GCR GLOBAL CREDIT RATING CO.
Local Expertise • Global Presence

Athi River Mining Limited

Melanie Brown brown@globalratings.net
Richard Hoffman hoffman@globalratings.net

Kenyan Industrial Analysis

Security class	Rating scale	Currency	Rating	Expiry date	Rating outlook
Short term	National	KShs	A1	06/2007	Positive
Long term	National	KShs	A	06/2007	

Fundamentals

Athi River Mining ("ARM") began operations in 1973 as a manufacturer of agricultural lime. Product offering has since expanded to incorporate the quarrying and processing of numerous minerals for sale to a diverse range of industries. Key products include cement, lime and sodium silicate; with the group currently operating 4 plants (of which 2 are in Tanzania and South Africa). ARM is listed on the NSE and, as at 12 May 2006, had a market capitalisation of KShs6bn (equivalent to US$82m).

Rating rationale

Our rating is based on the following key factors:

- ARM's status as the leading producer of mineral related products in Kenya, and its leading position in most of its key markets (barring cement and fertiliser), was positively viewed.
- The experienced and innovative management team, which has successfully diversified and expanded the group's product offerings and geographic footprint. Management has also displayed an aptitude for identifying growth opportunities and successfully implementing horizontal integration strategies.
- The strong growth in profits and cash flows, coupled with growth potential throughout sub-Saharan Africa (in particular sodium silicate and lime), bodes positively for the group.
- The restructuring of the balance sheet, with a shift towards longer-tenor debt, with cognisance taken of the improvement in liquidity in F05. Further comfort is derived from the 3-year debt moratorium on principal repayments of 90% of its borrowings. Furthermore, ready access to capital markets (evidenced by the oversubscribed bond issue) and unutilised borrowing facilities were positively viewed.
- However, the sharp rise in interest-bearing debt (and concomitant rise in gearing) implies increased financial risk. Moreover, future expansion/acquisitions will require additional funding, although according to management net gearing is expected to remain relatively unchanged at 90% in F06, despite the increase in borrowings.

Funding profile

Total interest bearing debt rose by 272% to KShs1.4bn in F05, following the successful KShs800m bond listing during the year to fund the construction of the clinker plant at Kaloleni. Net gearing rose to 91% in F05, from 35% previously, below initial expectations of 108%. The bond raising exercise, together with an increase in bank loans and paydown of overdrafts, has enabled a shift in the maturity profile of debt - with a much lower 7% of debt payable in the short term (F04: 55%). This has eased liquidity pressure, with cash coverage of short term debt rising to 3x in F05 (F04: 0.1x). Moreover, the strong operating performance has sustained the high net interest coverage of 8x in F05 (F04: 11x).

Potential risks

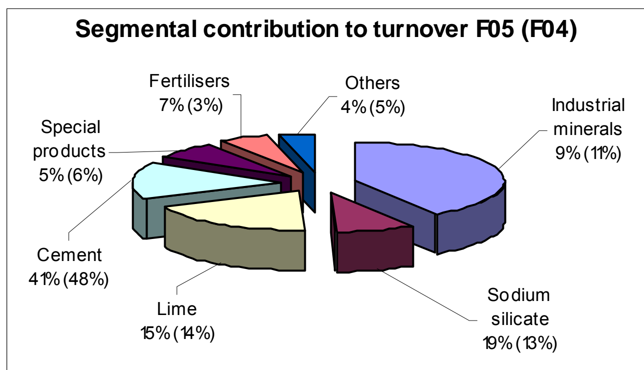
- The group's high exposure to the Kenyan economy, and in particular the building and construction industry, implies considerable risk. In particular, a slowdown in infrastructure spend could induce flagging demand for ARM's core cement product and costly excess capacity. Notwithstanding this, given supply deficits in both Kenya and its neighbouring countries, the risk of excess capacity in the medium term is considered marginal.
- ARM's rapid expansion increases it risk profile, not only as it exerts undue pressure on the balance sheet, but could also, *inter alia,* place strain on human capital, and increase the vulnerability to a slowdown in demand. However, cognisance is taken of the steps taken by management to mitigate these risks.

This document is confidential and issued for the information of clients only. It is subject to copyright and may not be reproduced in whole or in part without the written permission of Global Credit Rating Co. ("GCR"). The credit ratings and other opinions contained herein are, and must be construed solely as, statements of opinion and not statements of fact or recommendations to purchase, sell or hold any securities. No warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability or fitness for any particular purpose of any such rating or other opinion or information is given or made by GCR in any form or manner whatsoever.

GLOBAL CREDIT RATING CO.

Earnings diversification

Athi River Mining Ltd's ("ARM") core operations are based in Kenya with plants in Athi River (industrial minerals, silicate, fertilisers and special cements) and at Kaloleni (cements and lime). Furthermore, raw minerals are extracted from numerous quarries all over Kenya. As part of a geographic diversification initiative, subsidiaries have been established in Tanzania (ARMT) and South Africa (ARMSA). The Tanzanian operation, which has a plant at Tanga, manufactures lime and industrial minerals, whilst ARMSA's operation consists of a sodium silicate plant. These 4 plants service the broad sub-Saharan Africa region, with around 31% of revenue earned outside of Kenya (including exports from Kenya).



The group is essentially divided into 2 business segments, namely cement & special products and mineral & chemicals (sub-divided into industrial minerals, sodium silicate, lime and fertilisers).

Industrial minerals
Sales from this division are predominantly to the Kenyan market (65%), of which ARM currently possesses an 80% share. The remaining 35% of revenue is derived from export sales, largely to countries within the East African region.

In F05, restricted by capacity constraints, turnover increased by 9% to KShs192m, as compared to compound annual growth of 15% for the preceding 4 years. This is to be addressed through an approximate 30% increase in capacity in F06, which will facilitate increased domestic and export revenues and growth in the specialised industrial mineral products market.

Sodium Silicate
The group benefits from its status as a preferred global supplier to Unilever and future revenue in this division is assured through long-term contracts (around 70% of contracts). ARM's competitive advantage is augmented by its IS0 9001:2000 certification, which attests to the product's quality and enhances global credibility. ARM currently manufactures sodium silicate products at its Athi River Plant (40,000tpa) and at a dedicated facility in South Africa (24,000tpa). As such, ARM is the largest manufacturer of sodium silicate in East Africa (70% of sales in the region).

The SA plant commenced operations in September 2004, after management recognised the opportunity to exploit excess demand for high quality sodium silicate in the mining industry (for which there is only one other South African supplier). This has proven an immediate success, with the plant operating at full capacity in F05. The plant is supplied raw materials from Kenya, with the cost advantages achieved in Kenya mitigating transport costs. In F05, turnover from the division leapt to KShs409m (F04: KShs210m), with growth driven largely by sales from ARMSA (F05: KShs129m). During 2006, a second pressure vessel will be commissioned in South Africa, raising capacity by 50% to 36,000tpa.

The division is expected to be a key driver of revenue growth going forward, with ARM setting up operations in Mombasa. ARM will also commission a third silicate furnace, raising capacity in Kenya to 60,000 tons (from 40,000 tons per annum). The following benefits would accrue from the Mombasa operations:

- Open the Mombasa sodium silicate market to ARM.
- Give access to Mombasa's infrastructure and manufacturing base, which manifests cost savings in terms of sand, furnace oil, electricity and labour. The facility's total cost advantage relative to the Athi River facility will amount to KShs710/ton.
- Improved access to seaborne transportation, facilitating export cost advantages and an approximate KShs900/ton saving on transport costs of raw materials to South Africa.

Hydrated and Quick Lime
ARM produces both hydrated lime (at the Kaloleni plant) and quicklime (at Kaloleni and in Tanzania). These products are used in various industries, including mining, with ARM being the only manufacturer in East Africa that supplies quicklime to the specifications of the gold mining industry. It is noted that the Kaloleni lime and cement works has received both ISO 14001:2004 and ISO 9001:2000 certification.

The plant at Tanga in Tanzania (representing 38% of revenue in F05) was established in order to supply quicklime to the gold mines. In F05, the plant operated at full capacity (20,000tpa) and strong demand for quicklime has necessitated an expansion of this facility (to 40,000tpa in F06). This follows the scrapping of the proposed plant in Mali, as a result of language/cultural issues, although negotiations have begun for the acquisition of a plant in Zambia.

Recently, players in the South African paper and water treatment industry have indicated demand for ARM's white lime products (South Africa is a net importer of white lime). Accordingly, and particularly given that all lime contracts are long term, the expansion of output is particularly pressing.

Cement
Cement is the key contributor to ARM's revenue, with KShs901m (or 41% of revenue) emanating from this source in F05 (F04: 48%). This is, however, significantly lower than the 64% contributed in F01.

The production of cement is a three stage process. First raw materials are obtained, crushed and dried. Thereafter the materials are fired in a kiln to form clinker, which is the chief input in cement (75%). The clinker is then ground, together with gypsum, to form the final product. ARM currently has 120,000tpa cement capacity but produces no clinker. As such, ARM has been purchasing 80,000tpa of clinker from Bamburi Cement. The division's main competitors are East African Portland Cement and Bamburi Cement, which holds stakes in both of its competitors.

In F04 the group began construction on a 215,000tpa clinker plant. The clinker plant, costing a total of KShs1.3bn, should be operational by 3Q F06. As cement capacity will take up to 4 years to match clinker capacity, an agreement has been entered into whereby Bamburi Cement will purchase all excess clinker (approximately 40,000 tons in F06). Accordingly, if there were a downturn in the construction industry, clinker would still be sold to full capacity. Going forward, ARM expects its market share to increase to around 20% (from 6% currently) once full clinker capacity is utilised internally.

Special Products
Special products consist of a range of building products such as surface coating, tile adhesives & tile grout, cement based wall coating and marble & granite. The division has benefited from strong commercial and housing demand, with a significant contract recently obtained for the Jomo Kenyatta International airport. Revenue increased 18% to KShs123m in F05, lowering compound annual growth for the 5-year review period to 49% (also stemming from capacity constraints).

Fertilisers
Given the broad range of raw materials quarried by ARM, a natural diversification has been to utilise these for fertiliser. In this regard, ARM launched its Mavuno fertiliser in F03. Mavuno is a NPK fertiliser (nitrogen, phosphorus and potassium), which is far more effective and environmentally friendly than the common DAP (diammonium phosphate) fertiliser. This product, aside from quality advantages, is relatively simple to produce. The division's key challenge has been in educating consumers, for which it has hired NGOs to perform demonstrations. In F05, revenue rose by 228% to KShs161m.

Aside for ongoing drought concerns in Kenya, the prospects for the division are strong and, with just a 3% market share, there is significant room for growth. As such, the division will continue to engage in marketing/education activities and plans to expand its product offering to include various soil/crop-specific fertilisers.

Economic overview

As reflected below, around 83% of revenue and 88% of profits are earned by the Kenyan operations, albeit that a lesser 69% of revenue is derived from domestic sales (F04: 70%). In this regard, the group's overall performance is largely determined by its results in the Kenyan market; and hence is particularly disposed to Kenya's economic and political prospects.

Revenue by region- F05	Revenue	Profit after tax
Kenya*	1,834	175
Tanzania	245	13
South Africa	129	12
Total	2,208	200

* Net of inter-company sales.

The group is exposed to the Kenyan Shilling exchange rate in that ARM's growing export earnings tend to be in hard currency (31%), whilst its cost base is largely in Shillings, and a portion of debt (37%) is US dollar denominated. Although the Shilling has remained relatively stable over the review period, it strengthened in 2005 to average KShs75.6/US$ for the year (2004: KShs79.3/US$). However, given rising energy costs and expected weak exports, a depreciation in the KShs is expected for 2006.

Kenya
As ARM's revenue in Kenya is derived from a wide range of industries, the overall performance of the economy systematically impacts these industries.

The National Rainbow Coalition ("NARC"), under President Mwai Kibiki, was elected to rule in 2002 and inherited a beleaguered economy, suffering under drought and economic stagnation. Under a broad-based economic reform package supported by the IMF, Kenya's economic outlook has improved considerably, with economic growth transpiring in a comparatively stable macroeconomic environment. Real GDP growth registered 5.2% in 2005, up from 4.3% in 2004 and 2.8% in 2003. Economic expansion in recent years has been driven by strong performance in the trade and tourism sector, coupled with a recovery (albeit erratic) in the agricultural sector.

A key focus of Kenya's economic policy framework has been to diversify the economic base, while also attracting foreign direct investment. In spite of this, Kenya remains an agrarian-based economy and predisposed to the region's volatile weather patterns. The economy has, however, benefited from considerable donor aid following political transformation, which has provided much needed funding for infrastructural development. Donor aid remains conditional, however, and issues such as the rejection of the new constitution and political instability

could negatively impact donor goodwill. In this respect, the World Bank recently withdrew US$250m in aid to Kenya following the attacks by government on the free press.

Prospects for the economy have been hampered in 2006 by sustained and severe drought conditions. Tea, coffee and horticulture, which are the country's major export earners, are expected to compromise GDP growth in 2006, with projections having been downwardly revised from 6% to 4.5%. Furthermore, weak exports will place significant pressure on the exchange rate. A weakening of the exchange rate in a context of high oil prices and domestic food shortages is likely to exert significant inflationary pressure, and in turn place pressure on interest rates.

Building & construction and cement

ARM is particularly impacted by the building & construction sector; from whence demand for cement and special products emanates (56% of ARM Kenya's revenue and 46% of total revenue). Real growth of 3.5% occurred in the building and construction industry in 2004 and is estimated to have risen further in 2005. This is visibly evident in rising cement sales, which amounted to 1.4Mt in 2004 (2003: 1.3Mt), and are estimated to have risen to 1.8Mt in 2005.

A major constraint to cement production in Kenya is high energy costs (17% increase in June 2006), which impact production (up to 50% of the costs of cement are energy) and transportation, as well as disruptions to the power supply. In order to reduce the risk of the latter, ARM has independent power supplies at both its plants.

Financial performance

A five-year financial synopsis is reflected at the end of this report and brief comment follows hereafter.

The sustained growth of the Kenyan economy, coupled with measured increases in capacity, resulted in a 35% rise in turnover to KShs2.2bn. This was underpinned by a 95% rise in silicate sales, 44% rise in lime sales and a sizeable 229% rise in the sale of fertiliser. Overall, the group has evidenced a compound annual growth rate of 20% since F00, enabled by the growing demand for its products and diversification achieved during the same period. In F05, the gross product margin increased to 33.5%, from 33.2% previously, on the back of relatively higher sales of value add products. Overall, the operating margin has risen consistently over the review period to a high of 14.4% (F01: 8.5%).

The net interest expense (net of capitalised interest from the bond issue) increased from KShs14m to KShs22m in F05, translating into a net interest coverage ratio of 13x (8x excluding capitalised interest). Overall, net profit before tax increased by a considerable 72% to KShs296m in F05. Following an effective taxation rate of 33% (F04: 32%), net pfit after taxation was 71% higher at KShs199.5m, having risen in each year of the review period.

Cash generated by operations rose by 60% to KShs442m in F05, translating into a cash conversion ratio of 108% (F04: 103%). Cash flow was, however, severely impacted by a considerable rise in working capital requirements of KShs116m (F04: KShs3m), largely as a result of a KShs125m increase in receivables. After higher finance charges and taxation, cash flow from operations increased by a lesser 15% to KShs249m.

Total capital expenditure rose to KShs958m in F05 (F04: KShs334m), of which KShs865m related to expansionary capex (pertaining largely to expenditure on the Kaloleni clinker facility). Overall, net debt increased by KShs708m, with a KShs291m rise in cash holdings.

Gearing profile

In F05, borrowings increased by 272% to KShs1.4bn. Accordingly, gross gearing rose to 116% (F04: 37%), whilst net gearing amounted to 91% (F04: 35%), although this is lower than the originally forecast ratio of 108%. Given the ongoing expansion of the group's operations, borrowings are expected to rise in F06, although strong profitability (KShs264m) and the revaluation of assets (KShs300m) should see net gearing remain relatively unchanged in F06.

KShs'm	F05	Forecast F06
Short term borrowings	102.4	102.5
Long term borrowings	1,306.3	1,605.4
Total borrowings	1,408.7	1,707.9
Less: cash	(302.2)	(133.8)
Net borrowings	1,106.5	1,574.1
Total debt: equity (%)	91.4	90.4
Net debt: equity (%)	116.4	98.1
Net coverage (x)	8.0	6.3

In addition, cognisance is taken of the three-year moratorium on 90% of its long term debt, as follows:

- The bond principal repayments begin in October 2008, at KShs160m every 6 months thereafter.
- The bank loan to the Kenyan operations, from PTA Bank, amounts to US$5.9m (KShs446m). The moratorium on the principal repayments of this 10-year loan ends in August 2007, although ARM has the option of extending the moratorium by 1 year.

Comfort is also derived from the fact that many of the projects are scheduled for completion in F06, and will therefore contribute fully to profits and cash flows in F07:

- Cement capacity – commissioning 3Q 2006.
- Quick & hydrated Lime – scheduled January 2007.
- Silicate – commissioning Oct 2006.

- Industrial Minerals – 80,000tpa capacity expansion to be completed end of June 2006.

There has been a marked improvement in the liquidity profile of the group. In this respect, short term debt now amounts to a much lower 7% of total debt (F04: 55%), with cash coverage of short term debt amounting to a healthy 3x (F04: 0.1x). Furthermore, net interest cover remains comfortable at 8x (F04: 11x). Cognisance is also taken of a KShs200m unused commercial paper facility, which further enhances liquidity.

Borrowing by type (KShs'm)	F04	F05	%
Bank overdrafts	140.1	60.6	4.3
Bank loans	219.7	503.2	35.7
Corporate bond	0.0	815.1	57.9
Finance leases	19.2	29.8	2.1
Total	379.0	1,408.7	100.0
Maturity Profile			
<1 year	201.5	90.0	6.6
1<2 years	50.4	26.7	1.9
2<5 years	108.0	1,016.1	73.7
> 5 years	0.0	246.0	17.8
Total*	359.9	1,378.8	100.0

* Excludes finance lease liabilities.

Future prospects

YTD performance	F06	1Q F06		1Q F05
	Budget	Actual	Budget	Actual
Turnover	2,947.1	622.4	629.2	491.3
Cost of sales	(1,735.4)	(421.7)	(435.4)	(336.0)
Gross profit	1,211.7	200.7	193.8	155.3
Operating profit	470.0	95.5	91.5	73.7
Finance costs	(72.0)	(7.6)	(4.1)	(9.8)
Profit before taxation	398.0	87.9	87.4	63.9

ARM is budgeting for a 33% rise in turnover to KShs2.9bn in F06, with Kenyan revenue alone expected to rise 38% to KShs2.5bn. Following an anticipated widening of the gross margin to 41% in F06 (F05: 34%), an operating profit of KShs470m is forecast. This translates into an operating margin of 15.9% (F05: 14.4%). Notably, finance charges are budgeted to rise by 225% to KShs72m, following the completion of the clinker plant in 2Q F06.

In F06, total capex of KShs441m is expected, of which 68% pertains to the balance of the expenditure on the clinker plant and does not include any potential acquisitions.

In F05, ARM completed its first 5-year strategic plan, during which time turnover increased by 150% and attributable earnings by 477%. The strategic vision, and growth opportunities, for the next 5 years are:

- To become a leading African manufacturer/processor of mineral raw materials, through sustained investment in technology and human capital.
- Expansion of its lime production to service the broad African market. In this regard, the doubling of capacity in Tanzania and a potential acquisition in Zambia should position the group to benefit from growing demand. The expanded sodium silicate division is also set for robust growth, underpinned by the mining sector.
- Utilising cost advantages from the new clinker plant to gain market share in the growing local cement market. The East African region is a net importer of cement, indicative of strong potential for regional expansion.
- Excellent potential for the expansion of the fertiliser division, particularly given the division's quality and cost advantages.

However, the group remains subject to a number of crucial threats/challenges, which need to be managed accordingly. These include:

- The highly geared balance sheet, coupled with the substantial rise in financing costs in F06. Furthermore, notwithstanding the restructuring of the balance sheet and easing of liquidity pressure, expansionary activity will continue to place strain on working capital.
- The group's rapid expansion increases both operational and financial risk, although cognisance is taken of the steps taken by management to mitigate these risks.
- Increased energy costs (driven by rising global oil prices) are considered a potential risk to the group, although ARM's formula based cost-plus pricing strategy ensures that ARM's margins are insulated to some degree, as an increase in input costs is immediately passed on to the customer. This strategy has allowed ARM to maintain its margins over the last couple of years despite substantial increases in energy costs.

Athi River Mining Limited

(KShs 000's except as noted)

Year end : 31 December

Income Statement	**2001**	**2002**	**2003**	**2004**	**2005**
Turnover	883,740	1,126,385	1,240,388	1,639,508	2,208,724
EBITDA	**132,705**	**160,888**	**179,808**	**271,814**	**410,565**
Depreciation	(57,450)	(59,863)	(62,223)	(85,204)	(92,232)
Operating income	**75,255**	**101,025**	**117,585**	**186,610**	**318,333**
Net finance charges	(24,228)	(18,822)	(11,618)	(14,174)	(37,293)
Interest capitalised	0	0	0	0	15,123
Amortisation	0	(67)	(68)	(68)	(243)
Abnormal/Exceptional items	0	0	25,298	0	0
NPBT	**51,027**	**82,136**	**131,197**	**172,368**	**295,920**
Taxation paid	(17,222)	(24,746)	(34,091)	(55,650)	(96,416)
NPAT	33,805	57,390	97,106	116,718	199,504
Attributable earnings	**33,805**	**57,390**	**71,808**	**115,998**	**195,124**
Cash Flow Statement					
Cash generated by operations	**139,080**	**166,242**	**184,837**	**276,955**	**442,341**
Utilised to increase working capital	(16,460)	10,276	(36,825)	(2,838)	(116,162)
Net finance charges	(24,010)	(18,527)	(11,635)	(16,249)	(20,795)
Taxation paid	0	(7,777)	(36,386)	(42,341)	(56,636)
Cash flow from operations	**98,610**	**150,214**	**99,991**	**215,527**	**248,748**
Maintenance capex*	(51,402)	(59,863)	(62,223)	(85,204)	(92,232)
Discretionary cash flow from operations	**47,208**	**90,351**	**37,768**	**130,323**	**156,516**
Dividends paid	(18,146)	(28,050)	(46,500)	(47,000)	0
Retained cash flow	**29,062**	**62,301**	**(8,732)**	**83,323**	**156,516**
Net expansionary capex	(390)	(52,676)	(165,681)	(248,498)	(865,422)
Investments and other	(285)	(655)	0	0	0
Proceeds on sale of assets/investments	3,686	350	80,799	1,290	500
Shares issued	0	0	0	0	0
Cash movement: (increase)/decrease	(4,229)	3,054	(22,680)	133,174	(290,515)
Borrowings: increase/(decrease)	(27,844)	(12,374)	116,294	30,711	998,921
Net increase/(decrease) in debt	**(32,073)**	**(9,320)**	**93,614**	**163,885**	**708,406**
Balance Sheet					
Ordinary shareholders interest	833,312	862,802	913,408	986,188	1,162,219
Outside shareholders interest	0	0	50,702	53,039	47,750
Pref shares and conv debentures	0	0	0	0	0
Total shareholders' interest	**833,312**	**862,802**	**964,110**	**1,039,227**	**1,209,969**
Short term debt	109,970	76,763	86,323	207,245	102,407
Long term debt	0	20,833	151,676	171,772	1,306,267
Total interest-bearing debt	**109,970**	**97,596**	**237,999**	**379,017**	**1,408,674**
Interest-free liabilities	317,511	454,756	373,294	607,747	620,021
Total liabilities	**1,260,793**	**1,415,154**	**1,575,403**	**2,025,991**	**3,238,664**
Fixed assets	858,666	910,926	1,073,489	1,333,281	2,168,985
Investments and other	17,335	12,340	5,579	9,348	12,642
Cash and cash equivalent	5,222	2,168	48,957	11,672	302,187
Other current assets	379,570	489,720	447,378	671,690	754,850
Total assets	**1,260,793**	**1,415,154**	**1,575,403**	**2,025,991**	**3,238,664**
Ratios					
Cash flow:					
Operating cash flow : total debt (%)	89.7	153.9	42.0	56.9	17.7
Discretionary cash flow : net debt (%)	45.1	94.7	20.0	35.5	14.1
Profitability:					
Turnover growth (%)	(0.7)	27.5	10.1	32.2	34.7
EBITDA : revenues (%)	15.0	14.3	14.5	16.6	18.6
Operating profit margin (%)	8.5	9.0	9.5	11.4	14.4
EBITDA : average total assets (%)	10.5	22.8	12.2	15.4	16.6
Return on equity (%)	4.0	6.8	10.9	12.2	18.2
Coverage:					
Operating income : net interest (x)	3.0	5.0	8.9	11.0	8.0
Activity and liquidity:					
Trading assets turnover (x)	4.2	5.3	5.4	7.0	7.8
Days receivable outstanding (days)	74.8	72.4	80.9	60.3	53.0
Current ratio (:1)	1.4	1.3	1.6	1.0	2.0
Capitalisation:					
Net debt : equity (%)	12.6	11.1	19.6	35.3	91.4
Total debt : equity (%)	13.2	11.3	24.7	36.5	116.4
Total debt : EBITDA (%)	82.9	60.7	132.4	139.4	343.1

*Depreciation used as a proxy.