KenolKobil Limited

Kenya Corporate Analysis **June 2013**

Security class	Rating scale	Rating	Rating outlook	Expiry date
Long Term	National	$A_{(KE)}$	Negative	06/2014
Short term	National	$A1_{(KE)}$		

Financial data:

(US$'m comparative)

	31/12/11	31/12/12
KShs/US$ (avg.)	90.1	86.7
KShs/US$ (close)	86.5	86.0
Total assets	521.4	367.3
Total debt	218.6	193.2
Total capital	124.4	64.8
Cash & equiv.	37.8	25.5
Turnover	2,466.2	2,221.9
EBITDA	87.3	(24.0)
NPAT	36.3	(72.5)
Op. cash flow	(9.4)	34.1
Market cap.*	US$201.1m	
Market share	n.a	

*As at 20 May 2013 @ KShs83.8/US$

Related methodologies/research:

Criteria For Rating Corporate Entities (Updated April 2013)
KenolKobil Limited ("KenolKobil") Rating Reports, 2004-2012

Rating history:

Initial Rating (11/2004)
Long term: $AA-_{(KE)}$
Short term: $A1+_{(KE)}$
Rating outlook: Stable

Last Rating (05/2012)
Long term: $A+_{(KE)}$
Short term: $A1_{(KE)}$
Rating outlook: Negative

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Summary rating rationale

The rating is based on the following key factors:

- KenolKobil's established position as a dominant regional oil marketer, underpinned by a strong brand and leading positions in middle to downstream oil importation and trading. The group's broad geographic footprint, which bolsters operating income, is also positively viewed.
- Despite the exceptional F11 performance, GCR had warned that the group's risk profile was increasing. This transpired in F12, as declining oil prices, sharply elevated interest charges, as well as exchange volatility, drove a KShs6.3bn net loss. Going forward, an operational overhaul, which includes, *inter alia*; improved marketing, enhanced inventory management and cost rationalisation, should support a return to profitability.
- While large trading volumes have previously driven large working capital absorptions, a deliberate effort to unwind high-cost inventories led to a large release in F12. While this was supportive of operating cash flows, a rebound in volumes and price recovery is likely to result in absorptions in the medium term, despite stricter cash management.
- Debt levels have risen substantially to fund the high business volumes arising from active participation on the open tender system ("OTS") and the sizeable trading business. This has constrained the group's financial flexibility, and resulted in persistently high gearing metrics on a month-to month-basis. Debt serviceability measures have also deteriorated, a factor exacerbated by the largely short dated nature of debt and resultant sensitivity to interest rate movements.
- The termination of the Puma sale agreement is viewed negatively, given the anticipated benefits in terms of the capital and operational support it would have provided. In light of the equity erosion and high gearing levels, finding a suitable partner is critical to continue the strong growth.
- Operations are highly susceptible to oil price and exchange rate volatility, as well as licencing and other regulatory changes in the various geographies it operates.

What could trigger a rating action

Positive movement factors:
Improved cash flows, underpinned by a return to sustainable profitability should be supportive of a more robust medium term credit profile. Capital support from current shareholders or a strategic investor will also alleviate funding pressure.

Negative movement factors:
The maintenance of substantial trading volumes without further funding support or improved exchange risk mitigants could drive further losses. Given the highly geared balance sheet, continued oil price deflation would place downward pressure on the rating.

Business profile and recent developments

KenolKobil (formerly Kenya Oil Company Limited) is a leading distributor and marketer of petroleum and associated products in East Africa. Its domestic position was consolidated through the acquisition of Kobil Petroleum Limited (originally domiciled in the USA) in 2008, making it one of the largest companies by asset size on the NSE. The group has also extended its footprint into Southern Africa, and has an overall network of 20 terminals that supply 413 petrol stations in 9 countries. Key shareholders as at December 2012 included Wells Petroleum Holdings (24.9%), Petroholdings (17.3%), and Highfield (12.5%).

In May 2012, KenolKobil announced that its majority shareholders had signed an agreement with Puma Energy International Plc ("Puma") to acquire their shares. It was envisaged that Puma would ultimately acquire the entire shareholding through a full-takeover bid. Puma is a global oil marketer that is 80% owned by Trafigura Baheer BV, a Dutch company interests spanning, *inter alia*; oil, coal, metals (ferrous and non-ferrous) and shipping. However, management announced the termination of the agreement, by mutual consent, in March 2013. No further information has been provided in this regard. According to press reports, the National Oil Company of Kenya ("NOCK"), a state-owned competitor, is contemplating an offer of US$300m to purchase KenolKobil. Management has not commented on these claims, stating instead that while they have been approached by potential investors, there have been no firm offers. KenolKobil remains open to proposals that are in line with its long term strategic focus for the business.

A new investor would be considered highly beneficial to KenolKobil, as it would support its strategic expansion plans. As such, management will consider transactions that can provide financial and commercial support to fund growth initiatives. In addition, a multinational investor would offer operational leverage, such as access to more competitive oil products in the international market, pricing benefits and access to shipping and storage facilities, as well as technical expertise.

Further compounding the oil marketer's woes was a large F12 net loss. Specifically, sharply decreasing oil prices at the beginning of the year, coupled with high cost inventories, notably constrained the gross margin. This was further compounded by losses deriving from forward contracts signed in F11, in an effort to mitigate the impact of the Shilling's volatility on earnings, which saw F12 foreign exchange losses virtually treble to KShs4.6bn. The group's foreign exchange exposure is a function of its large import requirement, which in recent years has been compounded by the markedly higher volumes, driven by aggressive expansion, its sizeable participation on the OTS and trading. The resultant KShs6.3bn loss consumed nearly half of the group's equity, which approximated pre-Kobil acquisition levels at FYE12. Coupled with the termination of the Puma deal, this has driven considerable underperformance of the counter. While the NSE All-share index has gained 35% since the beginning of the year, the KenolKobil share price fell to a 17-month low in April, bringing its market cap to a low of US$159m, from around US$284m in July 2012. The share price has since rebounded somewhat, on the back of takeover speculation. Considerable trades saw as much as 19 million shares traded in a single day (14 May, 2013). While speculation continues to drive share performance, management has stated that stronger results have since been achieved in 1Q F13, pointing to an expected recovery in performance in the current year.

Legacy issues continue to impact the industry, particularly inadequate storage, refining and distribution infrastructure. Inland bound deliveries from Mombasa face lengthy delays due to congestion and limited storage facilities at the port. KenolKobil's ability to maintain consistent supplies has also been affected by inefficient and inadequate refining capacity at government and Essar joint venture Kenya Petroleum Refineries Limited ("KPRL") and the state-owned Kenya Pipeline Company Limited's ("KPC") inadequate pipeline infrastructure.

These public infrastructure constraints result in excessive demurrage costs, disproportionate tariffs and capacity limitations. The situation has exacerbated challenges for oil marketers, and has contributed to large multinationals exiting the market. This has led to contention with several marketers and drawn out litigation by KenolKobil against KPC for breaching transportation and storage agreements.

The industry has come under increased regulatory scrutiny in recent years, which represents mixed fortunes. In the retail segment, the Energy Regulation Commission ("ERC") has introduced price regulation to stabilise fuel costs, and is seeking to further regulate distribution. The regulation of lubricants is meant to eliminate substandard products and protect legitimate players' market share.

In response, KenolKobil has sought to enhance its higher margin, ancillary product offering, with focus on LPG and lubricants and non-fuel business lines. The client loyalty programme, which is meant to improve the foot traffic at service stations, is gaining traction through its electronic fuel management system, which is available regionally. In pursuit of it expansion strategy, KenolKobil also seeks to expand the international retail and wholesale marketing of petroleum products, in order to diversify its revenue streams. The group has secured storage and depot facilities in Tanzania, Burundi, the DRC, Rwanda, Uganda and Zambia. It has also registered a Mozambican subsidiary, with a view to expanding its operations into that country and into Zimbabwe. In addition to LPG storage and filling sites established in Kampala and Kigali, the group is building a KShs120m plant in Western Kenya and another in Lusaka to be completed by latest FYE14. Looking ahead, the capex programme is likely to be scaled back, as KenolKobil focuses on consolidating its capital base in the wake of recent losses the reduction of borrowings.

Earnings diversification

Geographically, Kenya remains the key operational focus, as it accounts for around 80% of turnover. However, the group's diversification has enhanced profitability, with the other countries to contribute an average of 40% of earnings over time. Operationally, the group is segmented into Inland market (wholesale and retail operations), Export Trading & Aviation (oil trading, storage and distribution), and ancillary business lines such as LPG and non-fuels. The segments are closely aligned, with resultant synergies providing critical cost savings. Given this integration, the allocation of assets and liabilities to specific segments is superficial.

Inland market (KShs'm)	F11	F12	%Δ
Revenue	94,212	80,297	(14.8)
Gross profit	6,955	3,801	(45.3)
Op. income	**2,233**	**(2,078)**	**n.a**
Net fin. charge	(1,013)	(3,744)	269.6
NPAT	**793**	**(4,039)**	**n.a**
Gross margin (%)	7.4	4.7	-
Op. margin (%)	2.4	(2.6)	-
Net interest cover (x)	2.2	(0.6)	-

KenolKobil markets and distributes motor fuels, K-gas, branded lubricants as well as a range of non-fuel supplies including car care products and accessories. Marketing is further split into retail, which supplies consumers, and commercial, which caters for bulk orders from corporate clients. Although demand is more predictable than in the Export business, performance remains susceptible to price volatility, given its inherently thin margins. A broader retail footprint drove a 74% rise in revenue to a high of KShs94bn in F11. In F12, however, declining oil prices resulted in regulated pump price decreases in the first quarter, which saw the top line retreat by 15% to KShs80m. Volumes were not materially impacted, as they were shored up the group's customer loyalty programme, which offers discounts and pre/post-paid fuel cards. However, margins were markedly compressed by the reduced pump prices, a factor compounded by foreign exchange losses.

Export, trading, aviation (KShs'm)	F11	F12	%Δ
Revenue	123,783	108,367	(12.5)
Gross profit	3,804	(594)	n.a
Op. income	**3,604**	**(923)**	**n.a**
Net fin. charge	(1,213)	(2,889)	138.2
NPAT	**1,600**	**(2,728)**	**n.a**
Gross margin (%)	3.1	(0.5)	-
Op. margin (%)	2.9	(0.9)	-
Net interest cover (x)	3.0	(0.3)	-

KenolKobil sells crude and refined bulk petroleum and LPG to many countries in sub-Saharan Africa. Reliability, deriving from well-established linkages with its suppliers, provides a distinctive advantage over other indigenous oil marketers in the midstream petroleum market. In addition, a sound financial base and liquidity support ensure that the group is able to meet demand from its growing customer base in this segment, largely comprised of governments and other oil marketers. KenolKobil is also a key exporter of petroleum products to other countries in the region, where its position is protected by short lead times and high capacity storage depots and LPG filling plants. A sharp spike in the Kenyan Shilling oil price, coupled with the growth of the group's African trading operations, saw Export turnover nearly treble in F11. In contrast, F12 saw a 15% contraction in sales, driven by a decline in volumes, which arose from constricted export and aviation volumes, especially in the second half. The segment also reported losses in F12, reflecting the high cost base inherent in the industry. This was exacerbated by the strengthening of the Shilling and the inflated value of crude oil inventories. Looking ahead, the group continues to focus on the expansion of its client base. This will, however, require material fixed capital formation, particularly with regards to storage.

Other business lines (KShs'm)	F11	F12	%Δ
Turnover	4,308	3,864	(10.3)
Gross profit	1,436	1,081	(24.7)
Op. income	**1,398**	**916**	**(34.5)**
Net fin. charge	(79)	(245)	209.1
NPAT*	**878**	**485**	**(44.7)**
Gross margin (%)	33.3	28.0	-
Op. margin (%)	32.5	23.7	-
Net interest cover (x)	17.6	3.7	-

*Excludes equity accounted income.

This segment is an alternate revenue stream that mainly leverages off the group's service station network. This primarily comprises the leasing of premises to businesses, such as fast food outlets, minimarkets, banks, tyre dealers, and pharmacies. The administration is contracted out to third parties with the relevant real estate management expertise. K-gas is also sold through the petrol station network and supermarkets. Turnover contracted by 10% in F12, as some of the group's clients scaled back their operations in the face of high interest rates. Albeit still profitable, some margin compression was also evidenced, indicating the higher administrative outlay and lower escalations on leases. Looking ahead, the group intends to broaden this segment, and has begun remodelling and expanding some of its service stations to extend their lettable area.

Operating environment

The Kenyan economy remained stable despite the slowing global economy, with GDP growth of nearly 5% in 2012. This was driven by strong consumptive demand, coupled with robust fixed capital formation.

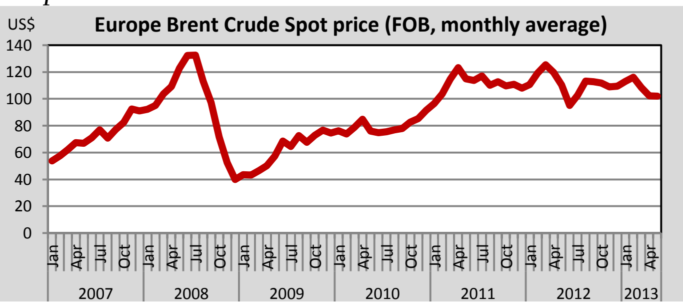
Economic indicators	2008	2009	2010	2011	2012 *
GDP (US$'bn)	30.0	30.6	32.1	34.1	41.1
Real GDP growth (%)	1.5	2.6	5.8	4.4	4.6
GDP per capita (US$)	801.4	792.2	807.5	832.5	976.5
Avg. inflation (%)	16.3	9.2	4.0	14.0	9.4
Avg. 91 day TB rate (%)	7.7	7.4	3.6	7.0	12.8
KShs/US$ (avg)	69.2	77.4	79.2	88.8	83.2

Estimates. Source: IMF, CBK

This notwithstanding, the operating environment has been fraught with challenges. Rapidly rising inflation, initially driven by escalating food and fuel prices, had knock-on effects on other productive sectors. As such, inflation rose to a high of 19.7% in November 2011. This prompted the Monetary Policy Committee ("MPC") to hike the Central Bank Rate by a cumulative 950 basis points to a high of 18% between December 2011 and June 2012. Positively, cost pressures have since eased, with inflation averaging 9% in 2012. Having opened at 3.2% in January 2013, the overall rate of inflation had crept up to 4.1% by the end of March, pointing to a recovery in business confidence following subdued activity in the run up to the elections. The MPC has progressively reduced the CBR to 9.5% from January 2013, while the 91-day T-bill rate had fallen to 10.2% as of April 2013, from highs of over 20%. Largely due to monetary policy changes and the resultant inflationary pressures, the Shilling depreciated sharply against major currencies during 2011, reaching a record low of KShs107/US$ in October of that year. Central Bank intervention and some profit taking has since seen the currency recover to average KShs83/US$ in 2012 and KShs85/US$ during 1Q 2013. Going forward, volatility is expected to derive from the fluctuation in the price of key imports such as oil and electricity, and efforts to address persistent balance of payment deficits.

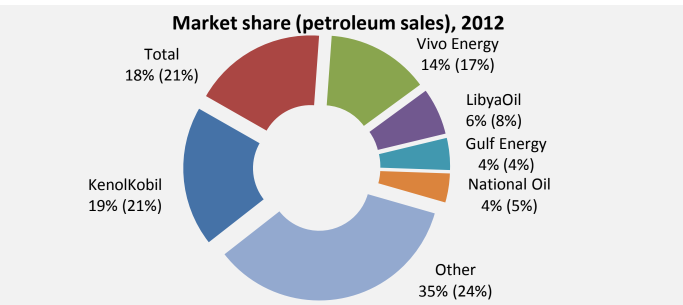
Looking ahead, the projected 2013 real GDP growth of 5.9% will be largely driven by private consumption. Despite intermittent inflationary pressures, levels of disposal income continue to rise. Lending to the private sector accounted for 79% of credit extended in 2012, with 14% of cash flows directed at households. While credit extension to the private sector has slowed, an uptick is expected in 2H 2013, given the accommodating monetary policy and envisaged business recovery. This should boost spending by the rapidly growing urban population, further driving demand for higher levels of economic activity and demand for oil and gas.

Oil prices



Oil prices remain close to all-time highs, driven by resilient global demand for energy and a relatively weak Dollar. From an average of US$79.5/bbl in 2010, prices rallied to a high of nearly US$127/bbl in May 2011. Some deceleration has since been in evidence, although prices continue to fluctuate within a relatively narrow band, averaging US$109.9/bbl in the 4 months to April 2013 (2012: US$111.7/bbl). Price increases are largely passed onto consumers, driving turnover growth and higher operating profitability. However, the costlier inventories and larger working capital absorptions drive significant liquidity pressure and raise gearing metrics.

Competitive positioning: KenolKobil has over the years accounted for over 40% of crude imports under the OTS, with Gulf energy procuring nearly 30% of the quota. The domestic crude requirement is estimated at 160,000MT per month. KPRL is expected to begin to import crude oil, and has reportedly secured KShs21bn in funding to facilitate an upgrade and transition to a merchant facility. This will allow marketers to buy product from international refineries, as opposed to the current requirement to process about 50% of their quota through KPRL. The timeline for this development, however, is highly uncertain.



Source: Petroleum Institute of East Africa

Currently petroleum sales are dominated by a few players that account for around 75% of the market share. This is complemented by a fluid, highly fragmented second tier. KenolKobil and Total dominate this segment, followed by Vivo Energy (formerly Kenya Shell). Local petroleum product sales volumes have increased at a compounded growth rate of 6% over the 5-year period to 2012, registering at moderately higher 4.6 million m^3.

Looking ahead, BP (which exited the market in 2007) intends to re-introduce its branded lubricants, increasing competition for the dominant players. This follows a year of general underperformance in the industry, which saw large players fail to return a profit. Total Kenya reported a second consecutive net loss of KShs202m in F12, from KShs71m previously, while Vivo Energy has reportedly laid off staff due to operating challenges. A comparison of KenolKobil and Total Kenya, the 2 major listed oil marketers, is shown below. While KenolKobil previously outperformed Total Kenya, both entities evidenced operational strain in F12. It is however, noted that the latter evidenced a 15% uptick in sales volumes, despite the difficult climate. Total Kenya's gearing metrics also improved notably, on the back of additional capital.

Comparatives (KShs'bn)	KenolKobil			Total Kenya		
	F10	F11	F12	F10	F11	F12
Revenue	101.6	222.3	192.5	64.4	92.5	107.5
Gross profit	7.6	12.2	4.3	5.3	4.7	5.9
Operating profit	**4.2**	**7.6**	**(2.1)**	**2.5**	**1.5**	**1.5**
NPAT	1.9	3.3	(6.3)	0.9	(0.1)	(0.2)
Op. cash flow	(9.7)	(0.9)	3.0	6.0	(2.0)	6.7
Equity	10.3	10.8	5.6	9.1	8.8	13.8
Total assets	**29.5**	**45.1**	**31.6**	**29.8**	**34.6**	**32.6**
Net debt*	11.6	15.6	14.4	9.0	13.3	4.5
Revenue Δ (%)	5.1	118.7	(13.4)	97.0	43.8	16.1
Gross margin (%)	7.5	5.5	2.2	8.3	5.1	5.5
Op. margin (%)	4.1	3.4	(1.1)	4.0	1.6	1.4
Interest cover (x)	10.5	6.6	neg	2.6	0.9	1.0
Net gearing (%)	112.5	145.3	258.8	99.0	151.6	32.8

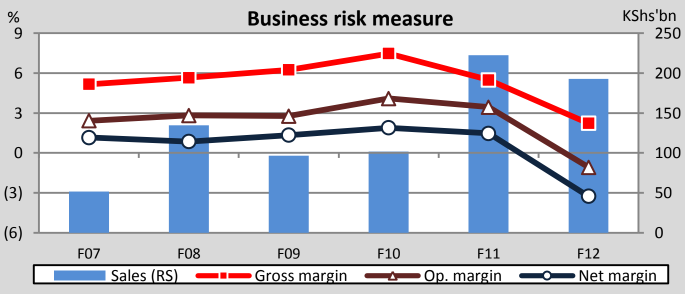
*Total Kenya's figure may include other liabilities for F12. Equity is inclusive of redeemable pref. shares.

Financial performance

A 5-year financial synopsis is appended to this report, whilst brief comment follows. PWC issued an unqualified audit opinion on the F12 financial results.

Financial performance (KShs'm)	F11	F12		%Δ
	Actual	Actual	Budget	
Revenue	222,302	192,527	268,931	(28.4)
Gross profit	12,195	4,288	11,866	(63.9)
EBITDA	7,871	(1,896)	8,229	n.a
Operating profit	**7,645**	**(2,084)**	**8,003**	**n.a**
Finance charges	(1,150)	(2,273)	(1,594)	42.6
Exchange gains/losses	(1,155)	(4,606)	-	-
NPBT	**4,931**	**(8,962)**	**6,409**	**n.a**
Revenue growth (%)	118.7	(13.4)	21.0	-
Gross margin (%)	5.5	2.2	4.4	-
Operating margin (%)	3.3	(1.1)	3.0	-
Net interest cover (x)	6.6	neg	5.0	-

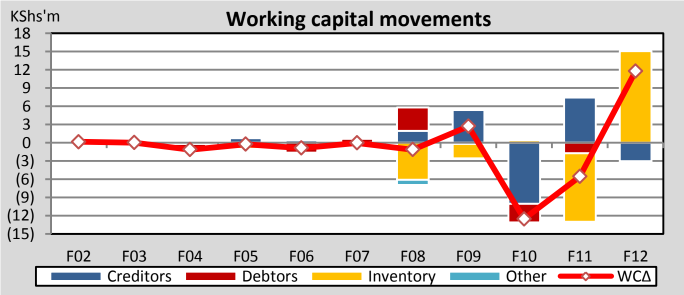
Price volatility, interspersed with organic and acquisitive growth, has seen top line performance fluctuate markedly over the review period. The Kobil acquisition saw group revenues more than double in the 15-month period to December F08. This, was, however, followed by a sharp decline in oil prices, which drove a 10% contraction in turnover in F09 and led to subdued performance in F10. Depreciation of the local currency in F11 drove a sharp rise in oil prices in Shilling terms, and coupled with robust volumes, underpinned a 119% rise in revenue to a high of KShs222.3bn. Reduced sales by the Africa trading desk in the second half, coupled with lower aviation demand, saw sales volumes decline by 21% in F12. In the face of waning prices, this underpinned a 13% decline in revenue to KShs192.5bn (28% behind the original target), despite stronger sales volumes from subsidiaries.



The gross margin came under considerable pressure when regulators reduced the pump price of petroleum products. In addition, the strengthening Shilling drove further margin compression for the Export, Trading, Power and Aviation business lines. The high levels of refined and crude oil inventories carried at high cost, also served to inflate the cost of sales, particularly in the first quarter. As such, the gross margin shed more than 3 percentage points to register at a low 2.2% in F12 (budget: 4.4%), compared to a review period high of 7.5%. Management has adopted various cost containment initiatives, including the rationalisation of operations to eliminate redundancies. However, administrative overheads were inflated by a change in the revaluation and measurement of inventory, which resulted in a KShs1.4bn charge in F12. In view of the thin gross margins, the group was unable to recoup its costs, and registered the initial operating loss over the 5-year period of KShs2.1bn.

The most material impact on profitability derived from foreign exchange volatility. Losses usually arise when the Shilling depreciates against the US$, adversely impacting unhedged oil purchases, or when the group hedges a purchase by buying foreign currency forward and the Shilling then appreciates against the US$. Hedges taken out towards the end of F11, and rolled-over forward contracts drove a KShs4.6bn loss in F12. Operations evidence considerable sensitivity to foreign exchange movements due to the high import component, and registered cumulative losses of KShs5.8bn since F11. According to management, KenolKobil currently only hedges specific transactions to mitigate this risk, which at 1Q F13 equated to 25% of its full exposure. Despite the decline in debt, the net finance charge more than doubled for the second consecutive year to reach a high of KShs2.3bn in F12. This has been driven by the sharp increase in interest rates, which saw lending rates rise to average around 20% p.a. from December 2011 to August 2012. Specifically, KenolKobil's effective rate rose to 20.9% in F12, from 13.8% previously. Note is also taken of the lower interest income derived from reduced cash during F12. Overall, and notwithstanding a KShs2.7bn taxation credit, the group reported a net loss of KShs6.3bn, against a target of KShs4.3bn.

Following record cash generation in F11, cash flows were notably constricted in F12, which saw operations utilise KShs5.7bn. Positively, a KShs11.7bn working capital release arose from a KShs15.1bn reduction of inventories, as the group offloaded its expensive stock of crude and refined product. This was partly offset by payments to creditors of KShs3.1bn and a moderate increase in receivables. Working capital requirements are sizeable, and fluctuate depending on the group's OTS participation. The positions change fairly quickly, and spikes in monthly requirements usually occur when the group has won OTS tenders. These are funded by short term facilities that unwind as inventories and debtors are released. KenolKobil uses letters of credit to facilitate credit terms on its imports. The group usually borrows to fund 35 days credit under the OTS, for both crude and refined products. Debt levels have become much higher since F08, due to the group's larger scale since the Kobil acquisition, as well as price and exchange rate volatility.



Following a combined interest and taxation outlay of KShs3.1bn, operations reverted to a positive cash flow of KShs3bn in F12. This followed 2 successive absorptions, driven by the group's active participation on the OTS. According to KenolKobil, management of inventories and credit control has improved notably, as evidenced by the containment of the average debtors collection period to 20 days, and higher inventory turnover. Nonetheless, an uptick in demand, especially in the Export and Trading segment is likely to drive absorptions going forward.

Between 40%-45% of net income has been paid out as dividends over the review period. Despite the losses registered, a KShs596m distribution was paid out in F12, drawing from reserves. Having doubled to KShs1.2bn in F11, capex decreased by 29% to KShs859m, falling behind a budget of KShs1.1bn. This largely related to the expansion of the local network, as well as development of storage and other infrastructure by regional subsidiaries. The group has spent a cumulative KShs2.1bn on capex in the past 2 years. A return to consistent profitability should see capex increase as KenolKobil augments its position in the region. Overall, the group reported a decrease in net debt of KShs1.2bn in F12 (F11: KShs4bn), contrasting a cumulative KShs15.1bn increase in the prior 2 years.

Funding and liquidity profile

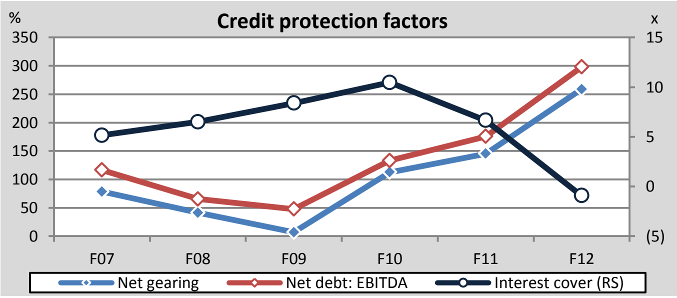
Non-cash current assets comprised a lower 70% of the asset base at FYE12, from 82% previously. This was largely driven by the large release of inventories, which consequently saw stocks decline to comprise 28% of assets (FYE11: 53%), a review period low. Cognisance is nonetheless taken of the elevated stock levels (partly attributable to high Shilling values) at the prior year end, which serve to distort the comparison somewhat. Notwithstanding the reduced capex outlay, fixed assets accounted for a higher 13% of the constricted asset base

(FYE11: 8%), and registered a moderate increase in value of 13% to KShs4.3bn.

Funding profile (KShs'm)	F10	F11	F12	Forecast F12*
Cash	2,133	3,272	2,191	847
Short term debt	13,678	17,375	15,947	14,711
Long term debt	95	1,530	668	446
Total debt	**13,773**	**18,905**	**16,615**	**15,157**
Equity	10,342	10,759	5,574	7,322
Net debt: EBITDA (%)	266.8	198.6	neg	2,651.2
Net debt: equity (%)	112.5	145.3	258.8	195.4
Cash: ST debt (x)	0.2	0.2	0.1	0.1
Net interest cover (x)	10.5	6.6	neg	0.0
NWC: ST debt (x)°	1.4	1.4	0.8	1.2

*Based on reviewed forecasts.
°Debtors plus inventories, less trade payables.

Over the review period, the funding profile has shifted towards debt, which at FYE12 constituted 53% of the group's financing, compared to a low 25% at FYE08. This has been driven by KenolKobil's active participation in OTS activities, as well as regional oil procurement and distribution. Accordingly, debt peaked at KShs18.9bn at FYE11, over 4x above the 5-year low reported at FYE09. Debt had been reduced to KShs16.6bn by FYE12, a factor attributed to improved management of working capital. Following a period of strong equity formation, the large losses reported in F12 significantly eroded the capital base. As such, equity declined by 48% to a new low of KShs5.6bn. Gearing measures, which had previously risen well above FYE09 lows due to liquidity pressures, deteriorated markedly as a result. Accordingly, net gearing was reported at a high of 259%, against a forecast of 195%, while earnings based gearing metrics were negative for the first time over the review period. Net interest coverage was also negative, contrasting the robust F11 position of 6.6x. Cash flow coverage of debt was positive, although it remains to be seen whether this can be sustained during periods of robust demand.



Debt has traditionally been largely short term in nature, comprising a high 96% of the total at FYE12 (FYE11: 92%). The group's reduced cash reserves covered short term obligations 0.1x (FYE11: 0.2x), while coverage by debtors and inventory fell to 1.4x, from 2.1x previously. In view of the reduced inventories held at FYE12, US$ bank borrowings accounted for a lower 44% of total debt (FYE11: 61%). Kenyan Shilling denominated notes and overdrafts comprised a further 34% (FYE11: 20%), whilst commercial paper (90 day maturities) constituted 10% (FYE11: 6%). The balance was largely comprised of debt in currencies that the group's subsidiaries trade in (predominantly the Tanzanian Shilling), with a nominal amount related to finance leases.

Bank borrowings were secured by fixed assets valued at around KShs3bn. KenolKobil has a consortium of banking counterparties, which include Stanbic, BNP Paribus, KCB, BoA, CBA and NIC. These provide trade financing facilities of up to US$360m. The group also had US$482m in letter of credit facilities (F11: US$581m), of which US$316m remained unutilised at year end. In order to fund capex, KenolKobil raised US$17m in medium term debt in F11, with maturities capped at 2 years.

Outlook

Although 1Q F13 revenues were subdued, the group evidenced some improvement in margins, and reported nominal foreign exchange losses. Management is currently focused on cost rationalisation, and managed to reduce monthly running costs by 35% in the first quarter. Going forward, KenolKobil is targeting higher margin business lines in order to ensure stable profitability. As a part of its enhanced working capital management policy, management is also actively reducing fuel inventories, and is planning to pay down as much debt as possible to alleviate funding pressure and finance costs. In this regard, the group also recently put up some of its under-performing assets for sale. In addition, capex will be reined in over the short term to conserve capital. Together with competitive pricing across its product lines and more conservative hedging policies, management anticipates that these changes will drive stronger medium term performance.

Full year targets anticipate relatively conservative volume growth and a return to profitability, supported by strict cost containment and improved procurement policies. Margins are, however, not likely to rebound to pre-F12 levels in the short term, given that oil prices remain subdued. Capex spend is expected to be moderate, with capital commitments at FYE12 registering at a low KShs237m and the total for the year not expected to exceed KShs500m. Looking ahead, borrowings will continue to be driven by operational activity. In this regard, capital support deriving from a strategic investor would enable KenolKobil to further expand its geographic footprint, without unduly exacerbating funding pressure.

KenolKobil Limited

(Kenyan Shillings in Millions except as Noted)

Year ended : December	2008°	2009	2010	2011	2012
Income Statement					
Net Turnover	**134,518.3**	**96,692.8**	**101,649.6**	**222,302.3**	**192,527.5**
Gross profit	7,608.6	6,038.0	7,597.0	12,194.8	4,288.2
EBITDA	4,161.2	3,048.3	4,362.3	7,871.3	(1,896.2)
Depreciation	(375.2)	(368.3)	(204.5)	(226.3)	(187.7)
Operating income	**3,786.0**	**2,680.0**	**4,157.7**	**7,645.0**	**(2,083.9)**
Net finance income (charge)	(581.6)	(319.5)	(397.5)	(1,149.7)	(2,272.8)
Net foreign exchange transaction gains/(losses)	(980.3)	(134.8)	(573.1)	(1,155.5)	(4,605.6)
Amortisation	(342.5)	(292.9)	(351.9)	(409.2)	0.0
Abnormal/Exceptional items	(1.8)	0.0	0.0	0.0	0.0
NPBT	**1,879.8**	**1,932.9**	**2,835.3**	**4,930.6**	**(8,962.3)**
Taxation charge	(724.5)	(639.0)	(921.2)	(1,660.0)	2,680.1
NPAT	**1,155.3**	**1,293.9**	**1,914.1**	**3,270.7**	**(6,282.2)**
Attributable earnings	1,155.3	1,294.5	1,915.0	3,273.8	(6,284.6)
Extraordinary items	0.0	0.0	0.0	0.0	0.0
Cash Flow Statement					
Cash generated by operations	3,275.4	2,582.4	3,884.1	7,130.1	(5,657.9)
Utilised to increase working capital	(1,141.6)	2,680.9	(12,549.6)	(5,587.1)	11,744.4
Net finance charges	(581.6)	(319.5)	(397.5)	(1,149.7)	(2,272.8)
Taxation paid	(451.3)	(794.0)	(634.5)	(1,244.8)	(857.7)
Cash flow from operations	**1,100.9**	**4,149.8**	**(9,697.5)**	**(851.5)**	**2,956.1**
Maintenance capex*	(375.2)	(368.3)	(204.5)	(226.3)	(187.7)
Discretionary cash flow from operations	**725.7**	**3,781.5**	**(9,902.0)**	**(1,077.8)**	**2,768.4**
Dividends paid	(748.3)	(479.2)	(479.6)	(1,582.7)	(596.2)
Retained cash flow	(22.6)	3,302.2	(10,381.6)	(2,660.6)	2,172.2
Net expansionary capex	(113.7)	(8.1)	(381.1)	(979.5)	(666.7)
Investments and other	(400.2)	(306.7)	(312.2)	(528.4)	(320.4)
Proceeds on sale of assets/investments	11.1	522.5	2.2	162.6	11.4
Shares issued	0.0	0.0	0.0	0.0	0.0
Cash movement: (increase)/decrease	(182.8)	(1,194.1)	1,580.8	(1,126.4)	1,093.6
Borrowings: increase/(decrease)	708.1	(2,315.9)	9,491.9	5,132.3	(2,290.1)
Net increase/(decrease) in debt	525.3	(3,510.0)	11,072.7	4,005.8	(1,196.5)
Balance Sheet					
Ordinary shareholders interest	10,060.2	8,963.2	10,342.1	10,759.2	5,574.1
Outside shareholders interest	0.0	0.0	0.0	0.0	0.0
Pref shares and conv debentures	0.0	0.0	0.0	0.0	0.0
Total shareholders' interest	**10,060.2**	**8,963.2**	**10,342.1**	**10,759.2**	**5,574.1**
Short term debt	6,464.8	4,204.9	13,677.7	17,375.2	15,947.2
Long term debt	131.9	75.9	95.0	1,529.7	667.6
Total interest-bearing debt	**6,596.7**	**4,280.8**	**13,772.6**	**18,904.9**	**16,614.8**
Interest-free liabilities	10,196.0	15,336.1	5,391.1	15,418.9	9,393.6
Total liabilities	**26,853.0**	**28,580.1**	**29,505.8**	**45,083.1**	**31,582.5**
Fixed assets	4,863.6	2,839.7	2,935.4	3,778.1	4,284.4
Investments and other	878.0	616.3	557.0	1,159.1	2,757.7
Cash and cash equivalent	2,437.9	3,677.9	2,133.1	3,271.7	2,191.0
Other current assets	18,673.5	21,446.2	23,880.4	36,874.1	22,349.4
Total assets	**26,853.0**	**28,580.1**	**29,505.8**	**45,083.1**	**31,582.5**
Ratios					
Cash flow:					
Operating cash flow : total debt (%)	13.4	96.9	neg	neg	17.8
Discretionary cash flow : net debt (%)	14.0	627.2	neg	neg	19.2
Profitability:					
Turnover growth (%)	108.5	(10.1)	5.1	118.7	(13.4)
Gross profit margin (%)	5.7	6.2	7.5	5.5	2.2
EBIDTA : revenues (%)	3.1	3.2	4.3	3.5	(1.0)
Operating profit margin (%)	2.8	2.8	4.1	3.4	(1.1)
EBIDTA : average total assets (%)	27.3	12.4	16.7	22.8	neg
Return on equity (%)	12.3	13.6	19.8	31.0	neg
Coverage:					
Operating income : gross interest (x)	5.7	5.9	7.6	5.4	neg
Operating income : net interest (x)	6.5	8.4	10.5	6.6	neg
Activity and liquidity:					
Trading assets turnover (x)	18.7	12.4	8.0	10.2	20.0
Days receivable outstanding (days)	18.7	29.9	34.3	19.6	20.0
Current ratio (:1)	1.3	1.3	1.4	1.2	1.0
Capitalisation:					
Net debt : equity (%)	41.3	6.7	112.5	145.3	258.8
Total debt : equity (%)	65.6	47.8	133.2	175.7	298.1
Total debt : EBITDA (%)	198.2	140.4	315.7	240.2	neg
Net debt : EBITDA (%)	124.9	19.8	266.8	198.6	neg

* Depreciation used as a proxy.

° Post Kobil acquisition, 15 months to 31 December. For periods prior to 2008 KenolKobil's year end was 30 September.

SALIENT POINTS OF ACCORDED RATINGS

GCR affirms that a.) no part of the rating was influenced by any other business activities of the credit rating agency; b.) the rating was based solely on the merits of the rated entity, security or financial instrument being rated; c.) such rating was an independent evaluation of the risks and merits of the rated entity, security or financial instrument; and d.) the validity of the rating is for a maximum of 12 months, or earlier as indicated by the applicable credit rating document.

KenolKobil Limited participated in the rating process via face-to-face management meetings, teleconferences and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible.

The credit rating/s has been disclosed to KenolKobil Limited with no contestation of the rating.

The information received from KenolKobil Limited and other reliable third parties to accord the credit rating included the latest audited annual financial statements (plus four years of comparative numbers), full year detailed budgeted financial statements, most recent year to date management accounts, corporate governance and enterprise risk framework, capital management policy, industry comparative data, regulatory framework and a breakdown of facilities available (including related counterparties). In addition, information specific to the rated entity and/or industry was also received.