The Pakistan Credit Rating Agency Limited

# Rating Report

# Master Tiles and Ceramic Industries Limited

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**Rating History**

| Dissemination Date | Long Term Rating | Short Term Rating | Outlook | Action | Rating Watch |
|---|---|---|---|---|---|
| 03-Sep-2018 | A- | A2 | Stable | Initial | - |

## Rating Rationale and Key Rating Drivers

The ratings incorporate the company's emergence as a growing entity, evident from consistent expansion in business volumes and ensuing profitability. Simplified ownership structure and induction of second generation in business provides comfort regarding succession. Family dominated governance framework, with no independent director or sub-committees exists. The company has established a strong position in its operating segment through competitive pricing and provision of better quality products to the end consumers. Technological upgrade and installation of new production facilities alongside experienced management team transpire into operational efficiencies. Local demand for tiles on the backdrop of construction boom bodes well for business prospects of the company. Additionally, anti-dumping duties instigated on imports from China are favorable for the domestic Industry. The management intends to capitalize on this growth opportunity through expansion. Currently, operating with two production plants, the company is undergoing installation of a third unit which is expected to be completed by Sep-18. Two other projects are also in the pipeline. Current financial profile reflects a transitionary stretch amidst expansion, hence prudent management of the associated risks are critical for the ratings. The company's financial appetite is supplemented by healthy profits and ample cashflows which provide comfort on the debt servicing ability. Going forward, management intends to rationalize debt mix and stabilize capital structure, as it emerges out of the expansion transit.

The ratings are dependent on the company's aptness to manage its liquidity profile while keeping up with its debt obligations. Prudent working capital strategy is an imperative driver to the ratings. Additionally, materialization of expansion venture into better cashflows and stronger margins would be of significance to the ratings. Meanwhile, margin deterioration, due to competition or excessive borrowings, leading to dilution of coverages will have negative impact on the ratings.

**Disclosure**

| | |
|---|---|
| **Name of Rated Entity** | Master Tiles and Ceramic Industries Limited |
| **Type of Relationship** | Solicited |
| **Purpose of the Rating** | Entity Rating |
| **Applicable Criteria** | Methodology \| Corporate Ratings(Jun-18),Methodology \| Criteria \| Rating Modifier(Jun-18),Methodology \| Correlation Between Long-Term And Short-Term Rating Scale(Jun-18) |
| **Related Research** | Sector Study \| Construction \| Ceramic Tiles(Jun-18) |
| **Rating Analysts** | Jhangeer Hanif \| jhangeer@pacra.com \| +92-42-35869504 |

| MASTER TILES & CERAMIC INDUSTRIES LTD - PROFILE | |
|---|---|
| **Incorporated** | 1992 |
| **Major business lines** | Manufacture and sale of tiles |
| **Legal status** | Public Unlisted |
| **Head office** | Hafeeza Tufail Building, Gujranwala |
| **Plant Location** | Gujranwala |
| **Capacity** | ~45,800 square meters/day |

**INDUSTRY SNAPSHOT**

- Demand-driven Industry
- Consumption of over ~100mln square meters of tiles per annum
- Imported tiles cater ~50%-60% of the annual consumption
- Production/local capacity concentrated in top players of the organized segment
- Protection to the domestic producers through introduction of anti-dumping duty on imported tiles from China and increase in custom tariffs.

## OWNERSHIP

- Incorporated in 1992, Master Tiles & Ceramic Industries Limited (herein referred to as "the company" or "Master Tiles") emerged as a family oriented business including seven brothers and five sisters headed by their father. All brothers separated their businesses gradually. Currently, seven diversified entities exist under the brand "Master".
- The brand "Master" was launched in 1982 with the establishment of "Master Sanitary Fittings Limited" prior to which the family was involved in the business of utensils, pots and trays by the name of "Sheikh Brothers Industries Limited" based in Multan.
- The ownership of various businesses is now settled amongst brothers and complete shareholding of Master Tiles belongs to Mr. Mehmood Iqbal and his family. A restructuring was proposed in 4QFY18 which designated Mr. Mehmood Iqbal to hold ~84% stake in Master Tiles while his wife :~3%, three sons :~4% each and one daughter :~1%. Formal notification in this regard has been disseminated to the Regulator. Prior to the proposal, shares of the company vested with Mr. Mehmood Iqbal and his two other brothers - Mr. Muhammad Asghar and Mr. Muhammad Akbar in the ratio ~34%, ~33% and ~33% respectively.

## GOVERNANCE

- The Board of Directors, after change in ownership structure, includes Mr. Mehmood Iqbal (the CEO) and his family members with no independent director or sub-committees.
- Ilyas Saeed & Co. Chartered Accountants – a QCR rated firm classified under 'A' category by the SBP are the External Auditors of the company.

## MANAGEMENT

- Well-defined organization structure with clear lines of responsibilities exists.
- The CEO, Mr. Mehmood Iqbal is the pioneer of the company and is a prominent tiles industry veteran. He has over ~30 years of experience in the relevant industry and thoroughly understands local and global industry dynamics.
- A committee comprising of the (i) Production Director (ii) CFO (iii) COO and (iv) Special Coordinator to CEO has been formed for oversight of all strategic matters which would present recommendations to the new board.
- The HR base of the group is strong with top management possessing ample knowledge and expertise of the related business and their areas of responsibilities.
- Strong focus on research & development with emphasis on innovation and efficiency.
- The company's operations are segregated into various support departments, including: (i) Marketing & sales, (ii) Production, (iii) Accounts and Finance, (iv) Human Resource and Admin, (v) Supply chain – Packaging, Stores & Spares, and Machine related equipment, (vi) IT and (vii) R & D.
- The current MIS is generated through in-house developed software known as "Master MIS". The company is, however, in the process of getting SAP installed from an external vendor – Seimens which is expected to go live in 2QFY19.

## BUSINESS RISK

- Strong demand potential in the sector bodes well for the business prospects of the company. Leading market position drives the company to adopt a rapid growth strategy. This has been laid down in the form of business volume expansion. Unit-3, for the production of granite tiles, is expected to be completed by Sep-18, adding a capacity of 24,000 square meters of tiles per day. Plans for installation of a 4$^{th}$ and 5$^{th}$ unit are also in the pipeline.
- The company's topline clocked in at PKR~7.1bln in FY18 (FY17: PKR~5.1bln) recording a high growth rate of ~39% YoY. Bottom-line translated into ~9% of the topline recording at PKR~637mln in FY18 (FY17: PKR~516mln). Gross margins remained relatively stable at ~24% (FY17: ~23%), while operating margins improved to ~18% (FY17: ~16%) due to cost rationalization.

## FINANCIAL RISK

- Financial risk profile remained relatively stretched in FY18 as expansion necessitated funding through external sources. This is expected to improve, as the company intends to load off sizable debt burden and generate additional cash inflows from the operations of existing and new unit.
- Significant improvement in net working capital cycle was observed in FY18 supported by reduction in inventory levels. Net working capital days recorded in FY18 were 28 days (FY17: 54 days, FY16: 62 days). High dependence on short term borrowings was seen; FY18: PKR~1.6bln (FY17: PKR~1.3bln). However, cushion in short term lines as at End-June18 remains. Going forward, management intends to shift mix of borrowings towards long term debts to fuel further CAPEX.
- Debt servicing capacity (coverages) was adequate, with core and total coverage recording at 1.1x in FY18 (FY17: 2.3x). Despite healthy FCFO of PKR~1.2bln in FY18 (FY17: PKR~863mln), elevated short term borrowings kept the coverages tight. Management projects an FCFO of PKR~2bln in FY19, which would be sufficient to meet its future debt servicing needs.
- Leveraging rose to ~63% at End-June'18 (End-June'17: ~40%, End-June'16: ~41%). Reduction in overall debt burden is expected to dilute this ratio, going forward.

PKR mln

# Master Tiles & Ceramic Industries Limited

| BALANCE SHEET | 30-Jun-18 | 30-Jun-17 | 30-Jun-16 |
|---|---|---|---|
| | FY18 | FY17 | FY16 |
| **Non-Current Assets** | **6,875** | **3,582** | **3,683** |
| **Investments (incl. Associates)** | **79** | **19** | **53** |
| Equity | - | - | - |
| Debt Securities (incl. income funds) | 79 | 19 | 53 |
| **Current Assets** | **2,411** | **2,195** | **1,854** |
| Inventory | 365 | 686 | 622 |
| Trade Receivables | 836 | 539 | 514 |
| Others | 1,209 | 969 | 718 |
| **Total Assets** | **9,364** | **5,796** | **5,590** |
| **Debt/Borrowings** | **4,731** | **1,745** | **1,840** |
| Short-Term | 1,611 | 1,253 | 1,012 |
| Long-Term (incl. Current Maturity of Long-Term Debt) | 3,120 | 492 | 828 |
| Other Short-Term Liabilities | 1,310 | 935 | 655 |
| Other Long-Term Liabilities | 549 | 545 | 482 |
| **Shareholder's Equity** | **2,775** | **2,570** | **2,614** |
| **Total Liabilities & Equity** | **9,364** | **5,796** | **5,590** |
| **INCOME STATEMENT** | | | |
| **Turnover** | **7,127** | **5,127** | **4,071** |
| Gross Profit | 1,697 | 1,180 | 894 |
| Other Income | (8) | 10 | 30 |
| Financial Charges | (218) | (163) | (178) |
| **Net Income** | **637** | **516** | **372** |
| **Cash Flow Statement** | | | |
| Free Cash Flows from Operations (FCFO) | 1,270 | 863 | 710 |
| Net Cash changes in Working Capital | (10) | 139 | (352) |
| Net Cash from Operating Activities | 1,072 | 835 | 184 |
| Net Cash from InvestingActivities | (3,500) | (156) | (54) |
| Net Cash from Financing Activities | 2,553 | (655) | (172) |
| Net Cash generated during the period | 125 | 24 | (42) |
| **Ratio Analysis** | | | |
| **Performance** | | | |
| Turnover Growth (v.s same period last year) | 39.0% | 25.9% | 20.2% |
| Gross Margin | 23.8% | 23.0% | 22.0% |
| Net Margin | 8.9% | 10.1% | 9.1% |
| ROE | 23.0% | 19.9% | 17.7% |
| **Coverages** | | | |
| Debt Service Coverage (times) (FCFO/Gross Interest+CMLTD+Uncovered STB) | 1.1 | 2.3 | 1.3 |
| Interest Coverage (times) (FCFO/Gross Interest) | 5.8 | 5.3 | 4.0 |
| Debt Payback (Total LT Debt Including Uncovered Total STBs) / (FCFO - Gross Interest | 3.5 | 0.7 | 1.6 |
| **Liquidity** | | | |
| Net Cash Cycle (Inventory Days + Receivable Days - Payable Days) | 28 | 54 | 62 |
| **Leveraging** (Total Debt/Total Debt+Equity) | 63.0% | 40.4% | 41.3% |

**Total Debt = Long-Term Debt + Short-Term Debt*

***** June-18 figures are based on Unaudited Accounts***

# Rating Scale

## Credit Rating Scale & Definitions

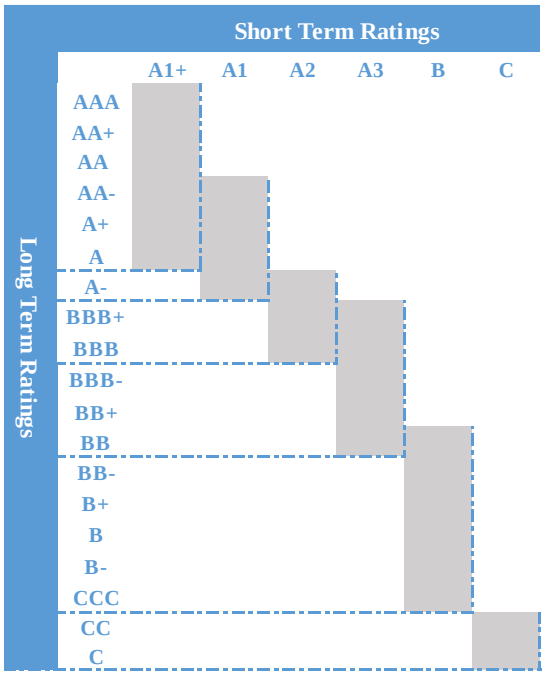
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

### Long Term Ratings

| | |
|---|---|
| AAA | **Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments |
| AA+<br>AA<br>AA- | **Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events. |
| A+<br>A<br>A- | **High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions. |
| BBB+<br>BBB<br>BBB- | **Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity. |
| BB+<br>BB<br>BB- | **Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met. |
| B+<br>B<br>B- | **High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment. |
| CCC<br>CC<br>C | **Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default. |
| D | Obligations are currently in default. |

### Short Term Ratings

| | |
|---|---|
| A1+ | The highest capacity for timely repayment. |
| A1 | A strong capacity for timely repayment. |
| A2 | A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions. |
| A3 | An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions. |
| B | The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. |
| C | An inadequate capacity to ensure timely repayment. |




**Outlook (Stable, Positive, Negative, Developing)** Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

**Rating Watch** Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

**Suspension** It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

**Withdrawn** A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

**Harmonization** A change in rating due to revision in applicable methodology or underlying scale.

**Rating Team Statements**
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

**Restrictions**
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

**Conduct of Business**
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

**Independence & Conflict of interest**
(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

**Monitoring and review**
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
**Probability of Default**
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)
**Proprietary Information**