



Credit Rating Notification

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

Rating Action

Johannesburg, 25 November 2022 – 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 sustained recovery in earnings and sound credit protection metrics evidenced over the review period, despite a challenging operating environment. This is supported by the group's robust competitive position, anchored by its broad product diversity and domestic 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.

Although FY22 was fraught with numerous challenges within the operating environment (such as global supply chain disruptions, volatility in global commodity prices, rising global inflation, the civil unrest and floods in South Africa), KAP's revenue increased by a notable 16.8% to R28bn (FY21: R24bn). This was supported by robust performances by PG Bison and Safripol, which offset the weaker performances by Restonic, Feltex and Unitrans, demonstrating the benefits of its diverse operations. This, coupled with KAP's 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.

Moreover, KAP's ability to pass on cost increases to its customers saw an improvement in earnings, with GCR calculated EBITDA rising to R4.4bn (FY21: R3.6bn) and GCR calculated EBITDA margin to 15.9% (FY21: 15.2%). Further revenue growth is expected over the rating horizon driven by the increased capacity in the newly commissioned Piet Retief plant available to support the strong order book in PG Bison. Whilst the moderation in commodity prices should see a return to lower but normalised margins in the chemical segment and GCR anticipates a squeeze in overall group margins due to the higher global inflationary environment, KAP's earnings are expected to remain strong in real terms. Over the medium to longer term, we believe that earnings growth will be further fortified by the planned large capex projects underway (particularly the MDF Expansion in the timber business) which should result in improved production capacity and efficiencies.

Against the backdrop of global supply chain disruptions, KAP strategically increased its inventory investment giving rise to a fairly large working capital absorption of R463m (FY21: R43m). This, coupled with capex growth of c.R2.2bn (excluding business acquisitions), resulted in net debt increasing by R929m to R7.5bn at FY22. This notwithstanding, credit protection metrics remained modest on the back of higher earnings, with net debt to EBITDA reported at 1.7x (FY21: 1.8x; FY20: 2.5x) and interest cover improving to 8.9x (FY21: 7.8x FY20: 4.4x). GCR anticipates that interest cover could weaken to around the 6x-7x level amidst the increasing interest rate environment, however, these ratios should continue to display ample headroom against covenant levels of 3.5x. The group also demonstrates strong relationships with a wide base of funders as well as strong access to debt capital markets, resulting in a well laddered maturity

profile. Further, GCR positively views KAP's intention to fund the bulk of its increased capex budget from cash resources in support of conservative credit metrics being sustained over the next 12 months.

KAP's liquidity profile remains moderate with GCR calculated liquidity coverage registering at 1.3x (excluding uncommitted facilities) over the next 12 months. Sound operating cash flows are forecast over the rating horizon, and this, together with the healthy cash balance of R1.7bn reported at FY22, should more than cover the c.R2.9bn capex forecast for FY23 for the planned new MDF plant and other manufacturing facilities. In need, the group also has access to an unutilised committed revolving credit facility of R750m, as well as uncommitted general banking facilities of R1.9bn. Debt maturing over the next 12 months as at FY22 amounts to cR2bn, however KAP has recently issued R1.8bn in new DMTN notes to refinance the majority of the expiries.

Outlook Statement

The Stable Outlook reflects GCR's expectations that solid earnings will be supported by sustained demand trends in core segments despite increased cost pressures. Moreover, strong treasury management should sustain funding and liquidity profile stability despite the increased capex activity.

Rating Triggers

Downward rating action could derive should the group's earnings evidence a material weakening and/or if liquidity and credit metrics deteriorate as a result of the increased capex budget if 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, January 2022
 Criteria for Rating Corporate Entities, January 2022
 GCR Rating Scales Symbols and Definitions, May 2022
 GCR's Country Risk Score report, published August 2022
 GCR's SA Sector Risk Score report, published March 2022

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	Nov 2021
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	1.25
Earnings profile	0.25
Leverage and cash flow	1.00
Liquidity	0.25
Comparative profile	0.00
Government support	0.00
Peer analysis	0.00
Group support	0.00
Total Risk Score	14.00

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 2022
- Four years of comparative audited numbers
- Group SENS, presentations and trading updates
- Debt facility details at 30 June 2022 and 30 September 2022
- Medium-term cash flow projections

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