



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
04-Mar-2019	A-	A2	Stable	Maintain	-
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 activities may bode well for business prospects of the company. Additionally, anti-dumping duties levied on imports from China are favorable for the domestic industry. The management is capitalizing on this growth opportunity through expansion. The company has completed third unit, adding to its existing capacity. Two other projects (unit 4 & 5) are also in the pipeline. Current financial profile reflects a transitional 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 hold debt mix and stabilize capital structure, with the support of incremental cashflows.

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

<b>Name of Rated Entity</b>	Master Tiles and Ceramic Industries Limited
<b>Type of Relationship</b>	Solicited
<b>Purpose of the Rating</b>	Entity Rating
<b>Applicable Criteria</b>	Methodology   Corporate Ratings(Jun-18),Methodology   Criteria   Rating Modifier(Jun-18),Methodology   Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
<b>Related Research</b>	Sector Study   Construction   Ceramic Tiles(Jun-18)
<b>Rating Analysts</b>	Muhammad Obaid   muhammad.obaid@pacra.com   +92-42-35869504

## Profile

**Legal Structure** Incorporated in 1992, Master Tiles & Ceramic Industries Limited (herein referred to as “the company” or “Master Tiles”) is a Public Unlisted Company under the Repealed Companies Ordinance, 1984 (now Companies Act, 2017).

**Background** Master Tiles emerged in early 1990s’ 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.

**Operations** The registered office of the company is located at Hufaiza Tufail building, Gujranwala, Pakistan whereas the vicinity of its manufacturing plants is also in Gujranwala. The company’s core business activity is the manufacture and sale of different kinds of ceramic, porcelain and granite tiles. The company was established with an initial production capacity of 1,600 square meters of tiles per day. At present, the company is operating with three manufacturing units located at a single site in Gujranwala. The current combined production capacity from the three units is approximately ~70,000 square meters of tiles per day. The third unit which added a capacity of ~24,000 square meters of tiles per day recently came on line in 2QFY19.

## Ownership

**Ownership Structure** 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%. 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.

**Stability** Ownership structure of Master tiles is simple with appropriate succession planning and clearly identifiable “man at the last mile” – Mr. Mehmood Iqbal. The structure is derived from the history of the group and has subsequently evolved in to its current form where the family now holds the entire shareholding.

**Business Acumen** 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.

**Financial Strength** The financial strength of Master tiles’ sponsors is considered good. The group started off with establishing the business of sanitary fittings and later diversified into various other sectors which included business of baby diapers, ballpoints, CPV films, Real Estate, Ceramic tiles and beverages and foods (see background section). All entities are run by brothers of the same family, which implies availability of inter-company financial support, if need arises.

## Governance

**Board Structure** 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.

**Members’ Profile** Mr. Mehmood Iqbal is the CEO and pioneer of the company who has played a significant role in the establishment of the overall group. The other board members, comprising his family, are however not directly involved in the routine business management and therefore, are expected to develop more acquaintance of the business, going forward.

**Board Effectiveness** The Governance framework of the company needs improvement in terms of the structure, role of the Board Committees and effectiveness of the Board meeting minutes.

**Financial Transparency** The External Auditors of the company are Ilyas Saeed & Company – Chartered Accountants, a QCR rated audit firm classified under Category-A by the State Bank of Pakistan under section 35(1) of Banking Companies Ordinance, 1962.

## Management

**Organizational Structure** Well-defined organization structure with clear lines of responsibilities exists. Strong focus on research & development with emphasis on innovation and efficiency.

**Management Team** 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.

**Effectiveness** 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.

**MIS** 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 the ongoing period.

**Control Environment** The Company has deployed separate Internal Audit Department to monitor efficiency and effectiveness of operations and report its findings and recommendations to the Board. Sub-committees of the board do not yet exist.

## Business Risk

**Industry Dynamics** The sector is a mix of organized and unorganized players. The ceramic tile industry is in consolidation phase where existing players are trying to capitalize on their existing facilities by upgrading and enhancing capacities to tap on the strong potential of growth.

**Relative Position** Master Tiles’ performance indicators surpassed other players’ business in terms of size and margins. Therefore, its relative position is considered strong. The Company has deployed a dedicated Research and Development team for exploration, extraction and refinement of clay for use as the major raw material.

**Revenues** During 1HFY19, company’s topline clocked in at PKR 4,228mln (FY19: PKR 7,127mln). Trend in the growth of turnover is escalating over the years and is expected to take further upsurge in FY19, as the company’s 3rd manufacturing facility has been brought into operations from Dec18.

**Margins** Improved gross margins backed on controlled cost of production (Dec18: 26% Jun18: 23%). This translated into fine operating margins (Dec18: 20% Jun18: 17%) as the company has well managed administrative and selling costs. Pre-tax return on equity also increased from 13.0% in Jun18 to 14.7% in Dec18. During 1HFY19, there was a significant increase in the finance cost, as the Company incurred PKR 168mln in just six months (FY18: 187mln).

**Sustainability** The sector offers surplus demand to be fed by the local producers. Factors that previously hindered the growth of this sector are gradually being mitigated to support local industry. These positive demand/supply prospects bode well for the sustainability of the company.

## Financial Risk

**Working Capital** Net working capital days have been reflecting volatile dips since FY16, backed on account of reduction in raw material days. (Average raw material days: 1HFY19: 19; FY18: 27). This also reflects inclination towards an aggressive working capital policy, coupled with extensive use of short-term borrowings (Dec18: PKR 2,170mln; Jun18: 1,616mln).

**Coverages** Free cash flows from operations were recorded at PKR~714mln (FY18: PKR~1200mln). On account of higher interest cost, interest coverage against FCFO deteriorated however still remaining highly comfortable (Dec18: 4.4x; Jun18: 6.4x). Capital expenditure of PKR 2,339mln during six months resulted in net cash out-flow of PKR 6mln.

**Capitalization** Engaged in expansion transition, the financial profile of the company represented a highly leveraged structure of ~60% at Dec18 (Jun18: ~60%). At Dec18, total equity of the company clocked in at PKR~3,506mln (Jun18: PKR~2,886mln), whereas total borrowings were recorded at PKR~5,189mln (Jun18: PKR~4,343mln). Current Debt-to-Total Debt ratio increased from 47% in Jun18 to 56% in Dec18.



**Master Tiles & Ceramic Industries Limited**

**BALANCE SHEET**

	31-Dec-18	30-Jun-18	30-Jun-17	30-Jun-16
	1HF19	FY18	FY17	FY16
	Unaudited	Audited	Audited	Audited
<b>Non-Current Assets</b>	<b>8,399</b>	<b>6,979</b>	<b>3,582</b>	<b>3,683</b>
<b>Investments (incl. Associates)</b>	-	-	19	53
Equity	-	-	-	-
Debt Securities (incl. income funds)	-	-	19	53
<b>Current Assets</b>	<b>2,926</b>	<b>2,362</b>	<b>2,195</b>	<b>1,854</b>
Inventory	517	349	686	622
Trade Receivables	1,135	780	539	514
Others	1,274	1,233	969	718
<b>Total Assets</b>	<b>11,325</b>	<b>9,341</b>	<b>5,796</b>	<b>5,590</b>
<b>Debt/Borrowings</b>	<b>5,190</b>	<b>4,344</b>	<b>1,745</b>	<b>1,840</b>
Short-Term	2,170	1,616	1,253	1,012
Long-Term (incl. Current Maturity of Long-Term Debt)	3,019	2,727	492	828
Other Short-Term Liabilities	1,916	1,438	935	655
Other Long-Term Liabilities	713	673	545	482
<b>Shareholder's Equity</b>	<b>3,506</b>	<b>2,886</b>	<b>2,570</b>	<b>2,614</b>
<b>Total Liabilities &amp; Equity</b>	<b>11,325</b>	<b>9,341</b>	<b>5,796</b>	<b>5,590</b>

**INCOME STATEMENT**

<b>Turnover</b>	<b>4,228</b>	<b>7,127</b>	<b>5,127</b>	<b>4,071</b>
Gross Profit	1,107	1,626	1,180	894
Other Income	(4)	(7)	10	30
Financial Charges	(168)	(187)	(163)	(178)
<b>Net Income</b>	<b>620</b>	<b>748</b>	<b>516</b>	<b>372</b>

**Cash Flow Statement**

Free Cash Flows from Operations (FCFO)	741	1,200	863	710
Net Cash changes in Working Capital	50	575	139	(352)
Net Cash from Operating Activities	646	1,618	835	184
Net Cash from Investing Activities	(1,540)	(3,838)	(156)	(54)
Net Cash from Financing Activities	888	2,352	(655)	(172)
Net Cash generated during the period	(6)	132	24	(42)

**Ratio Analysis**

<b>Performance</b>				
Turnover Growth (v.s same period last year)	118.6%	39.0%	25.9%	20.2%
Gross Margin	26.2%	22.8%	23.0%	22.0%
Net Margin	14.7%	10.5%	10.1%	9.1%
ROE	35.4% *	25.9%	19.9%	17.7%
<b>Coverages</b>				
Debt Service Coverage (times) (FCFO/Gross Interest+CMLTD+Uncovered STB)	0.7 *	0.9	2.3	1.3
Interest Coverage (times) (FCFO/Gross Interest)	4.4	6.4	5.3	4.0
Debt Payback (Total LT Debt Including Uncovered Total STBs) / (FCFO - Gross Interest)	3.6 *	3.4	0.7	1.6
<b>Liquidity</b>				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	24 *	27	54	62
<b>Leveraging</b> (Total Debt/Total Debt+Equity)	59.7%	60.1%	40.4%	41.3%

\*annualized

## 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		Short Term Ratings	
<b>AAA</b>	<b>Highest credit quality.</b> Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	<b>A1+</b>	The highest capacity for timely repayment.
<b>AA+</b> <b>AA</b> <b>AA-</b>	<b>Very high credit quality.</b> 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.	<b>A1</b>	A strong capacity for timely repayment.
<b>A+</b> <b>A</b> <b>A-</b>	<b>High credit quality.</b> 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.	<b>A2</b>	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
<b>BBB+</b> <b>BBB</b> <b>BBB-</b>	<b>Good credit quality.</b> 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.	<b>A3</b>	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
<b>BB+</b> <b>BB</b> <b>BB-</b>	<b>Moderate risk.</b> 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>B</b>	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
<b>B+</b> <b>B</b> <b>B-</b>	<b>High credit risk.</b> 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.	<b>C</b>	An inadequate capacity to ensure timely repayment.
<b>CCC</b> <b>CC</b> <b>C</b>	<b>Very high credit risk.</b> 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.		
<b>D</b>	Obligations are currently in default.		



**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 surveil the opinion due to lack of requisite information.

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

**Disclaimer:** PACRA's ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security's market price or suitability for a particular investor.

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(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

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- (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.
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- (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)
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- (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)

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