

**CREDIT RATING ANNOUNCEMENT****GCR upgrades KAP Industrial Holdings Limited's rating to A+(ZA); Outlook Stable**

Johannesburg, 30 Oct 2017 -- Global Credit Ratings has today upgraded the long term national scale Issuer rating assigned to KAP Industrial Holdings Limited to A+(ZA), and affirmed the short term national scale Issuer rating of A1(ZA). A stable rating outlook has been accorded to the ratings.

**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 ratings take cognisance of the group's strong execution through the cycle, underpinned by well-entrenched businesses with leading market positions, integration along the respective product value chains, as well as continual investment in modern technology. The R3.9bn Safripol acquisition has materially enhanced KAP's scale and product reach, while enabling the group to achieve critical mass across three distinct operating divisions.

The streamlining and repositioning of pre-existing operations is largely complete, barring the second phase of the new integrated bedding facility and the disposal of the last of KAP's non-core assets. Coupled with the natural hedge provided by Dollar-margin businesses, these initiatives are expected to support competitively priced offerings and relative margin resilience in the medium term.

Revenue increased by 23% YoY to R19.8bn in FY17, on the back of momentum from acquisitions. While organic growth has been somewhat restrained in certain business lines, acquisitions and capacity enhancement have supported compound annual growth in revenue of c.10% over the five years under review. The normalised EBIT margin has progressively risen to a new high of 12.8% (FY16: 12.1%), translating to compound annual growth in operating profit of c.20% over the same period.

The Steinhoff relationship remains a ratings consideration, in view of the access KAP has to support services and other structures (albeit at arm's length), as well as support provided for the recent equity raise and oversight evidenced by strong board representation. While the affiliation is deemed to be strategically important, note is taken of the funding independently secured by KAP, with extensive facilities from strongly rated financial institutions, as well as a R5bn DMTN programme (albeit limited headroom remains available on the latter).

Debt increased materially to R7.8bn at FY17 (FY16: R4.7bn), albeit in line with expectations, in view of the c.60:40 debt to equity guidance provided on the Safripol transaction. Accordingly, stressed net gearing rose to 97%, while net debt to EBITDA increased to 173% (FY16: 31% and 76% respectively), with note taken of the earnings drag arising from the acquisition. Gearing is expected to be rigorously managed within KAP's comfort levels, with notes and bank facilities to be paid down from internal cash reserves as they mature.

Cash generation remains robust, supporting sound liquidity metrics. EBITDA cover of interest moderated to 6.5x (FY16: 9x), and is expected to trend comfortably above the 4.5x covenant in the medium term, while free cash flow cover of debt service remains sound. Other liquidity considerations include ample untapped bank facilities and a well-spaced debt maturity profile.

The group remains exposed to an increasingly complex empowerment environment, which could curtail volume growth within its logistics business in particular, as well as the effect of protracted weakness in consumer spending on the downstream demand for products whose inputs are produced by the chemical and industrial divisions.

In view of the upgrade, there is limited scope for an upgrade over the rating horizon. Over the medium term, continued margin resilience, supporting strong free cash flows and debt service ratios despite challenging operating conditions would be positively considered. Conversely, elevated gearing metrics outside of management guidance, or failure to adhere to the planned redemption of debt, could warrant rating action. Material underperformance of any of the key subsidiaries would also be negatively viewed.



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## NATIONAL SCALE RATINGS HISTORY

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

Last rating (October 2016)  
Long term: A(ZA); Short term: A1(ZA)  
Outlook: Stable

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## APPLICABLE METHODOLOGIES AND RELATED RESEARCH

Global master criteria for rating corporate entities, updated February 2017  
KAP Industrial Holdings Limited Rating Reports, 2014-16

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

Cash Flow	The inflow and outflow of cash and cash equivalents. Such flows arise from operating, investing and financing activities.
Covenant	A provision that is indicative of performance. Covenants are either positive or negative. Positive covenants are activities that the borrower commits to, typically in its normal course of business. Negative covenants are certain limits and restrictions on the borrowers' activities.
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.
Downstream	Downstream refers to the processing of raw materials into a product required by end users and consumers.
Equity	Equity is the holding or stake that shareholders have in a company. Equity capital is raised by the issue of new shares or by retaining profit.
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.
Hedge	A form of insurance against financial loss or other adverse circumstances.
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.
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.
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.
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 Profit	Profits from a company's ordinary revenue-producing activities, calculated before taxes and interest costs.
Rating Outlook	A Rating outlook indicates the potential direction of a rated entity's rating over the medium term, typically one to two years. An outlook may be defined as: 'Stable' (nothing to suggest that the rating will change), 'Positive' (the rating symbol may be raised), 'Negative' (the rating symbol may be lowered) or 'Evolving' (the rating symbol may be raised or lowered).
Redemption	The repurchase of a bond at maturity by the issuer.
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.



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## SALIENT FEATURES OF ACCORDED RATINGS

GCR affirms that a.) no part of the rating process was influenced by any other business activities of the credit rating agency; b.) the ratings were based solely on the merits of the rated entity, security or financial instrument being rated; c.) such ratings were an independent evaluation of the risks and merits of the rated entity, security or financial instrument; and d.) the validity of the ratings 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 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:

- 2017 audited annual financial statements (plus four years of audited comparative numbers);
- revised group budgets/financial forecasts for the years 2018 to 2019 fiscal years;
- corporate governance and enterprise risk framework;
- information relating to affiliated listed entities; and
- industry related data.

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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