

CREDIT RATING ANNOUNCEMENT

GCR affirms KAP Industrial Holdings Limited's rating of A_(ZA); Outlook Stable.

Johannesburg, 25 Oct 2016 -- Global Credit Ratings has today affirmed the national scale Issuer ratings assigned to KAP Industrial Holdings Limited of A_(ZA) and A1_(ZA) in the long and short term respectively; with the outlook accorded as Stable.

SUMMARY RATING RATIONALE

Global Credit Ratings ("GCR") has accorded the above credit ratings to KAP Industrial Holdings Limited ("KAP") based on the following key criteria:

The R4.1bn agreement to purchase Safripol, and other recent bolt-on acquisitions, substantially enhance the group's scale and unlock further synergies amongst its core businesses. Safripol's strong market position and extensive infrastructure in particular, bring further depth and vertical integration to the Diversified Industrial segment, and are positively viewed.

Significant progress has been made in realigning KAP's pre-existing operations, including the disposal of marginal assets, sizeable investment in modern infrastructure, and the structural reorganisation of business clusters. The changes continue to enhance operating efficiencies, have produced sustainable cost savings, and have materially increased the competitiveness of KAP's products in a challenging operating environment.

The ratings still take cognisance of the Steinhoff affiliation, which gives access to robust support services and other structures, for which the group pays market rates. KAP also inherited strong leadership that continues to steer profitability. That said, it has made major strides since F12, securing, amongst other changes, funding flexibility *via* a DMTN programme and R5.7bn in standalone bank facilities with a number of highly rated financial institutions.

Although revenue was robust, at R16.2bn, YoY growth slowed due to weaker demand amidst rising competitive pressures in Diversified Logistics, which partly offset capacity-driven traction in Diversified Industrial. Both segments have sustained strong EBIT margins (12.7% and 11.6% respectively), which translated to a 19% increase in operating profit to R1.9bn. Overall growth will continue to be curtailed by the sluggish economy, with operations facing pressure from waning local demand. Regional operations are also sensitive to pressure on economic growth emanating from the drought and subdued commodity prices (*inter alia*). GCR does, however, take cognisance of KAP's exposure to both cyclical and defensive sectors, which provides insulation through the cycle.

KAP has settled all of the outstanding Steinhoff loans and interest, and as such, 45% of its debt relates to facility drawdowns, and the balance to listed and unlisted notes. A net R1.2bn raised in F16 brought total debt to R4.7bn, from a low of R3.5bn at FYE15. Nonetheless, credit protection metrics remain sound, with net gearing and net debt to EBITDA improving to 31% and 76% respectively (FYE15: 33%; 88%). While financing for the Safripol transaction cannot be disclosed presently, net gearing is expected to remain within management's conservative targets.

Cash generation remained robust, and was further enhanced by a strong release from creditors in F16. Accordingly, operating cash flow advanced to a new high of R2.7bn, covering gross debt by 58% (FYE15: 52%). Net interest cover rose to 6.2x (F15: 5.6x), while EBITDA interest cover went up to 8.9x, well above the 4.5x covenant baseline. Liquidity is enhanced by R2.6bn in unutilised bank facilities, while the debt maturity profile reflects no concentration in the next 18 months.

The bedding down of the Safripol transaction, coupled with continued resilience of the legacy businesses, would secure quality cash flows despite the challenging operating conditions, and would be positively viewed. Conversely, unduly elevated debt, or gearing materially above target due to aggressively funded investing activities, Safripol in particular; could result in negative rating action. Material underperformance of any of the key subsidiaries would also be negatively viewed.

NATIONAL SCALE RATINGS HISTORY

Initial rating (April 2014)
Long term: A-(ZA); Short term: A2(ZA)
Outlook: Stable

Last rating (November 2015)
Long term: A(ZA); Short term: A1(ZA)
Outlook: Stable

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APPLICABLE METHODOLOGIES AND RELATED RESEARCH

Criteria for rating corporate entities, updated February 2016
KAP Industrial Holdings Limited Rating Reports, 2014 - 2015

GLOSSARY OF TERMS/ACRONYMS USED IN THIS DOCUMENT AS PER GCR'S CORPORATE GLOSSARY

Balance Sheet	A statement of a company's assets and liabilities provided for the benefit of shareholders and regulators. It gives a snapshot at a specific point in time of the assets the company holds and how they have been financed.
Budget	Financial plan that serves as an estimate of future cost, revenues or both.
Cash Flow	The inflow and outflow of cash and cash equivalents. Such flows arise from operating, investing and financing activities.
Corporate Governance	Corporate governance broadly refers to the mechanisms, processes and relations by which corporations are controlled and directed, and is used to ensure the effectiveness, accountability and transparency of an entity to its stakeholders.
Credit Rating	An opinion regarding the creditworthiness of an entity, a security or financial instrument, or an issuer of securities or financial instruments, using an established and defined ranking system of rating categories.
Credit Risk	The possibility that a bond issuer or any other borrowers (including debtors/creditors) will default and fail to pay the principal and interest when due.
Debt	An obligation to repay a sum of money. More specifically, it is funds passed from a creditor to a debtor in exchange for interest and a commitment to repay the principal in full on a specified date or over a specified period.
Default	Failure to meet the payment obligation of either interest or principal on a debt or bond. Technically, a borrower does not default, the initiative comes from the lender who declares that the borrower is in default.
EBITDA	EBITDA is useful for comparing the income of companies with different asset structures. EBITDA is usually closely aligned to cash generated by operations.
Exposure	Exposure is the amount of risk the holder of an asset or security is faced with as a consequence of holding the security or asset. For a company, its exposure may relate to a particular product class or customer grouping. Exposure may also arise from an overreliance on one source of funding.
Fixed Capital	Fixed capital is the part of a company's total capital that is invested in fixed assets such as land, buildings and equipment that remains on the balance sheet, usually for years, but for at least one accounting period.
Gearing	With regard to corporate analysis, gearing (or leverage) refers to the extent to which a company is funded by debt and can be calculated by dividing its debt by shareholders' funds or by EBITDA.
Interest	Scheduled payments made to a creditor in return for the use of borrowed money. The size of the payments will be determined by the interest rate, the amount borrowed or principal and the duration of the loan.
Interest Cover	Interest cover is a measure of a company's interest payments relative to its profits. It is calculated by dividing a company's operating profit by its interest payments for a given period.
Interest Rate	The charge or the return on an asset or debt expressed as a percentage of the price or size of the asset or debt. It is usually expressed on an annual basis.
Margin	A term whose meaning depends on the context. In the widest sense, it means the difference between two values.



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Maturity	The length of time between the issue of a bond or other security and the date on which it becomes payable in full.
National Scale Rating	The national scale provides a relative measure of creditworthiness for rated entities only within the country concerned. Under this rating scale, a 'AAA' long term national scale rating will typically be assigned to the lowest relative risk within that country, which in most cases will be the sovereign state.
Operating Cash Flow	A company's net cash position over a given period, i.e. money received from customers minus payments to suppliers and staff, administration expenses, interest payments and taxes.
Operating Profit	Profits from a company's ordinary revenue-producing activities, calculated before taxes and interest costs.
Risk	The possibility that an investment or venture will make a loss or not make the returns expected. There are many different types of risk including basis risk, country risk, credit risk, currency risk, economic risk, inflation risk, liquidity risk, market or systemic risk, political risk, settlement risk and translation risk.
Shareholder	An individual, entity or financial institution that holds shares or stock in an organisation or company.

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KAP Industrial Holdings Limited participated in the rating process via face-to-face management meetings, teleconferences and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible.

The credit ratings have been disclosed to KAP Industrial Holdings Limited with no contestation of the ratings.

The information received from KAP Industrial Holdings Limited and other reliable third parties to accord the credit ratings include:

- 2016 audited annual financial statements (plus four years of comparative numbers);
- Revised group budgets/financial forecasts for the years 2017 to 2019;
- Corporate governance and enterprise risk framework;
- Information relating to affiliated listed entities; and
- A breakdown of banking facilities available and related counterparties at 30 June 2016.

The ratings above were solicited by, or on behalf of, the rated client, and therefore, GCR has been compensated for the provision of the ratings.

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