

EQUITY INSIGHTS

Sasol Limited: Exiting Our Position

Issue date: 1 August 2019

RECENT DEVELOPMENTS

On the 22nd May 2019 Sasol released a voluntary update to shareholders on the status of the transformational Lake Charles Chemicals Project ('LCCP') currently in progress in Louisiana, USA. The update guided shareholders to an increase in the estimated total capital cost of the project to between \$12.6 billion and \$12.9 billion. This marked the third revision to the original cost estimate of \$8.9 billion communicated to shareholders at inception of the project in 2014 - which at that stage was guided to become operational during 2018. Sasol also downgraded the expected internal rate of return (in US dollars) on the project to between 6.0% and 6.5% from a previously guided 7.5%. This raises the risk of future impairments given management's communicated cost of capital of 8% on the project. On the 25th of July 2019 Sasol released a detailed trading update for the financial year ended 30 June 2019. The update included an announced R18.1 billion in asset impairments, R12.9 billion (\$914 million) of which related to Sasol's North American value chain owing to increased capital costs at LCCP and a softer outlook for US chemical prices. This raises red flags relating to the project's economic viability (earning less than the cost of capital) and adds a further blemish to Sasol's less than stellar capital allocation track record. This does not imbue confidence given the scale and strategic importance of LCCP in Sasol's quest to transition from traditional mining and energy operations to higher value added chemicals operations.

QUALITY DOWNGRADED

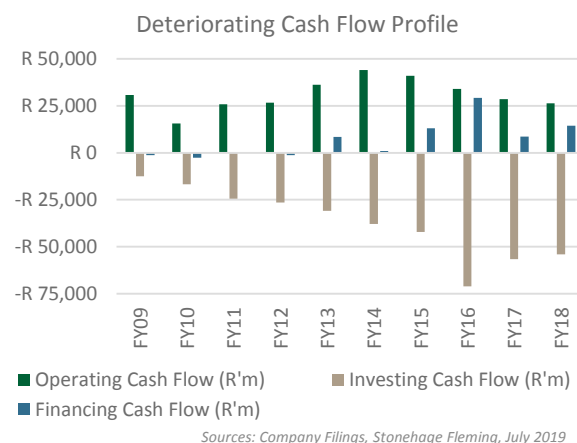
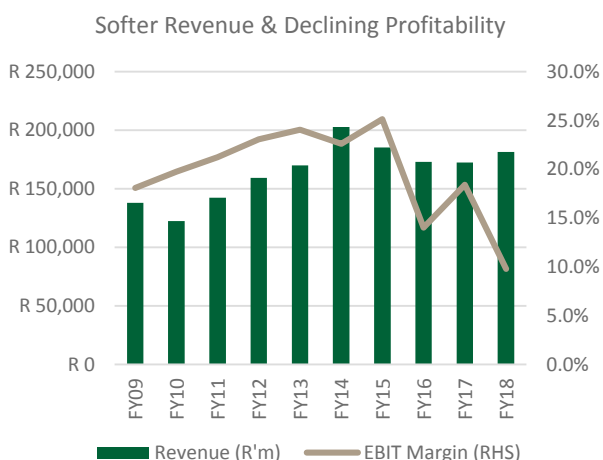
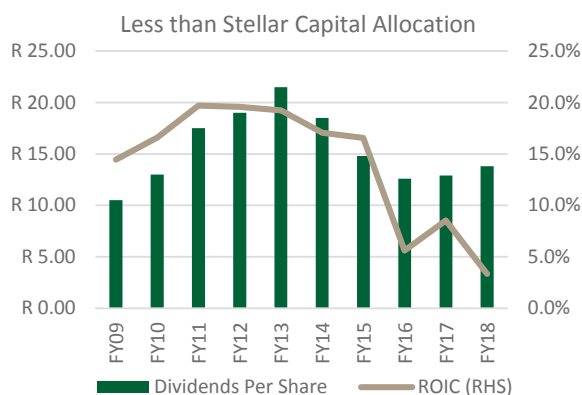
Our investment process strives to balance Quality, Risk and Value when assessing companies, with Management Stewardship, Business Strength and the Sustainability of Growth as the foundations of our Quality analysis. Sasol's sustained lack of delivery on LCCP has significantly eroded the credibility of management in our view. This, together with increasing ESG concerns at the business, has necessitated a downgrade of our assessment of Management Stewardship at Sasol. Aggressive capital expenditure and lower profitability has seen Business Strength weaken materially: return on invested capital (ROIC) has declined from nearly 20% five years ago to below 5% in the most recent financial year. Gearing is elevated relative to Sasol's history and management expect to exceed the previously communicated 'peak' of 49% net debt to equity in FY19. To reduce debt Sasol is considering asset disposals of up to \$2.0 billion and has also guided a -46% reduction in capital expenditure over the next two financial years. The operational ramp up of LCCP, which Sasol guide to occur over the coming years will play a critical role in driving Sasol's transition away from the mining and energy operations that have traditionally underpinned Sasol's solid cash flow profile. Our concerns with the weaker economics of this project have clear detrimental implications for the Sustainability of Growth at Sasol. This elevates risk to free cash flow generation (and ultimately dividends), which we view as becoming increasingly dependant on management's ability to reign in capital expenditure, dispose of assets and ramp up LCCP, notwithstanding the highly cyclical and notoriously unpredictable nature of the energy and chemicals industries within which Sasol operates.

SELLING SASOL

We see downside risk to Sasol's valuation given weak Management Stewardship, deteriorating Business Strength and questionable Sustainability of Growth integrated into our estimates. As such, we will be exiting our position in Sasol and have taken the view that capital will be better served in businesses that rate higher on Quality, Risk and Value over the long term.

	Sasol Limited
Market Cap	R195.7 billion
Current Share Price	R318.00
5Y Total Return	-39.3%
Price to Cash Flow	4.2x
Dividend Yield	4.3%
Next Financial Year End	30 June 2020

Sources: Factset July 2019



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