

**Credit Opinion: Kagiso Tiso Holdings Proprietary Limited**

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Global Credit Research - 11 Mar 2016

South Africa

**Ratings**

| Category             | Moody's Rating |
|----------------------|----------------|
| Outlook              | Stable         |
| NSR LT Issuer Rating | Baa2.za        |
| NSR ST Issuer Rating | P-2.za         |

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**Key Indicators**

| [1]Kagiso Tiso Holdings Proprietary Limited | 30/06/2015 | 30/06/2014 | 30/06/2013 | 30/06/2012 |
|---|------------|------------|------------|------------|
| (FFO + Interest Expense) / Interest Expense | 2.3x       | 3.0x       | 2.3x       | 1.4x       |

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. Source: Moody's Financial Metrics

Note: For definitions of Moody's most common ratio terms please see the accompanying [User's Guide](#).

**Opinion**

**Rating Drivers**

- >Predominantly South African focused investment portfolio with high asset and business sector concentration
- >Track record of conservative investment strategy and financial policies
- >Moderate market value leverage assessment
- >Adequate liquidity profile and limited refinancing in the next 12 months

**Corporate Profile**

Headquartered in Johannesburg, South Africa, Kagiso Tiso Holdings Proprietary Limited ("KTH" or the company) is an investment holding company that manages a portfolio of listed and unlisted investments mostly in South Africa, with a growing investment exposure to the rest of Africa. KTH has a combined gross total portfolio value of around ZAR13.4 billion (USD1.1 billion), as of financial year ended 30 June 2015 (FYE 2015).

**Rating Rationale**

KTH's Baa2.za/P-2.za national scale issuer rating is supported by (1) the scale of its investment portfolio with a combined gross total portfolio value of around ZAR13.4 billion, as at 30 June 2015; (2) its moderate level of market value leverage (defined as: net debt / estimated market value of portfolio of assets) of approximately 30.7% for FYE 2015; (3) its increased influence and control of key investments; (4) the track record that KTH has developed in pursuing a conservative approach to its investment strategy and financial policies; and (5) black ownership credentials driving future value accretive transactions.

KTH's ratings also factor (1) high concentration of investments within South Africa (Baa2 negative), which are exposed to a challenging macro-economic environment; (2) our expectation that KTH's asset concentration will remain constrained as it focuses on key pillar investments, which could also begin to limit its business sector diversification; (3) a weakening interest coverage towards 1.0x from 2.3x as of 30 June 2015 (calculated as: (funds from operations at the holding company + interest expense) / interest expense) and the risk that, in a liquidity constrained environment, debt serviceability of the debt at the centre could be adversely impacted if investee companies reduce or discontinue dividend payments; and (4) KTH's complex shareholding structure of individual investments.

## **DETAILED RATING CONSIDERATIONS**

### **REDUCING ASSET AND BUSINESS DIVERSIFICATION AS KTH PURSUES PILLAR STRATEGY**

KTH continues to pursue its asset pillar strategy, which aims to acquire significant holdings in a limited number of investments. Although we recognise that this strategy provides KTH with greater influence and control over its investments it limits its diversification across different industries which exposes KTH to potential cash flow volatility. KTH has high asset concentration with its three largest investments, (1) Kagiso Media Limited (28%); (2) MMI Holdings Limited (24%) and; (3) Actom Investment Holdings Limited (8%), representing 59.9% of its total gross portfolio value plus cash balance. KTH's largest sector exposure is to the media, insurance, manufacturing and mining industries. Over the past year the media and insurance sectors have performed well, however the manufacturing and mining sectors have shown to be less resilient in the current economic environment. The mining sector in particular remains under pressure given the weak commodity environment. Over time we expect KTH's asset concentration and business diversification to become more concentrated as management pursues its pillar asset strategy. While the rating accommodates some flexibility for higher concentration exposures by sector and individual investments, we will assess the diversity implications as and when key changes occur on the portfolio.

KTH's diversification is further limited to investments mostly concentrated in South Africa. This exposes KTH to the macro-economic challenges in South Africa, such as weak GDP growth prospects (Moody's is forecasting a 0.5% GDP growth rate for 2016 and 1.5% for 2017); weaker commodity prices; wage negotiations and potential labour unrest; and the country's ongoing power crisis. Management is broadening its footprint of investments into the rest of Africa (particularly East and West Africa), as demonstrated by the direct investments in Ghana (B3 negative) (15% investment in Fidelity Bank Ghana Limited) and Nigeria (Ba3 stable) (30% investment in Me Cure Healthcare Limited), in 2014 and 2015 respectively. KTH's exposure outside of South Africa accounts for 7% of its total gross portfolio value as at FYE 2015. Management is also looking to increase its African exposure indirectly, using its pillar assets as gateways, as seen in September 2015 through Kagiso Media Limited's investment in Ghana's Global Media Alliance Broadcasting Company Ltd. This reduces the current geographical concentration of the portfolio away from South Africa. However, we are aware of the unique risks inherent in investing into these markets, such as regulatory and political pressures as well as currency volatility and challenges faced in repatriating cash out of these countries. We do also recognise the opportunities that these markets offer, mainly higher economic growth rates relative to South Africa. We take some comfort in KTH's approach to investing in these markets, which include, amongst others, partnering with local players who understand and have experience in these markets.

### **TRACK RECORD OF SOUND GOVERNANCE AND TRANSPARENCY CONTINUES TO BE BUILT**

KTH continues to build upon its track record with regards to its financial policies and conservative investment strategy. We expect KTH to maintain financial policies that balance the interest of its creditors and shareholders, with dividend payout policies remaining conservative under KTH's management with a dividend payout ZAR130 million in respect of FYE 2015. This is in accordance with the company's dividend policy of not less than 30% of fair value adjusted net profit subject to liquidity and solvency requirements and board approval.

We view KTH's investment transparency as improving but still limited particularly given the higher weighting and growing number of unlisted investments (66% of gross total portfolio value), for which public information

around these investments is not easily accessible. We therefore continue to rely upon the annual third party independent valuations prepared by KPMG for which have showed positive overall like for like growth over the past few years. Successful investment management and corporate governance standards will continue to be important rating drivers.

#### MARKET VALUE LEVERAGE AND INTEREST COVERAGE EXPOSED TO PORTFOLIO VOLATILITY

KTH's market value leverage (MVL) is 30.7%, as FYE 2015 and as adjusted by Moody's. In our analysis of MVL we take into account qualitative considerations around Black Economic Empowerment (BEE) lock-in provisions, along with the organisational complexity associated with KTH's investment structure. Many of its investments consist of multiple holding entities between KTH itself and the direct investment that has been made, often with a mix of debt instruments at each of these entities. Combining this quantitative and qualitative analysis of MVL, KTH is moderately positioned in its Baa2.za rating category.

KTH's MVL could be adversely impacted by (1) a deterioration in total portfolio value; or (2) an increase in debt levels, which is not accompanied by similar growth in total portfolio value. This will be a particular focus going forward, given our tempered GDP growth forecast of around 0.5% for South Africa in 2016, which is likely to limit the quantum of value added to a number of KTH's investments operating in this economy. KTH's MVL has headroom to accommodate additional acquisitions and /or additional debt. KTH's debt capacity is determined by KTH's gearing policies of 40%-60% debt to equity (36.44% as at FYE 2015) and asset cover ratio measured by investment assets (net of debt) and cash at the centre to debt being greater than 4.1x (6.67x, as of FYE 2015). Based on current covenant levels, KTH had approximately ZAR1.4 billion of additional debt capacity at the centre as at 30 June 2015, which was decreased to ZAR600 million following a bond issuance of ZAR800 million post financial year end. We estimate pro-forma MVL post the bond raise to be around 35% and expect that its maximum MVL would trend towards, but not exceed, 40% based on its remaining debt capacity. We, however, do not expect management to raise additional debt at the centre and expect any further capital requirements to rather be met with equity.

We assess KTH's interest coverage by looking at its ability to meet its interest expenses through funds from operations, as well as the number of years that cash balances and committed credit facilities cover upcoming debt maturities. KTH's interest coverage for FYE 2015 was moderately positioned at 2.3x (within the Ba sub factor rating category in our methodology grid). However, we expect interest coverage to decrease towards 1.0x for the next 12-18 months driven by the higher debt serviceability requirements at the centre (holding level), which we consider weak for the rating category. We will continue to monitor KTH's dividend income particularly given the challenging macro-economic environment its investments are trading in, which could put pressure on dividend declaration across its portfolio of investments, notably those in which it does not have significant influence over. We do recognise that some of KTH's recent investments are still in a growth phase and once they do start paying dividends we would expect to see an improvement in interest coverage. This is however only expected in the next 2 to 3 years and will depend on the performance of these investments and general state of the respective economic and industry environment. We remain comfortable with KTH's interest cover trending towards 1.0x given its alternative sources of liquidity that it has, namely (1) sizable cash balances and undrawn revolving credit facilities of ZAR 971 million, as at 31 December 2015; (2) its strategy to dispose of non-core assets of which proceeds could be used to pay down debt thus reducing its interest expense and; (3) management's ability to upstream cash to the holding level from investments where it has control (Kagiso Media Limited (100%)), or significant influence over (Kagiso Asset Management (Pty) Ltd (50.1%)) should the need arrive. We would however expect management to prudently balance its growth investments with cash flow generating assets, in order to adequately meet its interest and central operating costs.

#### Liquidity Profile

KTH's liquidity over the next 12-18 months will be supported by (1) its sizeable cash balances at the centre of ZAR836 million as of 31 December 2015; (2) undrawn committed revolving facilities of ZAR135 million as of 31 December 2015; and (3) stable dividend income from its investments. These sources will be sufficient to cover KTH's increasing debt repayments and administrative head office costs over the next 12 to 18 months. We estimate that that cash balances and committed credit facilities will cover upcoming debt maturities for the next 1-2 years, which is considered weakly positioned.

#### Structural Considerations

The majority of KTH's investment portfolio is structured in such a way that each individual investment is contained in a special purpose vehicle (SPV) along with the debt that was used at the time to fund the

investment, which is ring-fenced to the SPV. Cession and pledge agreements limit security to the investment assets held in each SPV. Dividend payments from an investment are strapped to the repayment of the debt in each SPV that initially funded the investment. As such, dividends from an investment cannot be up streamed to the holding company level (unless they exceed funding costs) until such time that all debt in its SPV has been repaid. KTH, for financial reporting purposes, consolidates the debt in its SPVs along with the debt held at the holding company level, which includes a mix of bonds, preference shares and term loans. Moody's uses both ring fenced debt and debt at the centre to calculate market value leverage and uses cash flows (dividends received from the various SPVs) to calculate the ability of KTH to fund its finance expenses on debt obligations at the holding level (centre).

## **Rating Outlook**

The stable outlook is based on our expectation that KTH will continue to build a track record of sound corporate and financial governance, accompanied by transparent monitoring and reporting. The outlook also assumes that there will be no material change in KTH's market value leverage, asset concentration and business diversity. In addition, the outlook assumes KTH's liquidity profile does not deteriorate.

## **What Could Change the Rating - Up**

Positive pressure on KTH's rating could build over time as a result of:

- (1) a decrease in market value leverage closer to 30%, on a sustained basis, accompanied with the removal of BEE lock-in clauses from its larger investments and a simplification of some of the more complex investment structures;
- (2) improved interest coverage above 2.5x, on a sustained basis;
- (3) a consistent track record of prudent financial policies;
- (4) improved corporate governance standards in terms of more frequent and transparent reporting of third-party independent investment valuations and overall investment strategy; and
- (5) prudent investment strategy over the longer term without significant volatilities or spikes in market-value based leverage.

Moody's would also view positively a staggered debt maturity profile accompanied by a diverse funding mix.

## **What Could Change the Rating - Down**

Negative pressure on KTH's ratings could arise should:

- (1) market value leverage trend towards 40%;
- (2) the interest coverage ratio sustainably weaken towards 1.5x and/or does not remain supported by solid liquidity for meeting debt maturities and committed cash outlays;
- (3) any general deterioration in KTH's current disclosure standards; and
- (4) a change in investment strategy towards capital allocation to more volatile investments with greater underlying business and liquidity risk.

## **Other Considerations**

### **MAPPING TO THE METHODOLOGY**

Moody's Global Investment Holding Companies and Conglomerates Methodology, published in December 2015, sets out how Moody's analyses the credit risk of investment holding companies and arrives at their ratings. The methodology examines the core factors that Moody's considers most relevant to investment holding companies, sets out the range of possible outcomes by factor, and maps these outcomes to a rating range. Each factor is appropriately weighted and, in combination, contributes to the rating output by the methodology grid.

The grid indicated Global Scale Rating (GSR), as of 30 June 2015, is Ba1 with a 12-18 month forward view of Ba2. The assigned National Scale Rating of Baa2.za corresponds to a Ba2 or Ba3 GSR. The corresponding GSR also factors KTH's expansion into Africa, which may also expose the company to additional risks, which are not captured in the grid.

## Rating Factors

### Kagiso Tiso Holdings Proprietary Limited

| Investment Holding Companies Industry Grid [1][2]                   | Current FYE 30/06/2015 |              | [3]Moody's 12-18 Month Forward View As of 25/02/2016 |              |
|---|------------------------|--------------|--|--------------|
| <b>Factor 1 : Investment Strategy (10%)</b>                         | <b>Measure</b>         | <b>Score</b> | <b>Measure</b>                                       | <b>Score</b> |
| a) Investment Strategy  | Baa                    | Baa          | Baa  | Baa          |
| <b>Factor 2 : Asset Quality (40%)</b>                               |                        |              |  |              |
| a) Asset Concentration  | B                      | B            | B  | B            |
| b) Geographic Diversity   | B                      | B            | B  | B            |
| c) Business Diversity   | Ba                     | Ba           | Ba   | Ba           |
| d) Investment Portfolio Transparency                                | Ba                     | Ba           | Ba   | Ba           |
| <b>Factor 3 : Financial Policy (10%)</b>                            |                        |              |  |              |
| a) Financial Policy   | Baa                    | Baa          | Baa  | Baa          |
| <b>Factor 4 : Estimated Market Value-based Leverage (MVL) (20%)</b> |                        |              |  |              |
| a) Estimated Market Value-Based Leverage                            | 30.70%                 | Baa          | 32-38%   | Baa          |
| <b>Factor 5 : Debt Coverage and Liquidity (20%)</b>                 |                        |              |  |              |
| a) (FFO + Interest Expense) / Interest Expense                      | 2.3x                   | Ba           | 1x-1.5x  | B            |
| b) Liquidity  | B                      | B            | B  | B            |
| <b>Rating:</b>  |                        |              |  |              |
| a) Indicated Rating from Grid                                       |                        | Ba1          |  | Ba2          |
| b) Actual Rating Assigned   |                        | Baa2.za      |  | Baa2.za      |

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. [2] As of 21/12/2015; Source: Moody's Financial Metrics [3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures

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