

This quarter, we look back at the hotel and casino empire famously known for the Sun City Resort - Sun International.

“It's hard to walk away from a winning streak, even harder to leave the table when you're on a losing one.”

Sun International's beginning can be traced back to 1969, when the Southern Sun Hotel Group was created in a collaboration between South African Breweries (SAB) and South African Businessman, Sol Kerzner. In 1983, SAB split its hotel interests into two - Southern Sun; and Sun International, which would be headed up by Sol Kerzner. Kerzner organised the holdings of Sun International as a subsidiary of Kersaf Investments Ltd. – his new investment holding company. By 1984, Sun International listed on the Johannesburg Stock Exchange.

In 2004, Kersaf Investments Limited merged with Sun International to form Sun International Limited, the company that exists today. Sun International now operates in six countries - South Africa, Chile, Panama, Colombia, Swaziland and Nigeria; and boasts 42.5% market share of the South African casino Industry.

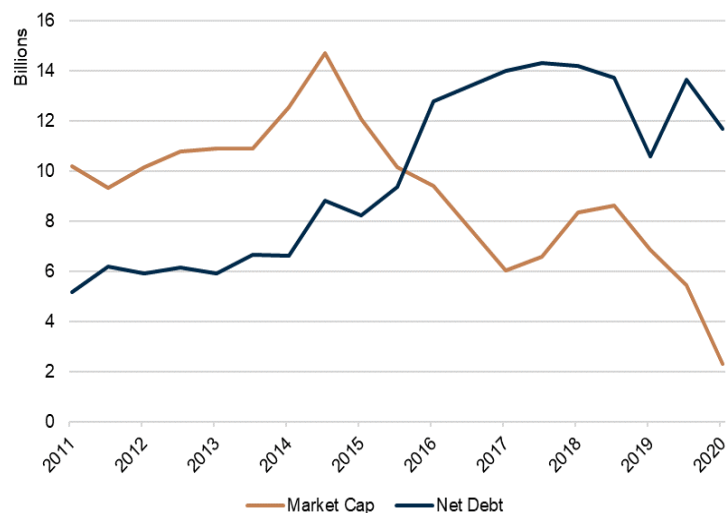
Sun International was also the pioneer of gaming, having brought casinos to this part of the world in the late 1970s. This strategy slotted into the company's vision – specifically: "We have a pretty basic strategy that is in no danger of making its way into business-school textbooks. Quite simply, we develop unusual destinations where people have fun and where we make money. We like to operate in markets that enjoy barriers to entry or where we can truly distinguish ourselves from the competition." – Solomon Kerzner, Chairman/CEO



Lingering problems long before COVID-19

However, while 2020 has certainly proven to be challenging for the company, it was by no means the beginning of their troubles. Debt has been rising for years, while their ability to pay it off was declining.

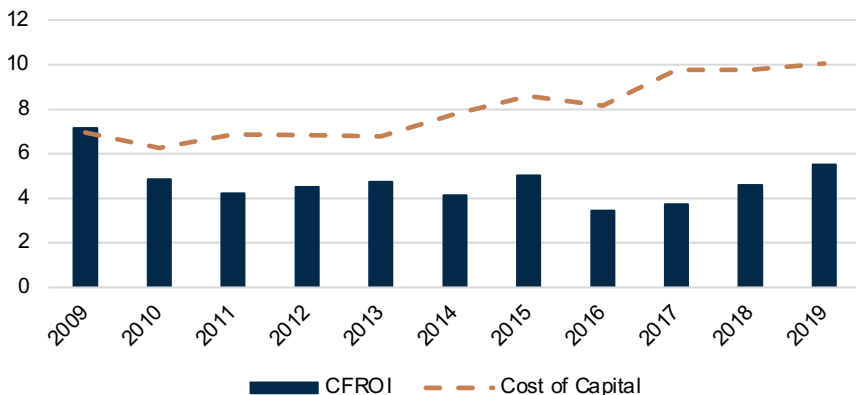
Figure 1: Debt overtakes Market Cap



Source: Bloomberg

In fact, Sun International hasn't managed to cover its cost of capital since 2009. Essentially, they have been increasing leverage while profits have been falling, leaving them in a difficult position in the midst of a pandemic.

Figure 2: Sun International Return on Investment



Source: Credit Suisse HOLT

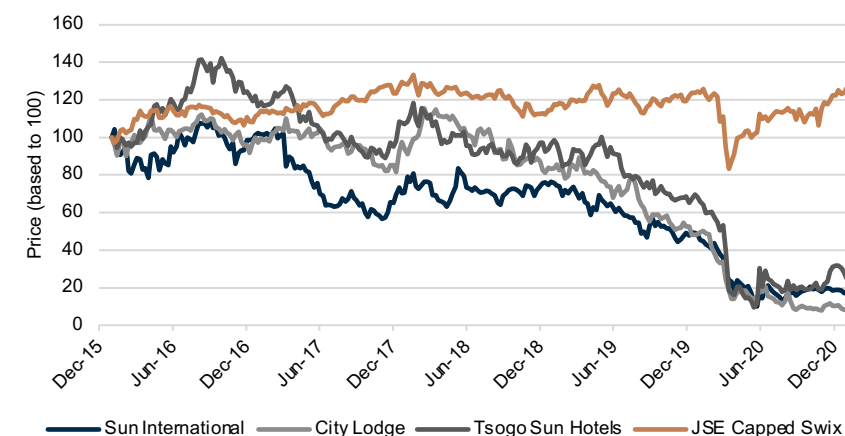
**CFROI – Cash flow return on Investment. To learn more: <https://www.linkedin.com/feed/update/urn:li:activity:6754308816080269312>

A global pandemic blocks out the Sun

When a company already has a weak balance sheet it will be seriously caught out during a financial crisis. Company's such as Sun International can only really make money when the economy is booming, and an economic contraction, such as the current one will pull the carpet out from under their feet.

The company reported a 56.2% year-on-year decline in revenue for the first half of the year. The difficult trading environment has seen the company's share price drop a staggering 86% from the end of December 2016 to end-December 2020. Over the course of 2020 alone, while Sun International wasn't the most affected in its peer group, it underperformed the broad market by just over 60%.

Figure 3: Sun International Return on Investment



Source: Bloomberg

In August 2020, in order to improve the company's liquidity and strengthen its balance sheet, the company announced a rights issue worth R1.2 billion, almost doubling the number of shares in issue.

Sun International's alternative gaming operations have provided a small lifeboat. Sun Slots which includes limited pay-out machines in bars and restaurants; and Sunbet, which focusses on online betting, collectively generated about a fifth of the group's revenue at the start of the fourth quarter of 2020.

Owning companies that don't meet their cost of capital is risky business because when problems in the economy arise, they tend to come undone.