GCR RATINGS

CREDIT RATING ANNOUNCEMENT

GCR affirms KAP Limited's national scale issuer rating at A+$_{(ZA)}$ with the Outlook revised to Stable.

Rating action

Johannesburg, 21 November 2024 – GCR Ratings (GCR) has affirmed KAP Limited's long and short-term national scale Issuer ratings at A+$_{(ZA)}$ and A1$_{(ZA)}$ respectively. The Outlook has been revised to Stable from Negative.

Rated entity	Rating class	Rating scale	Rating	Outlook/Watch
KAP Limited	Long Term Issuer	National	A+$_{(ZA)}$	Stable
	Short Term Issuer	National	A1$_{(ZA)}$	

Rating rationale

The rating affirmation and Outlook revision to Stable reflects GCR's increased confidence that KAP Limited (KAP or the group) is better positioned given actions taken to curb the impact of certain underperforming business. Accordingly, although leverage metrics are relatively high, GCR expects that an earnings recovery will see KAP reduce absolute debt levels and improve credit metrics over the next 12-24 months in line with stated targets. The ratings also benefit from the group's operational diversity, coupled with KAP's leading competitive position in various sectors and a history of solid cash flow generation through-the-cycle.

Following two strong years, KAP's 2023 financial performance (ended 30 June) was affected by subdued domestic demand, loadshedding, a cyclical downturn in the chemicals business (Safripol), whilst the logistics division (Unitrans) continued to be plagued by various challenges notwithstanding previous restructuring efforts. Despite 5.9% revenue growth, EBITDA in financial 2023 declined 7.4% to ZAR4 billion. As anticipated, group earnings in financial 2024 continued to be weighed down by ongoing pressures in Safripol (31% of total revenues), however, all other business lines reported improvements. Most notable was that of Unitrans (33% of total revenues), which after deeper restructuring and optimisation initiatives has started to report better results. Whilst Safripol remains susceptible to challenging global conditions, we believe completed production interventions will improve efficiencies and produce higher-specification polymers, increasing earnings stability.

Furthermore, the group is expected to continue to benefit from strength in its wood products division (PG Bison), having recently completed a large multi-year capital expansion of its medium-density fibreboard plant in June 2024, an investment that is important in sustaining its competitive position and operating costs. PG Bison accounted for 19% of total revenues and 43% of operating profits in financial 2024. KAP's operational success prior to its recent challenges demonstrate the strength of its broad product diversity and strong market positioning underpinned by consistent strategic execution of technological investments. We believe the actions undertaken will drive improving revenues and margins in financial 2025.

GCR expects KAP's credit protection metrics to improve over the next 12-24 months on the back of a progressive recovery in profitability and KAP's public commitment to reduce net debt by ZAR1 billion over the next 12 months and further thereafter. Thus, while net debt to EBITDA rose to 2.3x in financial 2024 due to peak capex at a time of earnings pressures, the metric is expected to fall back below 2x by financial 2025 and trend closer to around 1.5x in financial 2026. Interest cover is expected to improve more gradually to within rating sensitivities over the forecast period from the low of 3.7x in financial 2024 and widen headroom against the covenant level of 3.25x in financial 2025 and 3.5x in financial 2026. The group continues to demonstrate strong relationships with a wide base of funders, and good access to debt capital markets.

KAP's liquidity profile remains a positive ratings factor. GCR calculated liquidity coverage is estimated at a strong 1.8x over the next 12 months and 1x over 24 months, including non-committed funding lines. Notably, the group has access to a significant ZAR1.8 billion in uncommitted facilities, the majority of which are short-term in nature and can be utilised to support working capital. A new ZAR1 billion 18-month facility was recently secured, alleviating refinancing pressures and providing the necessary support for increased working capital largely for PG Bison's expanded capacity needs. GCR also expects that free cash flows will benefit from lower capital intensity, core operational improvements and management's decision to suspend dividends to prioritise debt reduction.

Outlook Statement

The stable outlook is based on GCR's expectation that KAP's business position will remain strong, and its diverse operations and commissioning of new projects as planned will allow for improving profitability over the next 12-18 months. This, together with capital management commitments are expected to see credit protection measures restore towards levels that are supportive of its current rating.

Rating Triggers

Upward rating action is considered unlikely over the rating horizon. Over the medium to longer term consistent top line and profit growth, leading to widening margins and cash flows could be positive to the ratings. At the same time, credit protection metrics would need to improve materially, and liquidity sources would need to be sufficient to sustain continuous capex activity to support business competitiveness.

Downward rating action could derive should earnings not improve as projected that causes KAP to deviate from GCR's expectations for leverage reduction to the mid 1x range by 2026. Constrained liquidity would also be negatively viewed.

Analytical contacts

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Related criteria and research

Criteria for the GCR Ratings Framework, May 2024
Criteria for Rating Corporate Companies, May 2024
GCR Ratings Scales, Symbols & Definitions, May 2023
GCR Country Risk Scores, August 2024
GCR Corporate Sector Risk Scores, March 2024

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)	Negative	November 2023
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
Sustainability	0.00
Financial profile	**1.50**
Earnings	0.25
Leverage & cash flow	0.50
Liquidity	0.75
Comparative profile	**0.00**
Group Support	0.00
Peer comparison	0.00
Total Risk Score	**13.75**

Glossary

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 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.

The rated entity participated in the rating process via in person interaction and/or via online virtual interaction and/or via electronic and/or verbal communication and 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 annual financial statements to 30 June 2024 (plus four years of audited comparative numbers)
- The 2024 integrated report
- A breakdown of debt facilities at September 2024
- Results presentations
- Medium-term cash flow projections

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