

## CREDIT RATING ANNOUNCEMENT

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

Johannesburg, 27 May 2015 -- Global Credit Ratings has today affirmed the national scale, long term rating assigned to KAP Industrial Holdings Limited of A-(ZA), and upgraded the national scale, short term rating to A1-(ZA); with the outlook accorded as Stable.

#### SUMMARY RATING RATIONALE

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

KAP is underpinned by businesses acquired from Steinhoff International Holdings Limited ("Steinhoff"), whose operations largely consist of branded logistics solutions and the manufacture of timber-based products, chemicals, automotive products, and bedding components. As such, while the group structure in its current guise has a fairly short track record, its operations are anchored by well-established entities that generate sound earnings, leveraging off a strategy to maintain a significant market share by integrating its businesses into the operations of its customer base or by controlling the value chain. Although KAP is now a Steinhoff associate following a reduction in the latter's shareholding, it remains closely linked to its former parent, utilising its legal, corporate services and other structures. In this regard, and given the retention of former Steinhoff executives in the group and board representation, the linkage is considered in support of the ratings.

Top line growth registered at 9% in F14, which saw turnover rise to R14.8bn (1H F15: 9% YoY). With cognisance taken of the sale of ancillary entities, this matched the organic growth achieved in F13. KAP's core businesses continue to reflect steady operating margins (which registered at a stable 9.3% in F14 and 1H F15), supporting sound cash flows. Despite rising pressure from import costs, Rand fuel prices and high utility expenses, structural refinements are expected to support stable medium term margins.

KAP has secured R5.4bn in facilities and issued R1bn in bonds under its DMTN programme, a portion of which was used to repay R3.2bn in outstanding Steinhoff loans related to the reverse acquisition. Debt has remained below the review period high reported at FYE12 of R4.9bn, registering at R4bn at FYE14 (1H F15: R4.6bn). This translated to lower than projected net gearing and net debt to EBITDA of 48% and 127% respectively (1H F15: 57%; 145%). With future capex to be mainly funded from internal cash flows, the metrics are expected to moderate further in the medium term. Although cash generation has been robust, a working capital absorption saw an 18% decline in F14 operating cash flows. As expected, an interim working capital absorption impacted operating cash flows in 1H F15 (with a 12% YoY decrease attributed to higher stocks and debtors due to increased activity and seasonality), albeit that normalisation is expected for the full year. Debt serviceability is sound, with net interest cover registering at 4.5x in 1H F15 (F14: 4.2x), while credit lines amounting to R1.3bn remain unutilised.

The effects of the weak domestic economy will continue to impact operations, given that the bulk of KAP's businesses are domiciled in South Africa. Note is nonetheless taken of the burgeoning regional footprint and balanced exposure to both cyclical and defensive sectors.

Upward rating migration could result from the continued bedding down of new capacity and operational structures, which coupled with proven ability to sustain the growing regional presence, should ensure sound earnings growth despite the challenging operating environment. However, a material elevation in debt and gearing metrics (even to fund strategic acquisitions), and/or the significant underperformance of KAP's core subsidiaries against budget, would place downward pressure on the ratings.

## NATIONAL SCALE RATINGS HISTORY

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

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## APPLICABLE METHODOLOGIES AND RELATED RESEARCH

Criteria for Rating Corporate Entities, February 2015  
KAP Industrial Holdings Limited credit rating report, 2014

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

Bond	A long term debt instrument issued by either a company, institution or the government to raise funds.
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 Rating Agency	An entity that provides credit rating services.
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.
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.
Leverage	With regard to corporate analysis, leverage (or gearing) refers to the extent to which a company is funded by debt.
Liquidity	The speed at which assets can be converted to cash. It can also refer to the ability of a company to service its debt obligations due to the presence of liquid assets such as cash and its equivalents. Market liquidity refers to the ease with which a security can be bought or sold quickly and in large volumes without substantially affecting the market price.
Liquidity Risk	The risk that a company may not be able to meet its financial obligations or other operational cash requirements due to an inability to timeously realise cash from its assets. Regarding securities, the risk that a financial instrument cannot be traded at its market price due to the size, structure or efficiency of the market.
Long term rating	A long term rating reflects an issuer's ability to meet its financial obligations over the following three to five year period, including interest payments and debt redemptions. This encompasses an evaluation of the organisation's current financial position, as well as how the position may change in the future with regard to meeting longer term financial obligations.
Margin	A term whose meaning depends on the context. In the widest sense, it means the difference between two values.
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 Margin	Operating margin is operating profit expressed as a percentage of a company's sales over a given period.
Operating Profit	Profits from a company's ordinary revenue-producing activities, calculated before taxes and interest costs.
Principal	The total amount borrowed or lent, e.g. the face value of a bond, excluding interest.
Redemption	The repurchase of a bond at maturity by the issuer.
REPO	In a REPO one party sells assets or securities to another and agrees to repurchase them later at a set price on a specified date.
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.
Short term rating	A short term rating is an opinion of an issuer's ability to meet all financial obligations over the upcoming 12 month period, including interest payments and debt redemptions.
Turnover	The total value of goods or services sold by a company in a given period. Also known as revenue or sales. Turnover can also refer to the total volume of trades in a market during a given period.

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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 rating/s has been disclosed to KAP Industrial Holdings Limited with no contestation of the rating.

Information received from KAP Industrial Holdings Limited and other reliable third parties to accord the rating(s) includes:

- 2014 audited annual financial statements (plus four years of comparative numbers);
- Group budgets/financial forecasts for the years 2015 to 2018;
- Unaudited financial statements for the six months to December 2014;
- Corporate governance and enterprise risk framework;
- Industry comparative data and regulatory framework;
- Information relating to affiliated listed entities and
- A breakdown of facilities available and related counterparties.

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