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CREDIT RATING ANNOUNCEMENT

GCR affirms KAP Industrial Holdings Limited's rating of A^{+(ZA)}; Outlook Stable

Johannesburg, 15 November 2018 -- 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 has accorded the above credit ratings to KAP Industrial Holdings Limited ("KAP") based on the following key criteria:

The ratings incorporate the group's broad product diversification and leading market positions in most of its key business lines, supported by either high barriers to entry or a competitive edge through vertical integration. KAP has also demonstrated a track record of making bolt-on acquisitions and smoothly integrating the acquired businesses in the past few years, which together with expanding existing operations has enhanced its business risk profile.

Such diversity and market positions have enabled the group to largely protect its profit margins despite the current economic weakness. KAP posted strong FY18 results with revenue growth of 16% and a sustained high EBITDA margin of 17%. The current positive momentum, particularly in the chemical division, is expected to continue to translate into earnings growth, with the group well positioned when certain end-markets pick up. Nevertheless, exposure to geographical concentration risk, fluctuations of foreign exchange rates and commodity prices and cyclical demand in a number of its segments do restrain the assessment.

The ratings also factor in management's conservative financial policies, supported by a robust balance sheet with moderately low leverage and high financial flexibility. KAP's net debt/EBITDA ratio improved to 147% (FY17: 173%), while free cash flow/net debt coverage rose to 25% (FY17: 15%). Although EBITDA coverage of interest moderated to 5.5x, it remains sound. GCR expects gearing metrics will continue to steadily improve from the highs reached at FY17 on account of acquisitions and capex enhancements, given management's commitment pay down maturing obligations from robust internal cash reserves.

KAP's strong liquidity profile is underpinned by available facilities of R2.5bn, with sufficient covenant headroom, robust cash generation and cash balances of R2.2bn to meet near term obligations and capex. Liquidity is also enhanced by strong relationships with a number of banks and financial institutions and good access to credit markets through the R10bn DMTN programme.

A ratings upgrade could be considered if gearing and debt serviceability metrics show a sustained improvement and would also require that KAP maintain strong liquidity. Negative rating action could be triggered by a significant deterioration in KAP's credit metrics due to a weaker operating performance or aggressive debt-financed M&A activity. Adverse regulatory/other geopolitical pressures impacting the earnings profile would also be negatively considered.

NATIONAL SCALE RATINGS HISTORY

Initial Rating (April 2014)

Long term: A^{-(ZA)}

Short term: A2^(ZA)

Outlook: Stable

Last Rating (October 2017)

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 2018
 KAP Industrial Holdings Limited Issuer rating reports, 2014-17

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

Balance Sheet	Also known as Statement of Financial Position. 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.
Cash Flow	The inflow and outflow of cash and cash equivalents. Such flows arise from operating, investing and financing activities.
Commodity	Raw materials used in manufacturing industries or in the production of foodstuffs. These include metals, oil, grains and cereals, soft commodities such as sugar, cocoa, coffee and tea, as well as vegetable oils.
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.
Diversification	Spreading risk by constructing a portfolio that contains different investments, whose returns are relatively uncorrelated. The term also refers to companies which move into markets or products that bear little relation to ones they already operate in.
Exchange Rate	The value of one country's currency expressed in terms of another.
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.
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.
Operating Margin	Operating margin is operating profit expressed as a percentage of a company's sales over a given period.



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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.
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.

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 as well as 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.

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

- 2018 audited annual financial statements (plus four years of comparative numbers);
- investor presentations;
- group budgets/financial forecasts for FY19 and FY20;
- available debt facilities and related counterparties at FY18.

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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