

THE STRAIGHT TALKING

# CURVED THINKING

QUARTERLY

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## ARE THE ODDS IN YOUR FAVOUR?

“A Dollar won is twice as sweet as a dollar earned” – Paul Newman

Why do people gamble? Over the years physiological, personality, cognitive and other theories have tried to answer this question; whatever that answer may be the simple reality is that gambling has and always will be a part of any society, whether in a regulated or illegal form.

People are attracted to the glitzy glamour and the “promise” of easy money.

The low “price to hope ratio” of money wagered is too easy a proposition to turn down. After all, casinos are sexy and glamorous, and people are inherently attracted to this dream. After watching George Clooney smooth talking his way through the Bellagio or Daniel Craig wagering a small fortune in Monte Carlo, who doesn't want to head off to Montecasino to try their hand at Blackjack? Massive marketing budgets reinforce places like these as appealing, location based entertainment options, with a host of activities for the whole family. They also offer gambling.

Risk lovers are lured by the emotional thrill of wagering, while the more risk averse amongst us might consider it a way to make big money from a relatively small outlay.

Either way, people display various levels of emotion. To many of us emotions are a powerful driving force, and for this reason the thrill of the punt will remain.

Most gamblers tend to think of gambling as a low-risk, high-yield proposition. However the opposite is true, even after considering that local casino slot machines pay out around 95% of the handle (5% hold ratio). The odds always favour the house, and hopefully the investors in a well-run casino operator.

# HISTORY OF GAMING IN SOUTH AFRICA

Gambling in South Africa has a long history, initially depicted in early Bushmen paintings and subsequently being outlawed in the Western Cape by the Dutch in the 1670s.

The diamond and gold rushes of the late 1800s in the Witwatersrand area established gambling on a grand scale. Since then it has been a very stop-start affair, riddled with regulatory hoops and challenges.

In more recent times, the Gambling Act of 1965 banned all forms of gambling except for horseracing, which was deemed a sporting activity. However, the prior establishment of ten Bantustans or homelands, of which Bophuthatswana, Ciskei, Transkei and Venda were declared independent by the apartheid government, gave gambling a place to grow and thrive.

Within these four homelands, activities deemed illegal within the Republic such as gambling and topless revue shows, were allowed.

Sun City, arguably the most well-known of the homeland casinos, opened its doors in 1979 and soon attracted hordes of holidaymakers and punters from across the country. With the change to democracy in 1994, the homelands were reincorporated into the republic, and the casinos thus had to be shut down or legalised. The latter occurred, with the subsequent establishment of the 1996 Gambling Act.

Both Sun International and Tsogo Sun Holdings can trace their early beginnings back to South African business tycoon Sol Kerzner. After establishing South Africa's first 5 star hotel in 1964, the Beverley Hills in Umlanga, as well as numerous other landmark properties such as the Elangeni in North Beach, Kerzner and South African Breweries (SAB) teamed up in 1969 to establish Southern Sun, which today is the leading hotel group in Africa with a portfolio of over 90 hotels and over 14500 rooms.

In 1983, SAB split its hotel interests in two, with Sun International retaining the resort-type hotels and casinos situated in the previous homelands, and Southern Sun retaining the rest of the South African hotel portfolio.

Post establishment of the 1996 Gambling Act, Southern Sun started to develop its own gaming assets and started to compete head on with its former sister company. Today, Southern Sun is 100% owned by Tsogo Sun Holdings, who also acquired the attractive Gold Reef casino assets in 2011 via a reverse acquisition. These two heavyweights, along with the unlisted Peermont, dominate the local gaming and leisure market.

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## THE SOUTH AFRICAN GAMING INDUSTRY AND WHY WE LIKE IT

Today there are 37 casinos operating in South Africa.

There are three remaining licenses, of which two have been issued, with the third and final Mpumalanga license in the process of issuing a request for proposals. Arguably the most attractive of these gaming assets includes Tsogo Sun's Montecasino and Suncoast casinos, Sun International's GrandWest and Sibaya properties as well as Peermont's Emperor's Palace. How well, though, does our economy support these assets?

The fact is that casinos are a relatively defensive consumer play, and seem to do relatively well through the good times and the bad. Of course, casino spend is linked to GDP and consumer confidence, with many large punters being entrepreneurial, adding an element of cyclical. The data does, however, indicate that gaming spend is more defensive than other consumer discretionary sectors.

Graph 1 below indicates the total national casino and LPM spend per the National Gambling Board.

Graph 1

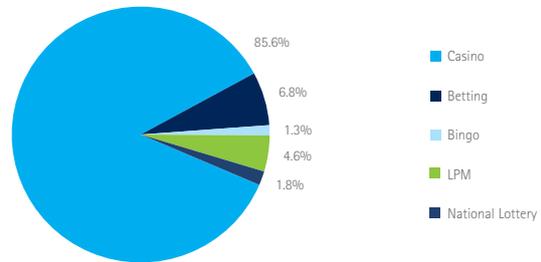


Although casino revenue is considered defensive, casinos as investments are less so. This is due to the operational leverage inherent in the fixed cost nature of running a large property, and the financial gearing evident in certain local operators. It is therefore important to back a solid management team who are able to manage costs and boost revenue when trends start to slow. Good management, coupled with the massive regulatory and financial barriers to entry, mean that a well-run operator has the potential to be an extremely attractive investment, valuation permitting of course. There are challenges too, with the provincial gambling boards often trying to increase levies when times are tough. We have also recently seen the negative effect of a smoking ban on gambling spend at Sun International's Monticello Casino in Chile. Although South Africa should be far less effected due to us already having some level of smoking bans in place (separate smoking areas), any developments as to local legislation need to be considered and closely monitored.

The defensive nature of casino revenues should attract other forms of gambling investment to the fore, and in recent years we have seen new types of gambling begin to thrive, including limited pay-out machines (LPMs), electronic bingo terminals, sports betting and the National Lottery.

Horse racing is the oldest form of regulated gambling in South Africa, the steady decline of which is clearly evident. We won't delve into this here though; the sheer scope of the sport warrants its own newsletter. Graph 2 below indicates the percentage spend on the various forms of gaming in South Africa.

Graph 2



The first limited pay-out machine (LPM) was installed in Mpumalanga in 2003. Essentially, an LPM is a slot machine found in pubs and taverns with a minimum bet of R5 and a maximum pay-out of R500, although this is in line to be increased. The original aim of the rollout was to provide additional revenue streams to non-casino venues and to assist in business development. There were also strict requirements stipulating that a majority should be located in previously disadvantaged (PDI) areas. The anticipated rollout allowed for a total of 50,000 machines throughout the country. Ten years on and there are currently just over 8,000 machines in South Africa, the slow rollout caused by difficulties in finding attractive sites, often due to the PDI requirement.

The form of gambling that has most attracted the ire of the National Responsible Gambling Programme (NRGP) is the national lottery, which has grown steadily since being launched by former President Thabo Mbeki in Langa in 2000. The 2012 National Lotteries Board Annual Report reveals that almost R4.6bn worth of ticket sales were made that year, creating 68 millionaires.

## IN CLOSING

Despite ever-present regulatory threats and the alternative forms of gaming discussed, we continue to favour the solid casino and hotel offering of Tsogo Sun Holdings.

The defensive nature of the group's cash flows, outstanding management, prudent capital allocation to expand attractive local sites such as Suncoast, Montecasino and Silverstar, as well as the potential to significantly grow their African hotel exposure through the Southern Sun umbrella of brands, leads us to believe the share is still undervalued by the market. We began accumulating the stock in early 2012 from around R16.50 per share, and it was one of our key contributors to performance in 2012.

On a 13.5x 12m forward PE currently (excluding the announced capacity expansions), we remain very happy holders of the stock.

"Gambling is not a vice, it is an expression of our humanness. We gamble. Some do it at the gaming table, some do not. You play, you win, you play, you lose. You play."

Tantalum MNC Fund						
Strategy	Multi-strategy, hedge					
Fund Objective	The fund is targeting above average real returns (8% to 12%) over the medium term at lower volatility than the market. Returns come from equity alpha on the long and short side, with yield enhancement from fixed interest, preference shares, hybrid instruments and listed property.					
Launch date	Jun-05					
AUM	R839m					
Return data:	3-mth	YTD	12-mnth	3-yr (p.a.)	Incept (p.a)	Total Return
	4.97%	7.28%	10.50%	10.15%	12.34%	163.78%
Risk data:	12-mth Std Dev	3-yr Std Dev	Std Dev since incep			
	3.91%	3.42%	7.33%			
Tantalum Focus Fund						
Strategy	Multi-strategy, hedge					
Fund Objective	The fund is targeting above average real returns (10% to 15%) over the medium term at lower volatility than the market. Returns come from equity alpha on the long and short side, with yield enhancement from fixed interest, preference shares, hybrid instruments and listed property.					
Launch date	Nov-10					
AUM	R261m					
Return data:	3-mth	YTD	12-mnth	3-yr (p.a.)	Incept (p.a)	Total Return
	4.54%	6.98%	9.85%	N/A	11.99%	39.14%
Risk data:	12-mth Std Dev	3-yr Std Dev	Std Dev since incep			
	4.18%	N/A	5.27%			
Tantalum Fusion Fund						
Strategy	Fixed Income, hedge					
Fund Objective	The fund is targeting cash + 2% returns over the medium term at lower volatility than the market. Returns come from fixed income alpha on the long and short side, with yield enhancement from preference shares, hybrid instruments and listed property.					
Launch date	Mar-06					
AUM	R53m					
Return data:	3-mth	YTD	12-mnth	3-yr (p.a.)	Incept (p.a)	Total Return
	2.02%	4.68%	6.53%	7.81%	8.78%	89.35%
Risk data:	12-mth Std Dev	3-yr Std Dev	Std Dev since incep			
	1.09%	1.58%	3.28%			
Tantalum Resources Fund (ZAR)						
Strategy	Resources, hedge					
Fund Objective	The fund is targeting 15%-25% over the medium term at lower volatility than the resources and commodity markets. The fund invests in a global portfolio of mining and energy equities, commodities and associated derivatives trading on the LSE, JSE, ASX, TSX and NYSE.					
Launch date	Mar-13					
AUM	R47m					
Return data:	3-mth	YTD	12-mnth	3-yr (p.a.)	Incept (p.a)	Total Return
	13.91%	4.40%	N/A	N/A	7.66%	4.40%
Risk data:	12-mth Std Dev	3-yr Std Dev	Std Dev since incep			
	20.67%	N/A	20.67%			
Tantalum Global Resources Fund (USD)						
Strategy	Resources, hedge					
Fund Objective	The fund is targeting 10%-20% over the medium term at lower volatility than the resources and commodity markets. The fund invests in a global portfolio of mining and energy equities, commodities and associated derivatives trading on the LSE, JSE, ASX, TSX and NYSE.					
Launch date	May-12					
AUM	\$5.2m					
Return data:	3-mth	YTD	12-mnth	3-yr (p.a.)	Incept (p.a)	Total Return
	12.67%	-2.10%	0.69%	N/A	-0.42%	-0.60%
Risk data:	12-mth Std Dev	3-yr Std Dev	Std Dev since incep			
	12.49%	N/A	11.24%			
Tantalum Enhanced Cash Fund						
Strategy	Fixed Income, long only					
Fund Objective	The fund is targeting cash plus returns over the medium term. Returns come from fixed income alpha, with yield enhancement from preference shares, hybrid instruments and listed property.					
Launch date	Aug-10					
AUM	R310m					
Return data:	3-mth	YTD	12-mnth	3-yr (p.a.)	Incept (p.a)	Total Return
	2.06%	4.92%	6.76%	8.42%	8.89%	30.94%
Risk data:	12-mth Std Dev	3-yr Std Dev	Std Dev since incep			
	1.13%	1.41%	1.52%			
Tantalum Balanced Fund						
Strategy	Multi-Asset, long only					
Fund Objective	A Reg 28 compliant fund which invests in a mix of domestic equities, bonds, property, commodities and cash where the asset allocation is tactically managed. Maximum net equity exposure is 75% and index derivatives may be used to reduce net equity exposure.					
Launch date	May-13					
AUM	R1m					
Return data:	3-mth	YTD	12-mnth	3-yr (p.a.)	Incept (p.a)	Total Return
	6.17%	8.08%	N/A	N/A	20.50%	8.08%
Risk data:	12-mth Std Dev	3-yr Std Dev	Std Dev since incep			
	4.97%	N/A	4.97%			