MOODY'S
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Credit Opinion: Kagiso Tiso Holdings Proprietary Limited

Global Credit Research - 04 Feb 2014

South Africa

Ratings

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

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Key Indicators

Kagiso Tiso Holdings Proprietary Limited[1][2][3]

	2013	2012
EBIT / Interest Expense	2.5x	2.0x
Debt / EBITDA	3.7x	3.9x
Debt / Book Capitalization	27.1%	28.7%
FFO / Debt	3.0%	4.4%
RCF / Net Debt	-2.2%	1.9%

[1] All ratios are calculated using Moody's Standard Adjustments. [2] Source: Moody's Financial Metrics [3] Financial Year End 30 June

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Rating Drivers

>South African comprised investment portfolio with moderate asset and high sector concentration

>Evolving track record of sound governance and investment transparency

>Moderate market value leverage

Corporate Profile

Headquartered in Johannesburg, South Africa, Kagiso Tiso Holdings Proprietary Limited ("KTH") was formed by an equity swap merger on 1 July 2011 between Kagiso Trust Investments (Proprietary) Limited ("KTI") and Tiso Group (Proprietary) Limited ("Tiso"), a similar sized investment holding company in South Africa. Subsequent to the merger, all assets and liabilities from KTI and Tiso were transferred to KTH. The merged entity has a combined gross total portfolio value of around ZAR13 billion.

Rating Rationale

KTH's Baa2.za/P-2.za national scale issuer rating is supported by (1) the moderate scale of its investment portfolio with a combined value of around ZAR13 billion; (2) a diverse portfolio ranging across a number of different sectors and comprising approximately 58% by value of unlisted investments factoring the Kagiso Media transaction; and (3) black ownership credentials driving future value accretive transactions.

KTH's ratings also factor: (1) 100% concentration of investment holdings within South Africa; and (2) moderate pro forma interest coverage of 2.3x as of 30 June 2013 (calculated as: (normalized dividends received + cash interest received)/gross interest) and the risk that, in a liquidity constrained environment, debt serviceability of non-ring fenced debt could be adversely impacted if investee companies reduce or discontinue dividend payments; and (3) a moderate level of market value leverage (defined as the average of two years: net debt/estimated market value of portfolio of assets) of approximately 30%.

DETAILED RATING CONSIDERATIONS

MODERATE ASSET CONCENTRATION AND BUSINESS DIVERSITY BUT GEOGRAPHICALLY CONCENTRATED

Following, KTH's acquisition of Kagiso Media, KTH's exposure to the media sector has increased to approximately 27% of the investment portfolio on a gross value basis. The Kagiso Media acquisition aligns with KTH's strategy of focusing on unlisted investments. This is driven by the limited number of entry points offered by unlisted investments. Listed investments are widely available to any investor, but unlisted investments are not as easily accessible and command a premium as a result, which generally benefit their valuation. We expect that KTH will unlock value beyond the premium which it paid for the stake that it did not already own in Kagiso Media, through integration of the company into its existing organisational structure and infrastructure. KTH will also be able to offer Kagiso Media additional management expertise and relieve it of onerous and time consuming constraints placed by listing requirements, following its delisting.

KTH investments across different business sectors which each exceed 10% of gross total portfolio value has reduced from four to three, which increases the asset concentration risk to the issuer. These comprise (1) Kagiso Media Limited (diversified media, 27% of gross total portfolio value); (2) MMI Holdings Limited (insurance: life and health, 17% of gross total portfolio value); and (3) Exxaro Resources Limited (metals and mining, 13% of gross total portfolio value). For our methodology grid, we look at the top 3 investments as a percentage of total gross portfolio value, which in KTH's case represent approximately 57%. We consider this as moderately positioned in term of its investment concentration. This investment concentration can be explained by a management focus to have a smaller number of investments in their portfolio where they exert significant influence.

Kagiso Media Limited and MMI Holdings Limited exhibited strong performance over the 2013 financial year although Exxaro Resources Limited continues to face cost pressures and a weak commodity environment which will likely continue to pressure growth prospects. While we view the asset concentration as moderate and business diversity as weak (attributed to its increased exposure to Kagiso Media), this is weakened further by the fact that the portfolio is limited solely to investments in South Africa. Management intends in the longer term to broaden its footprint of investments into the rest of Africa (particularly East and West Africa), thereby reducing the current geographical concentration of the portfolio. We are reticent of the unique risks inherent in investing into these markets but also recognise a number of opportunities that they offer, mainly high economic growth rates, which ultimately should benefit valuations.

TRACK RECORD OF SOUND GOVERNANCE AND TRANSPARENCY CONTINUES TO BE BUILT

KTH will need to continue to build upon its track record in the long term with regards to its financial policies, ongoing investment transparency (especially around its unlisted investments for which public information around these investments is not easily accessible), where successful investment management and corporate governance standards will be important rating drivers going forward. KTH is bedding down its portfolio monitoring program and is still adapting its use to more unique investment structures, where we will continue to focus closely on its broader execution in this respect, and until such time will continue to rely solely upon on the annual third party independent valuations prepared by KPMG.

Dividend payout policies are expected to continue to be conservative under KTH's management with a commitment to a maximum of 30% of fair value adjusted earnings per share going forward, subject to liquidity and solvency requirements. Additionally, KTH's board has limited debt capacity to a maximum of ZAR2.1 billion (currently ZAR0.9 billion outstanding), but there is no market value leverage target.

MARKET VALUE LEVERAGE EXPOSED TO PORTFOLIO VOLATILITY

KTH's market value leverage (MVL), is around 30% as adjusted by us, taking into account both divestitures and the Kagiso Media acquisition post the last third party portfolio valuation date of 30 June 2013. In our analysis of MVL we also 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 positions KTH moderately in its Baa2.za rating category, where we expect MVL to reduce its debt levels primarily through cash generated by wholly owned Kagiso Media. However, any reduction in KTH's MVL could be adversely impacted by a deterioration in total portfolio value or an increase in leverage 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 2.8% for South Africa in 2014 which are likely to limit the quantum of value added to a number of KTH's assets operating in this economy. KTH's MVL has headroom to accommodate additional acquisitions.

Liquidity Profile

KTH's interest coverage of 2.3x as of 30 June 2013 is a constraint to the rating. KTH's liquidity, however, is supported by its sizeable cash balances (ZAR1.284 billion as of 30 June 2013) along with undrawn committed revolving facilities (ZAR135 million). Furthermore, KTH has ZAR3.742billion in listed investments that could potentially be disposed of for liquidity purposes, after applying a 25% haircut to the independent valuation of the portfolio and subtracting associated debt while treating Kagiso Media as an unlisted investment. This includes two of the three of KTH's largest investments MMI Holdings Limited (approximately ZAR1.9 billion in value, net of debt) and Exxaro Resources Limited (approximately ZAR0.8 billion in value, net of debt).

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 which 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 SPV's along with the debt held at the holding company level, which includes a mix of bonds, preference shares and term loans. Moody's uses consolidated debt (including both ring fenced and non ring fenced debt) for calculating market value leverage.

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 a (1) decrease in market value leverage closer to 30% accompanied with the removal of BEE lock-in clauses from its larger investments and a simplification of some of the more complex investment structures; and (2) improved interest coverage above 2.5x, both on a sustained basis. Other factors that may place upward pressure on KTH's ratings or outlook are: (1) a consistent track record of prudent financial policies; (2) improved corporate governance standards in terms of more frequent and transparent reporting of third-party independent investment valuations and overall investment strategy; as well as (3) 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 market value leverage trend towards 40% or if the interest coverage ratio sustainably weakens towards 1.5x and/or does not remain supported by solid liquidity for meeting debt maturities and committed cash outlays. Any general deterioration in KTH's current disclosure standards could also prompt negative rating or outlook implications. A change in investment strategy towards capital allocation to more volatile investments with greater underlying business and liquidity risk would also put downward pressure on the rating or outlook.

Other Considerations

MAPPING TO THE METHODOLOGY

Under Moody's Global Investment Holding Company Methodology, published in October 2007, the grid indicated Global Scale Rating (GSR) as of 31 December 2013 is Ba1. The assigned National Scale Rating of Baa2.za corresponds to a Ba2 or Ba3 on the GSR. The ratings assigned take into account the future expectations for KTH, whereas the grid indicated rating is reliant on historic numbers. We note KTH's adjusted liquidity ratio is strongly positioned under our rating methodology. Even in the event of KTH not addressing its sizeable maturities in August 2017 and November 2017 twelve months prior to their maturity, their adjusted liquidity ratio would still provide a strong cushion (around 7x on a proforma basis) against these debt payments even if they were classified as short-term. In addition, KTH's evolving track record of investment management and financial strategy are not fully captured in the grid indicated rating where the assigned ratings incorporate this consideration.

Rating Factors

Kagiso Tiso Holdings Proprietary Limited[1][2]

Investment Holding Industry	Aaa	Aa	A	Baa	Ba	B	Caa
Factor 1: Asset Quality (30%)							
a) Asset Concentration (in 3 largest participations)				57%			
b) Geographic Diversity							Minimal
c) Business Diversity (# of sectors)					3		
Factor 2: Management Discipline & Group Transparency (10%)							
a) Discipline & Transparency					5.5		
Factor 3: Market Valued Based Leverage (20%)							
a) 2-year Average: Net Debt / Estimated MV of Assets					32%		
Factor 4: Cash Coverage (10%)							
a) Interest Coverage					2.3x		
Factor 5: Liquidity (15%)							
a) Influence over Dividends of Investees				40%			
b) Adjusted Liquidity Ratio	223.4x						
Factor 6: Portfolio Risk (15%)							
a) Portfolio Volatility Adjusted Leverage					Ba		
Rating:							
a) Indicated Rating from Methodology					Ba1		
b) Actual Rating Assigned					[3]Baa2.za		

[1] All ratios are calculated using Moody's Standard Adjustments. [2] Kagiso Tiso Holdings Proprietary Ltd at 31 December 2013. [3] National Scale Rating