

## EQUITY INSIGHTS

### Sun International: Quality Concerns

Issue date: 5 September 2017

#### SUMMARY

We are removing Sun International from our investable universe based on a review of the quality rating for the business.

#### ORIGINAL INVESTMENT CASE

Sun was approved for inclusion in our investable universe in April 2015. A key thesis was the fact that the gambling industry had historically exhibited a high degree of demand inelasticity, making Sun's revenues largely defensive in nature. Other attractions included: expected growth in Latin American assets; the ramp up of Time Square at Menlyn Maine; value accretive M&A activity (and portfolio restructuring) in South Africa to bolster free cash flow and pay down debt and; changes in gambling legislation allowing for a greater spectrum of online gambling. Downside risks included: a potentially weaker than expected trading environment across geographies; execution risk in M&A activity and non-delivery on efficiency gains from portfolio restructuring; greater than expected minority participation and; regulatory headwinds in South Africa.

#### WHAT HAS CHANGED?

The following developments have necessitated a review of our investment case in Sun: Sun's key South African assets have performed poorly and are losing market share (calling into question both the quality of these assets and the defensiveness of gambling spend); M&A activity has been mixed (e.g. Dreams success, Africa exit, Peermont settlement); debt levels have increased to the point where Sun may have to raise additional capital in the market; early indications are that the key Time Square development is underperforming relative to management's original guidance and; performance in Latin America has been softer than originally anticipated. Sun is also increasing the entertainment offering at a number of casinos to mitigate declining footfall. This arguably increases the cyclicality of these assets. Sun is due to report results on 2 October 2017. The consensus in the market seems to be that Sun may also issue a profit warning prior to the release of these results.

#### QUALITY RATING CHANGES

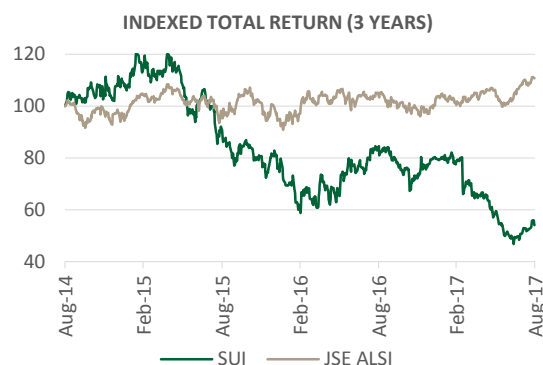
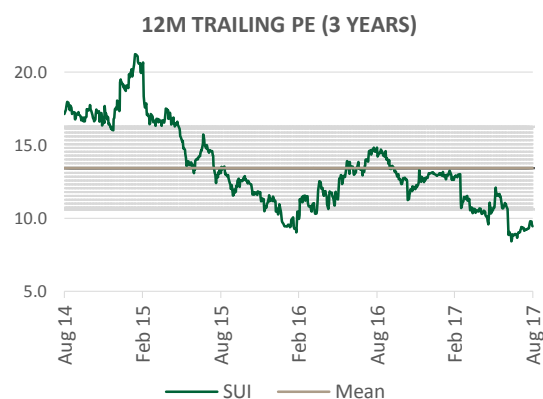
We have revised our quality rating down from 59.8 to 50.4 (out of 100). The primary change has been to our evaluation of management from 78 to 52.

#### VALUATION AND RECOMMENDATION

We calculate Sun's fair value at R69.98 using the average of an absolute (discounted cash flow) and relative (long term PE multiple) valuation methodologies. This translates into an estimated 2 year annualised return of ~23% at our generalised cost of equity of 13.8%. While this is admittedly an attractive return in absolute terms, our overriding concern is with the quality and long-term sustainability of Sun's business model. Given the current valuation, Sun may be considered appropriate as a speculative buy for investors with a high risk tolerance falling outside of the SFEM SA Quality equity mandate.

Industry	
Gaming & Leisure	
Industry View	
Cautious	
Recommendation	
Remove from Emerging Quality Universe (SELL)	

	SUI
Market Cap	R6.47bn
Share Price	R59.25
52w Low-High Range	R50.60 – R95.99
12m Price Target	R73.50
Trailing PE	9.4x
Trailing DY	0.0%
Next Financial Year End	31-Dec-2017
12m Share Price Volatility	High



**ANNUALISED TOTAL RETURNS**

	1 YR	3 YR	5 YR
SUI	-34.8%	-45.9%	-21.5%
JSE ALSI	8.3%	20.7%	82.8%

Source: Factset 30-Aug-17.

**FOR MORE INFORMATION PLEASE CONTACT:**

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