marble products. Interceramic USA also distributes marble and granite floor tile produced by third-party manufacturers, and sells through the ITS network a significant amount of products produced by third parties. For example, ITS's sales for 2003 of US $92.4 million were comprised of 39.20 percent ceramic tile manufactured by the Company with the balance consisting of products manufactured by other foreign and domestic companies.

Beginning in 2002, the Company commenced imports of strategic products into both the Mexican and United States markets, primarily from Italy and Spain, in its "private label" program in order to ensure sufficient quantities of these lower-end products in its customer offerings as well as to allow the Company to dedicate its own production capacity to the higher-end products.

Distribution and Marketing

Distribution

The Company believes that its continued strength is highly dependent upon its strong and modern distribution channel throughout North America that emphasizes its commitment to the final consumer. In Mexico, the Company effects sales solely through its system of independent franchise distributors and its Company owned stores in the Mexico City, Guadalajara, Chihuahua and Monterrey areas. As of December 31, 2003, this network consisted of 28 distributors with 200 outlets located throughout Mexico, each prominently displaying the Interceramic name. Due in part to the prominence of the franchise stores and a series of eye-catching advertising campaigns, market presence is strong throughout all areas of Mexico. The Company is continually monitoring its franchise network, dropping poor performing distributors or store locations and replacing or substituting as necessary. In late 1997, the Company terminated its relationship with its then franchisee in Mexico City, resulting in the loss of 31 points of sale. However, the Company aggressively pursued a strategy to establish a stronger presence in the Mexican capitol city through the opening of flagship, Company owned stores. The first store opened early in 1998, and by the end of 2003, the Company had 21 stores operating in Mexico City. With the acquisition and expansion of the Toluca franchise, the Company has five more stores to add to its Mexico City area presence.

Early in 1999, the Company acquired the business of its franchisee in the Guadalajara, Mexico area through a negotiated transaction under which the Company's Occidente subsidiary took possession of the eight locations in Guadalajara and substantially all of the assets and inventory used at those locations. At the end of 2003, the Company had 13 stores in the area. Three more Guadalajara-area stores were added to this total in early 2002 with the purchase of the Morelia franchise. Since the acquisition, the Company has added two additional stores in the Morelia area.

The Company believes that its relationship with its franchise distributors is one of the most important factors in its success in the Mexican markets. Franchisees are selected very carefully, and are required to carry and market solely products manufactured or otherwise authorized for sale by the Company, offering consumers a complete package that includes ceramic floor and wall tile, grouts and adhesives, sanitary fixtures, faucets, kitchen and bathroom accessories and related products. Additionally, franchisees must follow guidelines regarding store layout and exhibition techniques, provision of qualified customer services, pricing and business standards, designed to insure the perception of the Company and its products in the marketplace as first class in both quality and service. As part of its commitment to the franchise system, the Company has implemented a strong training and operational support program in order to help accelerate and solidify the development of the franchises. In recent years, the Company has also assisted franchisees with store remodeling and construction in order to facilitate the prominent presence of the "Interceramic" stores in their respective communities. The Company believes that the franchise system has proven successful, resulting in greater aggregate levels of sales and allowing the Company to maintain market share despite the poor economic conditions in Mexico in the middle years of the prior decade, and providing the Company with a strong base throughout Mexico during the recent years of modest recovery.

Sales to the United States and Canada are effected through Interceramic USA, which sells to a network of 79 independent distributors with a combined 180 locations, as well as to the 19 ITS locations. The Company has found that sales through ITS stores of Company products are typically much greater than through independent distributors, and the Company intends to continue the development of the ITS network in the United States, particularly in areas where existing distributors are not meeting the market potential. Additionally, Dal-Tile markets floor tile produced at the RISA Plant through its distribution network in the United States. Interceramic USA distributes substantially all Company products sold throughout the United States from its facilities in the Dallas, Texas area. Interceramic USA's facilities in Dallas are headquartered in the Garland Plant, and also include separately leased distribution warehouses.

Marketing

Advertising and marketing are important to the Company's business strategies, and the Company expends significant amounts annually in respect of advertising and marketing. Because the Mexican and International markets vary in several material respects, the Company takes a different approach in its marketing efforts in the two markets.

In Mexico, the Company promotes brand-name recognition and sales by advertising to the general public in the print and radio media, and has periodically conducted aggressive, nation-wide print and television media advertising campaigns, designed to heighten name recognition and product visibility. Advertising strategy has shifted more to the point of sale, with distinctive, high-profile stores and vignette displays and other materials promoting the Company and its products in the exclusive franchise stores. This involves working closely with its franchise network in creating product display strategies, by arranging product seminars to educate distributors as to product lines and new product introductions as well as by obtaining marketing feedback from distributors as to the success of particular product introductions and market strategies. This careful branding strategy has been demonstrably successful. Interceramic has for several years conducted an annual survey among female heads of household in Mexico, which has demonstrated a marked recognition of Company products. In the 2003 survey, and consistent with recent years, approximately 52 percent of respondents mentioned Interceramic when asked to recite unaided brands of ceramic tile–almost four times the mentions of any other tile producer, and 46 percent of all respondents mentioned the "Interceramic" brand first.

In the United States, marketing and advertising are effected through trade shows and magazines, showroom displays, catalogues and point of sale displays. Inasmuch as the United States market is dominated by com