The Pakistan Credit Rating Agency Limited

Rating Report

Master Tiles and Ceramic Industries Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
28-Aug-2020	A-	A2	Stable	Maintain	-
30-Aug-2019	A-	A2	Stable	Maintain	-
04-Mar-2019	A-	A2	Stable	Maintain	-
03-Sep-2018	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings incorporate Master Tile's emergence as a brand, evident from prevalent market presence, extended production capacity and further ongoing expansion. Master Tiles possesses clear ownership structure, involvement of second generation in business is taking place. Family dominated governance framework, with lack of independent oversight or sub-committees exists, though. The company has established a strong position in its operating segment through suitable marketing strategies, 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. Before the COVID-19 outbreak, local demand for tiles witnessed an up surge on the backdrop of anti-dumping duties levied on imports from China and increased duties / tariffs on imported tiles which bodes well for business prospects of the entity. However, the recent yet ongoing COVID-19 pandemic has dampened the demand side due to the country wide lockdown and later on general slowdown in economic activity. The management anticipates to capitalize the growth opportunity through expansion once the situation gets to normalise. The company has successfully completed third unit, adding to its existing capacity, also reciprocating figuratively. Work on Unit 4 has already started and the entity is working on finalizing the financial structure and modalities of this mega expansion project. At present financial profile reflects a transitional stretch amidst expansion, which is expected to continue for a while, hence prudent management of the associated risks are critical for the ratings. Modalities for the funding of the project are being finalized (with a mix of debt and equity), which will be evaluated in the backdrop of the entity's credit profile.

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 leading to further 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-20),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-20)
Related Research	Sector Study | Construction(Mar-20)
Rating Analysts	Raniya Tanawar | raniya.tanawar@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 ~65,000 square meters of tiles per day.

Ownership

Ownership Structure The ownership of Master Tiles belongs to Mr. Mahmood Iqbal and his family. Mr. Mahmood Iqbal holds ~84% stake in Master Tiles while his wife :~3%, three sons :~4% each and one daughter :~1%.

Stability Ownership structure of Master Tiles is simple with appropriate succession planning and clearly identifiable "man at the last mile" – Mr. Mahmood 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. Mahmood 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 includes Mr. Mahmood Iqbal (the CEO) and his family members with no independent director or sub-committees.

Members' Profile Mr. Mahmood 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 CategoryA 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 Currently in-house developed software known as "Master MIS" is being operated parallel with SAP installed by Siemens which went live on April 1st, 2019.

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.

Business Risk

Industry Dynamics Ceramic tiles industry emerged in Pakistan in 1978. It has an immense potential for growth and is substantially driven by developments in construction sector of the country. The sector is a mix of organised and unorganised players. The ceramic tile industry is in consolidation phase where existing players are trying to capitalise on their existing facilities by upgrading and enhancing capacities to tap on the strong potential of growth. Lately, more than ~50% of annual demand was being catered through imports, particularly coming from China, Iran and Afghanistan under both green and grey channels. This snag is however now controlled through appropriate initiatives taken by the government to foster the ceramic tiles sector. One of the major initiative includes imposition of provisional anti-dumping duties on imported tiles from specific Chinese vendors alongside increase in regulatory duty on Imports of tiles in general. Eventually increasing the demand for local made tiles.

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 Despite the challenges caused by COVID-19 outbreak, Master Tile's revenue reflected a positive growth of ~25% during FY20 as compared to ~40% in FY19. The company's topline clocked in at PKR 12bln (FY19: PKR 10bln, FY18: PKR 7bln). Trend in the growth of turnover is escalating over the years and is expected to take further upsurge as soon as the COVID-19 is in control. The company's 3rd manufacturing facility has been brought into operations from Dec'18 as well to cater the demand.

Margins Gross margin decreased merely by 2.5% due to couple of challenges including high inflation, mainly increase in cost of fuel, along with an addition of COVID-19 pandemic in the period under review and stood at FY20: ~20%(FY19: ~22%). The company aptly manages its operating expenses therefore operating margins (FY20: 14.6%, FY19: 15.3%). merely declined by a small margin (~1%). There was a significant increase of 2.5 times in the finance cost during FY20 as compared to same period of last year, on account of hike in interest rates by SBP, increase in borrowings to finance the working capital and capital expenditure purpose. As a result, net margin was recorded at ~6.5% during FY20 as compared to ~8% in FY19.

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 Working capital structure of the company mainly comprises inventory holding and receivables, managed through both internally generated cash and short term borrowings. During FY20, receivable days witnessed an increase on account of country wide lockdown driven by COVID-19 pandemic, gross working capital has increased to 84 days from 66 days in FY19. To finance the increased working capital needs, short term borrowings observed an upward trend over the course of time: FY20: PKR 3.7bln, FY19: PKR 3bln, FY18: PKR 1.6bln.

Coverages During FY20, increase in turnover supported the increase in free cash flows from operations (FCFO) of the company, which recorded at PKR~1.9bln (FY19: PKR~1.5bln). On account of higher interest cost, interest coverage against FCFO deteriorated although still remains comfortable (FY20: 2.6x; FY19: 3.4x).

Capitalization Engaged in expansion transition, the financial profile of the company represents a leveraged structure. During FY20, total equity of the company clocked in at PKR~4.5bln (FY19: PKR~3.7bln), whereas total borrowings heaved to PKR~13bln (FY19: PKR~6bln). Consequently, Current Debt-to-Total Debt plus Equity ratio inched up from 63% in FY19 to 75% in FY'20 on back of Increase of PKR 7bln in long term borrowings in the period under review.

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Financial Summary
PKR mln

Master Tiles & Ceramic Industries Limited Construction	Jun-20 12M	Jun-19 12M	Jun-18 12M
A BALANCE SHEET			
1 Non-Current Assets	15,954	8,859	6,979
2 Investments	-	-	-
3 Related Party Exposure	-	-	-
4 Current Assets	6,008	4,260	2,362
a Inventories	*1,029*	*1,004*	*349*
b Trade Receivables	*2,202*	*1,510*	*780*
5 Total Assets	21,962	13,118	9,341
6 Current Liabilities	3,087	2,085	1,438
a Trade Payables	*1,625*	*1,112*	*783*
7 Borrowings	13,214	6,219	4,344
8 Related Party Exposure	-	-	-
9 Non-Current Liabilities	1,168	1,131	673
10 Net Assets	4,493	3,683	2,886
11 Shareholders' Equity	4,493	3,683	2,886
B INCOME STATEMENT			
1 Sales	12,468	10,010	7,127
a Cost of Good Sold	*(10,026)*	*(7,794)*	*(5,501)*
2 Gross Profit	2,442	2,216	1,626
a Operating Expenses	(618)	(683)	(437)
3 Operating Profit	1,824	1,533	1,189
a Non Operating Income or (Expense)	*(59)*	*(75)*	*(75)*
4 Profit or (Loss) before Interest and Tax	1,765	1,458	1,113
a Total Finance Cost	*(790)*	*(475)*	*(187)*
b Taxation	*(166)*	*(185)*	*(178)*
6 Net Income Or (Loss)	809	798	748
C CASH FLOW STATEMENT			
a Free Cash Flows from Operations (FCFO)	*1,939*	*1,484*	*1,200*
b Net Cash from Operating Activities before Working Capital Changes	*1,396*	*1,099*	*1,043*
c Changes in Working Capital	*(768)*	*(941)*	*560*
1 Net Cash provided by Operating Activities	628	158	1,603
2 Net Cash (Used in) or Available From Investing Activities	(7,522)	(2,211)	(3,838)
3 Net Cash (Used in) or Available From Financing Activities	7,035	1,975	2,352
4 Net Cash generated or (Used) during the period	141	(78)	117
D RATIO ANALYSIS			
1 Performance			
a Sales Growth (for the period)	24.6%	40.4%	39.0%
b Gross Profit Margin	19.6%	22.1%	22.8%
c Net Profit Margin	6.5%	8.0%	10.5%
d Cash Conversion Efficiency (EBITDA/Sales)	17.6%	18.0%	18.5%
e Return on Equity (ROE)	19.8%	24.3%	27.4%
2 Working Capital Management			
a Gross Working Capital (Average Days)	84	66	60
b Net Working Capital (Average Days)	44	32	27
c Current Ratio (Total Current Assets/Total Current Liabilities)	1.9	2.0	1.6
3 Coverages			
a EBITDA / Finance Cost	3.0	4.1	8.7
b FCFO / Finance Cost+CMLTB+Excess STB	0.7	0.6	1.0
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	8.6	3.9	3.3
4 Capital Structure (Total Debt/Total Debt+Equity)			
a Total Borrowings / Total Borrowings+Equity	74.6%	62.8%	60.1%
b Interest or Markup Payable (Days)	194.6	122.3	134.0
c Average Borrowing Rate	7.6%	8.2%	5.0%

Credit Rating

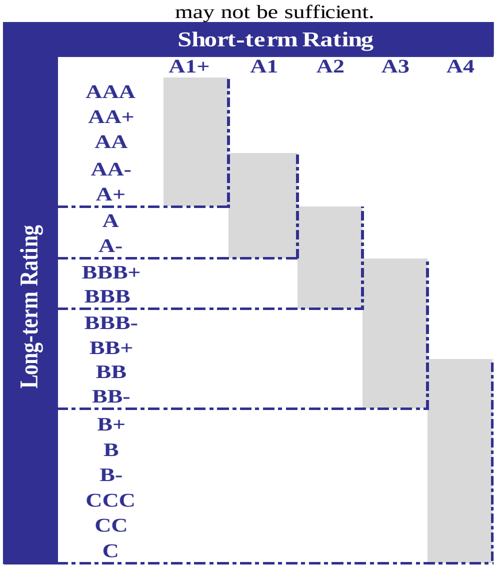
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA 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+ A 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+ BBB 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+ BB 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+ B 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 CC 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 Rating

Scale	Definition
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
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

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 some material identifiable event with indeterminable rating implications. 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 rating 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) 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.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

Entities
a) Broker Entity Rating
b) Corporate Rating
c) Financial Institution Rating
d) Holding Company Rating
e) Independent Power Producer Rating
f) Microfinance Institution Rating
g) Non-Banking Finance Companies (NBFCs) Rating

Instruments
a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

Regulatory and Supplementary Disclosure

(Credit Rating Companies Regulations,2016)

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