



Credit Rating Notification

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

Rating Action

Johannesburg, 20 November 2020 – 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 expectation that the group's diversified business will see a swift recovery in earnings and credit metrics over the rating horizon as demand stabilises after the severe negative impact of the global coronavirus outbreak in 2020.

Earnings diversity has helped KAP somewhat limit the negative impact of Covid-19, whilst a fairly rapid bounce back in demand in most of its business segments is anticipated to see a recovery in profitability going forward. The group reported materially weaker earnings in FY20 due to the coronavirus-linked disruptions and deterioration in market fundamentals in key segments, although GCR anticipates that higher volumes and cost rationalisation efforts should see margins widen in FY21. That said, margins are not anticipated to revert to pre-crisis levels as challenges in the automotive and polymers segments are likely to continue to weigh on cash flow growth over the medium term.

GCR is of the view that the weaker credit protection metrics reported in FY20 are temporary and expects that credit metrics will improve as earnings rebound. Optimising working capital needs should also see positive free cash flows resume in FY21, which should enable some deleveraging, as well as renewed capex activity as the group focuses on organic expansion. Thus, net debt to EBITDA is expected to register between 1.75x-2.0x (FY20: 2.4x) and interest cover around 6.5x (FY20: 4.2x) over the next 12 months. We have also noted that KAP has shown financial discipline by forgoing its dividend for FY20 and is likely to maintain a conservative approach to acquisitions and shareholder returns until earnings normalise. Notably, the group has not had to seek any temporary covenant relief measures, and we do not expect covenant pressures in view of the ample current headroom.

KAP reflects a sound liquidity position going into 2H FY21, with sources of liquidity estimated to exceed uses by at least 1.5x over the 12 months as at November 2020, and 1x over 24 months. We note that KAP has around R2bn of debt maturing in the near term, although we assume that a large portion of this will be refinanced, together with large upcoming capex. Comfort is provided by the committed revolving credit facility availability of about R1bn, as well as undrawn uncommitted general banking facilities of c.R1bn, with the later having previously been utilised to cushion the timing of refinancing.

The ratings also positively factor in KAP's strong competitive position, supported by its broad product diversity and market leadership in the areas of its operations. This partially mitigates against the risk of slowdown in any particular end-user industry. However, operations and sales are geographically concentrated to South Africa (84% of revenues) and remain vulnerable to cyclical industries, which restrains the assessment.

Outlook Statement

The Stable Outlook reflects GCR's expectations that a broad recovery in demand across most businesses will see an improvement in KAP's cash flows and credit metrics over the next 12-18 months. GCR also expects continued strong treasury management risk mitigants to sustain funding and liquidity profile stability in the short-term.

Rating Triggers

The ratings could be downgraded if the group's performance doesn't recover as expected and/or if liquidity deteriorates and credit metrics remain at weak levels. The possibility of an upgrade is limited at this point, but looking further ahead, upward rating action could be taken if KAP continues to demonstrate strong sustainable earnings growth, 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 May 2020

GCR's SA Sector Risk Score report, published July 2020

GCR affirms the national scale ratings on several South African corporates despite a deterioration in South Africa's operating environment, Aug 2020

Ratings history

KAP Industrial Holdings Limited

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

Risk Score Summary

Factors & sub-factors	Risk scores
Operating environment	11.00
Country risk	7.00
Sector risk	4.00
Business profile	1.50
Competitive position	1.50
Management & governance	0.00
Financial profile	1.00
Earnings profile	0.00
Leverage and cash flow	0.50
Liquidity	0.50
Comparative profile	0.00
Government support	0.00
Peer analysis	0.00
Group support	0.00
Total Risk Score	13.50

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 2020
- Four years of comparative audited numbers
- Group SENS, presentations and trading updates
- Debt facility details at Sep 2020
- Medium-term cash flow projections

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