



## Credit Rating Notification

GCR affirms KAP Industrial's A+(ZA)/A1(ZA) issuer ratings based on recovery in earnings and credit metrics, Outlook Stable

### Rating Action

Johannesburg, 19 November 2021 – GCR Ratings ("GCR") has affirmed KAP Industrial Holdings Limited's long-term and short-term national scale issuer ratings of A+(ZA) and A1(ZA) respectively, with a Stable Outlook.

Rated Entity	Rating class	Rating scale	Rating	Outlook / Watch
KAP Industrial Holdings Limited	Long Term Issuer	National	A+(ZA)	Stable Outlook
	Short Term Issuer	National	A1(ZA)	

### Rating Rationale

The affirmation of KAP Industrial Holdings Limited's ("KAP" or "the group") ratings reflects the recovery in earnings and credit protection metrics post the COVID-19 disruptions evidenced at FY20. This is supported by its robust competitive position, anchored by its broad product diversity and market leadership in its areas of operation. Geographic concentration of operations and sales to the riskier South African market does, however, remain a constraint on the rating.

The benefits of having diverse operating segments has been clearly evidenced over the past 18 months. Logistics remained stable in FY20, when all the industrial businesses came under significant pressure. However, the timber and bedding businesses, along with polymers reported improved results in FY21, whilst logistics came under pressure. This industry diversity, coupled with its leading competitive position in various sectors, and its wide-ranging customer base, across most economic segments, enables the group to withstand pressures in any one segment.

As a result of a strong rebound in demand evidenced across most segments, KAP's performance at FY21 displayed a marked recovery with revenue increasing by 11% to R24bn (FY20: R21.6bn), EBITDA increasing to R3.6bn (FY20: R2.9bn), and EBITDA margins to 15.2% (FY20: 13.2%). These improvements notwithstanding, KAP's earnings have not yet recovered to pre-COVID levels. GCR anticipates that higher volumes driven by increased demand, along with ongoing cost rationalisation efforts should see margins maintained around the c.15% level over the medium term, with enhancements materialising in the long term once certain capex projects have been completed and the resultant production capabilities brought on board.

Strong operating cash flows were boosted by a much smaller working capital absorption of R43m (FY20: R741m), coupled with reduced capex. This enabled KAP to repay c.R500m in short term facilities, reducing net debt to R6.6bn (FY20: R7.1bn). This combined with higher earnings saw credit protection metrics strengthen at FY21, with net debt to EBITDA moderating to 1.8x (FY20: 2.5x) and interest cover improving to 7.8x (FY20: 4.4x) against covenant levels of 3.2x and 3.5x respectively, thus displaying ample headroom. FY21's Interest cover was reported at its highest level since FY16 due largely to the favourable interest rate environment, despite EBITDA levels still registering below pre-COVID levels. Although GCR considers it likely that gross debt levels could increase to fund KAP's large capex budget, GCR expects conservative credit metrics to be sustained over the next 12 months as earnings continue to strengthen.

KAP's liquidity profile remains sound for the next 12 months with liquidity coverage at 1.07x (excluding uncommitted facilities), albeit this represents a slight deterioration in coverage reported in FY20. The weakness stems predominantly from the higher R2.9bn in projected capex for FY22 and R2.7bn in FY23, partly compensating for the lower spend during

COVID-19 and the planned expansion of existing chip board and other manufacturing facilities, so as to fortify its production capabilities in view of the strong market demand. Whilst GCR still considers the capex manageable given the normalisation of earnings, we do consider it likely that the group will have to rely on a large portion of its uncommitted general banking facilities of c.R1.7bn. Additional resources are also available from the unutilised R750m committed revolving credit facility (refinanced during FY22 for a further 3 years).

## Outlook Statement

The Stable Outlook reflects GCR's expectations that the recovery in demand across most business segments will be sustained, resulting in an improvement in KAP's cash flows and credit protection metrics over the next 12-18 months. Further, strong treasury management should sustain the funding and liquidity profile stability despite the increased capex activity.

## Rating Triggers

Downward rating action could derive should the group's earnings recovery not continue as expected and/or if liquidity and credit metrics deteriorate as a result of the increased capex budget which could see debt levels increase. Upward rating action could be taken if KAP continues to demonstrate strong sustainable earnings and cash flow growth sufficient to cover the capex budget, whilst maintaining a sound liquidity profile and/or more conservative leverage metrics.

## Analytical Contacts

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## Related Criteria and Research

Criteria for the GCR Ratings Framework, May 2019  
 Criteria for Rating Corporate Entities, May 2019  
 GCR Rating Scales Symbols and Definitions, May 2019  
 GCR's Country Risk Score report, published October 2021  
 GCR's SA Sector Risk Score report, published April 2021

## Ratings history

### KAP Industrial Holdings Limited

Rating scale	Review	Rating class	Rating	Outlook/Watch	Date
Long Term Issuer	Initial	National	A <sup>-</sup> <sub>(ZA)</sub>	Stable Outlook	Apr 2014
Short Term Issuer		National	A2 <sub>(ZA)</sub>		
Long Term Issuer	Last	National	A <sup>+</sup> <sub>(ZA)</sub>	Stable Outlook	Nov 2020
Short Term Issuer		National	A1 <sub>(ZA)</sub>		

## Risk Score Summary

Factors & sub-factors	Risk scores
<b>Operating environment</b>	<b>11.00</b>
Country risk	7.00
Sector risk	4.00
<b>Business profile</b>	<b>1.50</b>
Competitive position	1.50
Management & governance	0.00
<b>Financial profile</b>	<b>1.25</b>
Earnings profile	0.00
Leverage and cash flow	1.00

Liquidity	0.25
<b>Comparative profile</b>	<b>0.00</b>
Government support	0.00
Peer analysis	0.00
Group support	0.00
<b>Total Risk Score</b>	<b>13.75</b>

## 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.
Issuer	The party indebted or the person making repayments for its borrowings.
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.
Long Term Rating	See GCR Rating Scales, Symbols and Definitions.
Maturity	The length of time between the issue of a bond or other security and the date on which it becomes payable in full.
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.

## Salient Points 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; 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 KAP Industrial Holdings Limited. 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.

KAP Industrial Holdings Limited 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 KAP Industrial Holdings Limited and other reliable third parties to accord the credit ratings included:

- The audited financial results for the year to June 2021
- Four years of comparative audited numbers
- Group SENS, presentations and trading updates
- Debt facility details at September 2021
- Medium-term cash flow projections

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