GCR RATINGS

**CREDIT RATING ANNOUNCEMENT**

# GCR affirms KAP Limited's (formerly KAP Industrial Holdings Limited) national scale issuer rating at A+(ZA)/A1(ZA) with a Negative Outlook on the back of earnings pressures.

## Rating action

Johannesburg, 28 November 2023 – GCR Ratings (GCR) has affirmed KAP Limited's long and short-term Issuer ratings at A+(ZA) and A1(ZA). The Outlook has been revised to Negative, from Stable.

| Rated entity | Rating class | Rating scale | Rating | Outlook/Watch |
|---|---|---|---|---|
| KAP Limited | Long Term Issuer | National | A+(ZA) | Negative |
| | Short Term Issuer | National | A1(ZA) | |

## Rating rationale

The change in KAP Limited's (KAP or the group) Rating Outlook from Stable to Negative reflects the risk that its earnings and cash flows do not recover as expected over the rating horizon, which could see its leverage profile weaken as the group continues to invest heavily in its capacity expansion. Nevertheless, the affirmation of KAP's ratings is underpinned by low refinancing risks given the group's proactive treasury management, its robust competitive position and operational diversification.

Lower than expected domestic demand during financial 2023 (particularly the third quarter) exacerbated by worsening loadshedding negatively impacted sales volumes and margins within KAP's Chemical division (Safripol) which had been the largest revenue (36%) and earnings (48%) contributor during financial 2022. Additionally the Logistics division (Unitrans) which is also a large revenue and earnings driver, posted a weaker performance following, inter alia, the loss of a major contract. These softer performances were somewhat offset by improvements in PG Bison, Feltex and Restonic, demonstrating the benefits of the group's operational diversity, coupled with KAP's leading competitive position in various sectors, and its wide-ranging customer base across most economic segments This enabled the group to withstand pressures in the Chemicals and Logistics divisions and still remain profitable, albeit at a significantly lower level. To this end, pressure on earnings was noted with EBITDA falling to ZAR3.8 billion, from ZAR4.4 billion in financial 2022. This was largely due to the group's focus on the reduction of its large inventory stores in Safripol through exports, due to the weak domestic demand. These exports, which were at little to no margin, saw Safripol's operating profit margin reduce substantially to 7.4% in financial 2023 from 13.8% in the prior year, driving group EBITDA margins down to 12.8% (financial 2022: 15.9%).

Going forward, Safripol's earnings will likely remain volatile, but we expect to see continued earnings growth from PG Bison, particularly post the completion of the Mkhondo MDF expansion in July 2024. The continued recovery in the automotive industry should also support Feltex during financial 2024, and margin benefits in Restonic are expected following the restructuring activities completed during financial 2023. Enhanced returns within the Unitrans business are also expected following the rationalisation and restructuring of this division, which will include the closure of underperforming operations and disposal of related assets resulting in an estimated ZAR100 million in costs savings.

The increase in net debt by c.ZAR600m to ZAR8.1 billion at financial 2023, coupled with the softer earnings and higher interest rates translated into a deterioration in KAP's credit protection metrics. That said, net debt to EBITDA at 2.1x (financial 2022: 1.7x) and interest cover at 4.8x (financial 2022: 8.9x), although weaker than historical levels, are still sound and exhibit ample headroom against covenant levels of 3.2x and 3.5x respectively. Whilst gross debt levels are expected to reduce over the rating horizon, the strength of KAP's leverage profile hinges directly on a recovery in its earnings. The group also continues to demonstrate strong relationships with a wide base of funders, as well as good access to debt capital markets. In this regard, GCR positively notes KAP's proactive efforts to successfully procure a new syndicated revolving credit facility (RCF), which will be drawn down incrementally to settle debt maturing in financial 2024 and 2025, ensuring that a well laddered maturity profile is maintained. This will provide KAP with the financial flexibility to continue to fund the bulk of its sizeable capex budget from cash resources.

KAP's liquidity profile remains a positive ratings factor, with ample cash on hand of ZAR1.5 billion at financial 2023, sound forecast cash flows and the availability of the new RCF for financial 2024. Against contractual debt repayments of ZAR2.1 billion (ZAR527 million of which has already been refinanced) and relatively large cash-funded capex at similar levels to those recorded in financial 2022 (around ZAR2 billion), GCR calculated liquidity coverage over the next 12 months registers at 1.5x (financial 2022: 1.3x), excluding uncommitted facilities and 1.8x (financial 2022: 1.6x) including non-committed funding lines. Notably, the group has access to a significant ZAR1.4 billion in uncommitted facilities, the majority of which are short-term in nature, and can be utilised to support working capital. GCR also positively considers management's decision to suspend dividends so as to prioritise debt reduction in support of its liquidity profile.

KAP's ratings remain anchored by its broad product diversity and domestic market leadership in its areas of operation, however the concentration of operations and sales to the riskier South African market does remain a constraint on the rating.

## Outlook Statement

The Negative Outlook reflects GCR's concerns of a ratings downgrade should earnings growth in the group's more stable divisions not materialise over the ratings horizon so as to compensate for the earnings attrition evidenced in the more volatile business segments.

## Rating Triggers

Downward rating action could derive should the group's earnings continue to weaken or do not improve as per our expectations and/or earnings pressures translate into a deterioration in credit protection metrics and constrained liquidity. Non-compliance with covenants and the inability of the group to sustain its capex pipeline would also be negatively viewed.

Upward rating action is considered unlikely over the rating horizon. However, the Outlook could be revised to Stable over the over the next 12-18 months should group earnings and cash flows improve, such that credit protection metrics strengthen, the group continues to display ample covenant headroom and liquidity sources continue to sustain the increased capex activity.

## Analytical contacts


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## Related criteria and research

Criteria for the GCR Ratings Framework, January 2022
Criteria for Rating Corporate Companies, January 2022

GCR Ratings Scales, Symbols & Definitions, May 2023
GCR Country Risk Scores, August 2023
GCR Corporate Sector Risk Scores, March 2023

## Ratings history

| KAP Limited | | | | | |
|---|---|---|---|---|---|
| Rating class | Review | Rating scale | Rating class | Outlook | Date |
| Long Term Issuer | Initial | National | A-(ZA) | Stable | April 2014 |
| Short Term Issuer | | National | A2(ZA) | | |
| Long Term Issuer | Last | National | A+(ZA) | Stable | November 2022 |
| Short Term Issuer | | National | A1(ZA) | | |

## Risk score summary

| Rating Components & Factors | Score |
|---|---|
| **Operating environment** | **10.75** |
| Country risk score | 7.00 |
| Sector risk score | 3.75 |
| **Business profile** | **1.50** |
| Competitive position | 1.50 |
| Management and governance | 0.00 |
| **Financial profile** | **1.25** |
| Earnings | 0.25 |
| Leverage & cash flow | 0.50 |
| Liquidity | 0.50 |
| **Comparative profile** | **0.00** |
| Group Support | 0.00 |
| Peer comparison | 0.00 |
| **Total Risk Score** | **13.50** |

## Glossary

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|---|---|
| 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. |
| 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. In insurance, it refers to an individual or company's vulnerability to various risks |
| Long Term Rating | See GCR Rating Scales, Symbols and Definitions. |
| Rating Outlook | See GCR Rating Scales, Symbols and Definitions. |
| Risk | The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives. |

| | |
|---|---|
| Short Term Rating | See GCR Rating Scales, Symbols and Definitions. |
| Short Term | Current; ordinarily less than one year. |

## Salient points of accorded rating

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; and c.) such ratings were an independent evaluation of the risks and merits of the rated entity, security or financial instrument.

The credit ratings have been disclosed to the rated entity.

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

The rated entity participated in the rating process via face-to-face management meetings, as well as other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible. The information received from the rated entity and other reliable third parties to accord the credit ratings included:

- The audited financial results for the year to June 2023, as well as the Integrated Report
- Four years of comparative audited numbers
- Group SENS announcements, presentations and trading updates
- Debt facility details at 30 June 2023 and 30 September 2023
- Medium-term cash flow projections

kind. GCR adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources GCR considers to be reliable including, when appropriate, independent third-party sources. However, GCR is not an auditor and cannot in every instance independently verify or validate information received in the rating process or in preparing its Publications.

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