

# OPERATING ENVIRONMENT

We recognise that we cannot influence macro-operating environment factors beyond our control. Therefore, we focus on what we can control in the gaming and hospitality operating environment. We enhance our customers' experience by providing excellent customer service, offering new products, and seeking opportunities to create memorable experiences and enhance shareholder value.

## ECONOMIC ENVIRONMENT

Global economic growth for 2019 is projected at 3.5%<sup>[1]</sup> percent, 0.2% lower than forecast in October 2018. This decrease is largely due to diminished growth momentum and tighter financial conditions in emerging markets and developing economies. Other factors include increased trade tensions between the USA and other countries, geopolitical tension, over-indebtedness, and uncertainty over Brexit. In Latam growth is projected to recover from 1.1% in 2018 to 2.0% in 2019. South Africa's 2018 economic growth remained subdued at 0.8%. However, growth is projected to pick up to between 1.5% and 1.7% in 2019.

<sup>1</sup> Source: IMF World Economic Outlook

The economic overview that follows includes countries in which our core assets operate, namely South Africa, Chile, Peru and Argentina.

### South Africa<sup>[2]</sup>

The group's revenue largely depends on the South African economy. South Africa's GDP growth rate was 0.8% at the end of 2018, weighed down by lower investor confidence on the back of the controversial land reform debate, high unemployment rates, and a technical recession during the first half of the year. Economists expect the economy to improve marginally in 2019 ahead of the general elections in May 2019, which should increase household spend and fixed investment. Additional credit rating downgrades remain a concern amid economic and political tensions. Continued power outages and ever-increasing electricity prices are still a threat to the economy. Consumer disposable income remains under pressure since the 1% increase in VAT took effect. Consumers are likely to allocate less disposable income on leisure and entertainment spend.

<sup>2</sup> Source: Focus Economics

The rand experienced another volatile year, closing at R14.43 (2017: R12.38). It is trading stronger than expected to date in 2019, and is expected to average R14.40<sup>[3]</sup> for the remainder of 2019. A weaker rand tends to attract international visitors, as South Africa becomes an affordable tourist destination with excellent gambling and hospitality offerings.

<sup>3</sup> Source: Bureau for Economic Research

### Chile<sup>[4]</sup>

Chile's economy grew during the first half of 2018, but growth dropped notably in the third quarter amid faltering mining activity and weak external sector metrics. It recovered at the end of 2018. Chile's resilient construction industry and sustained investment in machinery and equipment improved solid fixed investment growth in the third quarter. Growth in 2019 is expected to remain solid, largely driven by sturdy domestic demand, although the pace of expansion will ease alongside moderation in global trade. The tightening labour market should sustain higher wages and drive private consumption.

<sup>4</sup> Source: Focus Economics

## Peru<sup>[5]</sup>

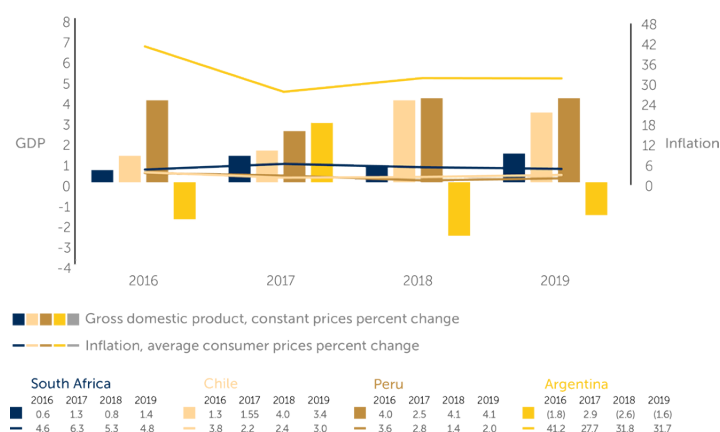
Peru's good growth in the first half of 2018 was muted by a significant dampening in business investment and public infrastructure funding during the third quarter. Public investment rebounded in the last quarter; credit continued to expand; and the agriculture and fishing sectors recorded outstanding performances. Growth is expected to improve in 2019, underpinned by a solid domestic economy and healthy external demand for commodities. Improving investor confidence, solid credit growth and favourable business growth is likely to reinforce fixed investment. The main risk stems from escalating global trade tensions and a possible slowdown in China's economy.

5 Source: Focus Economics

## Argentina<sup>[6]</sup>

Argentina's economy is expected to remain in recession due to challenging financial markets and a depreciation of the peso. Negative consumer confidence and rising debt levels prompted a sovereign downgrade by rating agencies. Looking ahead, the economy is likely to remain in recession, although this should subside. Inflationary pressures and rising taxes will place additional pressure on consumers, and high interest rates and shrinking public investment will impact fixed investment. Positively, the trade balance is expected to improve from a deficit to surplus on the back of higher agricultural exports and lower imports, and the fiscal deficit is expected to narrow.

6 Source: IMF October 2018 and Focus Economics.



## REGULATORY ENVIRONMENT

The group monitors its regulatory environment through its legal and compliance departments in South Africa and Latam. The NGB oversees the regulation in South Africa's gaming industry. Each province has its own gaming legislation. There are 40 authorised casino licences in South Africa, and 39 are issued. Sun International has 13 of these licences in its eight provinces of operation. The group is also a member of the CASA, which represents the interests of the country's legal casino gaming industry.

In 2015 the Minister of Trade and Industry published a notice increasing the number of casino licences in South Africa from 40 to 41. The additional casino licence is earmarked for the North West. CASA is appealing the matter on behalf of its members.

In Chile, the SCJ oversees 18 authorised casinos in 13 regions of the country, with another seven casinos operating under concession granted by certain municipalities. Sun International has seven licences in Chile. In terms of a new casino law, the licence for these casinos expired in December 2017 and the group submitted bids for five of these licences. The group was only awarded one licence – Iquique municipal licence – for a further 15 years. The new licences fall under the regulations of the SCJ.

Peru is preparing for legislative reforms, which, if approved, will regulate online gambling and sports betting services in the country. This will provide opportunities for Sun International to introduce online and sports betting products.

### Smoking legislation

In May 2018, the South African Department of Health published the Control of Tobacco Products and Electronic Delivery Systems Bill for public comment. The Bill prohibits smoking in all public enclosed areas and aims to control electronic delivery systems – including vapour-releasing electronic cigarettes and heat-not-burn devices that heat up tobacco, which were not covered by earlier legislation. The operation of casinos falls within the scope of this provision. Sun International submitted comments, with the main concerns being severe economic and social consequences such as lower revenue, job losses and the negative impacts on enterprise development. CASA<sup>[4]</sup> estimates that, if this Bill is passed, casinos could see as much as an 18% drop in GGR nationally, which translates to about R3.2 billion in the first year of implementation. This, in turn, will significantly reduce provincial gambling tax revenue by R343 million and national VAT revenue by R422 million in the same period. In addition, CASA estimates that 4 000 direct and indirect industry jobs could be impacted. This decrease in casinos profitability will necessitate cost-cutting measures, including a reduction in CSI. Sun International is actively monitoring this legislation and exploring mitigating actions if this Bill is passed.

<sup>4</sup> Source: CASA 2018 Survey of casino entertainment in South Africa.

#### REGULATORY AND INDUSTRY BODIES

##### South Africa

- ▶ The NGB
- ▶ The CASA
- ▶ The dti

##### Latam

*Argentina* has a federal structure and gaming activities remain under control of each province. In Mendoza, the entity that regulates gaming is the Instituto Provincial de Juegos y Casinos de la Provincia de Mendoza

##### *Chile*

- ▶ The SCJ – operating under the auspices of the Deputy Minister of Finance

##### *Colombia*

- ▶ The Coljuegos

##### *Peru*

- ▶ The General Direction of Casino Games and Slot Machines

##### *Panama*

- ▶ The Gaming Control Board – operating under the auspices of the Minister of Economy and Finance

#### PRIMARY GAMBLING LEGISLATION

**South Africa:** The National Gambling Act 7 of 2004

**Argentina:** Law No 5188 (Valle de Las Leñas Casino); Law No 5775 (Casinos in 4- and 5-star hotels); and Law No 6659 (Nuevo Plaza Hotel Mendoza)

**Chile:** The Law No 19.995

**Peru:** The Law No 27.153

**Panama:** The Law No 19 of 8 May 1947

## **Gaming taxes**

### ***Proposed amendment to the Gauteng casino tax regulations***

On 14 January 2019, the MEC responsible for Economic Development, Environment, Agriculture and Rural Development for the Gauteng province amended regulation 85 of the Gauteng Gambling Regulations, 1997. The amendment introduced a new tax regime for casinos in Gauteng. Prior to the amendment, regulation 85 of the Regulations provided that casino licensees were liable to pay a gaming tax amounting to 9% of each licensee's gross weekly gambling revenue. In terms of the amendment, gaming tax was to be determined with reference to a sliding scale of GGR. The taxes were due to be implemented with effect from 1 April 2019.

The CASA, on behalf of its members, vigorously opposed the implementation of the amendment resulting in the MEC's office agreeing to withdraw the implementation of the amendment and recommence the process including conducting an updated assessment to determine the effect such a proposed tax would have on the Gauteng casino industry.

### ***South African national gaming tax***

It was announced in the 2019 budget presented by the Minister of Finance that draft legislation introducing a gambling tax in the form of a 1% levy will be published for public comment. This tax was previously proposed and we will comment on the draft legislation when published.

### ***Peru gaming taxes***

According to a decree published in September 2018, from 1 January 2019, casinos will pay a monthly consumption tax levied against each machine and gaming table they offer in their venues. The specific amounts will vary according to the level of gaming revenue reported by each machine or table. This represents an estimated additional tax of 4.8% to the current 12% tax on gross gaming revenue. The gaming industry has declared this decree unconstitutional and illegal and has launched a legal challenge.

## **Financial Intelligence Centre Act**

The group revised its controls within its gaming operations to align with the amendments to the FICA and is at an advanced stage of implementing software and hardware improvements to its systems to identify customers who transact below R5 000. The group is implementing a third-party solution to identify politically exposed persons.

## **Liquor legislation**

The group's casinos in the Free State province trade on a 24-hour basis. The province's regulation amendments propose curtailing liquor trading hours at casinos from 08:00 to 04:00. The group will submit its comments on the proposed amendments to the Free State Gambling and Liquor Authority.

## **B-BBEE legislation**

The group embraces transformation and is committed to continually improving its B-BBEE credentials in its South African operations. As at 31 July 2018, Sun International achieved a Level 1 B-BBEE status and most units achieved Level 2 and higher.

**CASA members** generated GGR of **R18.5 billion** (2017: R17.8 billion) – up **3.5%**

## GAMING AND HOSPITALITY OPERATING ENVIRONMENT

### Gaming

South Africa's casino industry remains under pressure as a result of the tough economic climate that places pressure on consumer disposable income. Positively, CASA<sup>[8]</sup> reported that the industry's GGR experienced a 3.5% increase off the back of a decrease in GGR in the comparative period (31 March 2017). The gaming industry contributes significantly to the economy through employment opportunities (direct and indirect), boosting government tax revenues, progressing transformation and enabling social upliftment.

<sup>8</sup> Source: CASA 2018 Survey of casino entertainment in South Africa

Illegal and online gambling (currently prohibited in South Africa and Chile) leads to negative socio-economic impacts, including fewer collected taxes for national development and redundancies in casino jobs. Despite government's and the dti's commitment to combat this problem, illegal gambling continues to increase. More action needs to be taken in South Africa and Chile to avoid further revenue erosion from licensed casinos.

The proliferation of EBTs continues to impact the casino market in South Africa. While the NGB is against the rollout of EBTs, certain provinces continue to issue licences or are looking to do so. Sun International is opposed to an EBT rollout in the current regulatory environment. We object to licensing EBTs in the catchment areas of our casinos where significant investments have been made in return for the casino licence. Considerable regulatory reform is required from a socio-economic perspective.

The Western Cape's proposed legislation allows for the relocation of casinos, which could lead to declines in gambling revenue and a loss of jobs. Sun International's GrandWest and Worcester casinos will be directly impacted should this Bill be passed into law. Sun International submitted comments opposing the promulgation of the proposed legislation in its current form. The adverse impacts of the relocation of two outlying casinos into the Cape Metropole are projected to include:

- no material increase in total annual provincial GGR, which is forecast to rise by 3.6%
- a net decline in total annual provincial gaming tax revenue, which is forecast to fall by 7.5% per annum (if the newly proposed two-tier tax dispensation is introduced), or by 6.2% (if the existing six-tier tax dispensation is retained), which will ultimately not be offset by the economic opportunity fees provided for in the Bill
- a pronounced adverse impact on GrandWest, its employees and suppliers, and the community in which it operates
- irreversible negative impacts on the local economies of the areas from which the relevant casinos relocate.

The National Gambling Amendment Bill was tabled at Parliament near the end of 2018. One of the proposals is to reposition the NGB to become a National Gambling Regulator. CASA, on behalf of its members, submitted substantial comments against the Amendment Bill and the dti introduced the redrafted Bill to the Select Committee on Trade and International Relations.

#### TOTAL AFRICAN CASINO LICENCES: 40

- ▶ 13 Tsogo Sun
- ▶ 13 Sun International (South Africa)
- ▶ 1 Nigeria
- ▶ 1 Swaziland
- ▶ 2 Sun International (Other Africa)
- ▶ 8 Peermont Global
- ▶ 1 Caesars Entertainment
- ▶ 1 Desert Palace Casino\*
- ▶ 1 Leithlo Resort\*

South Africa source: CASA's 2018 Survey of Casino Entertainment in South Africa.

\* Non-CASA member.

#### TOTAL SUN INTERNATIONAL LATAM LICENCES: 12

- ▶ 7 Chile
- ▶ 1 Panama
- ▶ 4 Peru

Sun International owns and operates **six route operator licences LPMs, one online sports betting licence, and four cash betting retail stores.**

### **Hospitality**

The hospitality industry is particularly vulnerable to the ebbs and flows of economic conditions and increasing competition. In South Africa, other factors that impact our international tourism include: the confusion around the visa requirements for families travelling to South Africa; the oversupply of hotels in certain areas, including the Sandton central business district and the Western Cape; and the water crisis that mainly impacted the Western Cape and Eastern Cape. Towards the end of 2018, South Africa's Department of Home Affairs simplified the visa requirements for travellers from certain countries. Waiver agreements will be implemented for several African and Middle Eastern countries, which should lift the travel barrier going forward and increase tourist numbers. The water crisis has abated and Sun International implemented sustainable solutions to ensure our guests are not negatively impacted should a similar crisis reoccur.

Rooms make up 8% (2017: 8%) of Sun International's revenue. Most of the group's hotels focus on serving our gaming customers. In South Africa, Sun City, The Table Bay, The Maslow and Maslow Time Square are focused on local and international business and leisure travellers. In Chile, the group has several hotels at its casino properties that serve local travellers and VIP gaming customers.

### **TECHNOLOGY ENVIRONMENT**

Technology is inherent in Sun International's business. It assists in creating opportunities to understand and better serve our customers and identify efficiencies as we strive to contain costs. Our world-class Enterprise Gaming and Bally Business Intelligence systems provide invaluable customer data to track customer behaviour and interact with customers directly. During 2018, the group acquired premium international online gaming software that enriched Sun International's online sports betting offering ([SunBet.co.za](http://SunBet.co.za)).

The threat of cyberattacks is increasing in the gaming industry. Sun International implements various technologies group-wide to detect and block cyber threats.

Customer data protection is critical, as more protection provides comfort to customers in providing information, which enables the group to make informed decisions around customer behaviour. The group complies with relevant data protection legislation including the PoPI in South Africa, the GDPR in Europe, and other relevant internal policies and procedures.

## NATURAL ENVIRONMENT

Even though our business poses limited risk to the natural environment, the group remains committed to limiting its environmental impact through our various initiatives aimed at reducing resource consumption. The water crisis in the Eastern Cape and Western Cape has lessened, but management continues to look at implementing [sustainable solutions](#) to ensure our guests are not negatively impacted.

## SOCIETAL ENVIRONMENT

Our bookmaking, sports betting, LPMs and casino properties, which largely have exclusive rights in the areas where they operate, impact the surrounding communities. Many customers and employees come from these communities and play a meaningful role in community development through E&SD initiatives. Being a responsible corporate citizen is part of the group's DNA. We fully support responsible gambling through the SARGF – the entity that supervises the NRGF in cooperation with the gambling industry operators and governmental regulators. The NRGF integrates education, research and treatment into one programme.

Of the R15.6 million (as reported by CASA<sup>[8]</sup>) contributed by the casino industry to the SARGF, Sun International contributed approximately R8.1 million in 2018. Sun International paid a further R1 million in respect of its bookmaking and LPM businesses. These contributions are earmarked to provide free support to all people affected by problem gamblers.

<sup>8</sup> Source: CASA 2018 Survey of casino entertainment in South Africa