

CREDIT RATING ANNOUNCEMENT

GCR accords an initial rating of A-(ZA) to KAP Industrial Holdings Limited; Outlook Stable.

Johannesburg, 23 Apr 2014 -- Global Credit Ratings has today accorded initial national scale ratings to KAP Industrial Holdings Limited of A-(ZA) and A2(ZA) in the long term and short term respectively; with the outlook accorded as Stable.

RATING RATIONALE

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

KAP Industrial Holdings Limited ("KAP"), in its current guise, resulted from the reverse acquisition of parent Steinhoff International Holdings Limited's ("Steinhoff") industrial assets in April 2012. This saw marked scale enhancement and precipitated an operational overhaul, driving a change in scope towards a streamlined group with more efficient internal structures. Although the group structure is relatively new and has certain anomalies deriving from the recent transaction, the underlying businesses have a proven track record of sustained earnings growth, with Unitrans accounting for 58% of KAP's operating income in F13 and PG Bison a further 29% (1H F14: 55% and 24% respectively). KAP has therefore emerged as a diversified group, including specialised logistics solutions, as well as the manufacture of timber and an array of industrial products. Its key competitive advantage has been to entrench itself within the industries it operates through integrating into the operations of its customer base or controlling the value chain.

The group has reflected sound organic growth since the Steinhoff transaction, with stable top line performance over the medium term expected to derive from enhanced capacity. While margin pressure continues to derive from increased competition from imports as well as the impact of rising fuel prices and other input costs, ongoing restructuring is expected to enhance the price competitiveness of the group's offering.

As part of the aforementioned transaction, KAP secured loans from Steinhoff on an arm's length basis and at market rates, which constituted the majority of its debt at FYE12 (R3.6bn out of R4.9bn). Borrowings registered at R4.7bn at 1H F14 (FYE13: R4.4bn), translating to net gearing of 66% (FYE13: 62%) and net debt to EBITDA of 155% (FYE13: 160%). With capex to be largely funded from internal cash flows, debt is not expected to increase materially over the medium term, and is well within the Steinhoff group's comfort levels. While management has decided to fund KAP's operations more autonomously going forward, Steinhoff has issued guarantees of around R5.8bn (with respect to its subsidiary's liabilities and standing facilities), a large proportion of which will remain in place in the medium term. It is deemed unlikely in this regard that Steinhoff would enforce its rights should covenants on loans extended to KAP be breached.

Cash generation has been robust, supported by sound earnings. Debt serviceability has also been adequate, with net interest cover registering at 4.1x in 1H F14 (F13: 3.2x; 1H F13: 3.5x). Recourse to overdrafts to fund maturing obligations has, however, increased liquidity pressure. Management has advised GCR that the process of refinancing facilities is well advanced, and is expected to be finalised by FYE14.

Operations remain susceptible to external shocks originating from the sluggish domestic economy, particularly rising inflationary pressures, labour related disruptions and adverse interest rate movements. Note in this regard is taken of the group's focus on higher margin regional markets and the balanced exposure to both cyclical and countercyclical sectors.

Upward rating pressure over the medium term would derive from the successful bedding down of additional capacity and overhauled structures, ensuring sustainable growth despite the challenging operating environment. The timely securing of new facilities will also be required to sustain the current ratings. A material elevation in debt and gearing metrics owing to aggressive acquisitive growth, or the significant underperformance of KAP's subsidiaries relative to budget, would, however, place downward pressure on the rating. The downward migration of Steinhoff's rating could also warrant a downward review.

NATIONAL SCALE RATINGS HISTORY

Initial rating (04/2014)
Long term: A_(ZA); Short term: A2_(ZA)
Outlook: Stable

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APPLICABLE METHODOLOGIES AND RELATED RESEARCH

GCR's Criteria for Rating Corporate Entities, Updated August 2013

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GCR affirms that a.) no part of the rating was influenced by any other business activities of the credit rating agency; b.) the rating was based solely on the merits of the rated entity, security or financial instrument being rated; c.) such rating was an independent evaluation of the risks and merits of the rated entity, security or financial instrument; and d.) the validity of the rating is for a maximum of 12 months, or earlier as indicated by the applicable credit rating document.

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 rating/s has been disclosed to and contested by KAP Industrial Holdings Limited and was amended following the provision of further material information by the entity.

The information received from KAP Industrial Holdings Limited and other reliable third parties to accord the credit rating included the 2013 audited annual financial statements (plus four years of comparative numbers), financial forecasts for the years 2014 to 2016, unaudited financial statements for the six months to December 2013, corporate governance and enterprise risk framework, industry comparative data and regulatory framework and a breakdown of facilities available and related counterparties. In addition, information specific to the rated entity and/or industry was also received.

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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