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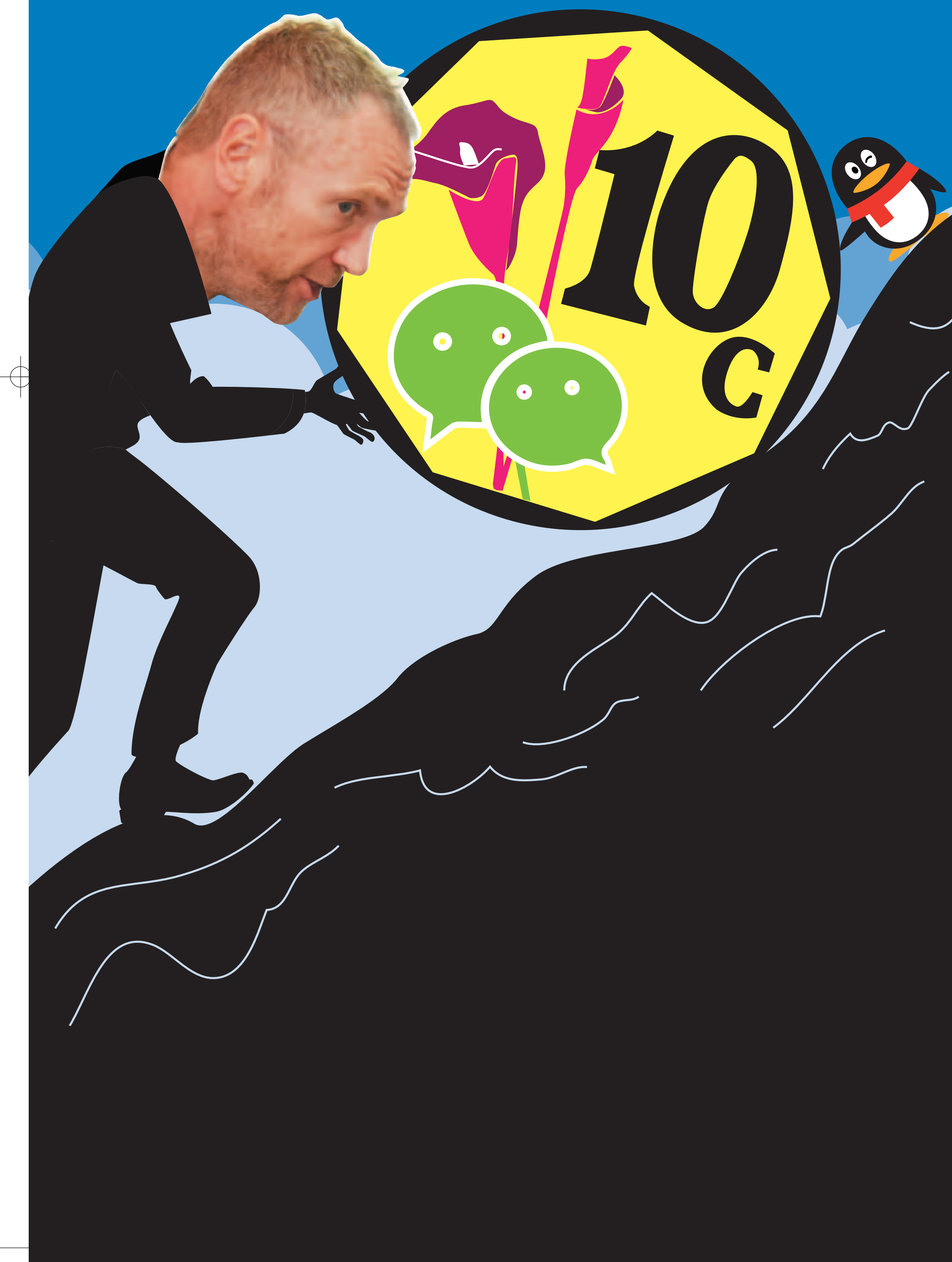


CRUSHED BY THE GOLDEN GOOSE

It's 20 years since Naspers took a R274m gamble on Chinese internet company Tencent. Today, its stake is worth R3-trillion — and that's after it reduced its holding to 28%. But while a couple of trillion rand can solve a lot of problems, it can create a fair number, too ...

TJ Strydom

Most of Shenzhen's 300 skyscrapers were yet to be built when, 20 years ago, Hans Hawinkels visited a modest set of offices in the Chinese city. He was chasing a lead on a possible investment opportunity.

That, after all, was his job. He'd been there since 1998, when Naspers boss Koos Bekker asked him to relocate to Hong Kong shortly after Britain handed the island back to the People's Republic of China. And as CEO of MIH Asia, a Naspers subsidiary, Hawinkels was instructed to scour the Far East for investment opportunities, with a clear focus on pay television and the internet.

Hong Kong and Shenzhen are as far apart as Joburg and Pretoria, so for Hawinkels hopping across to the city on the mainland was not the biggest trek.

He soon arrived at the headquarters of a start-up company, on top of a warehouse, where a few dozen people were working furiously on a fledgling instant messaging platform called QQ. Whatever QQ was, it was adding users at a viral rate.

By the time Hawinkels had his first discussions with Ma Huateng, the founder of this company named Tencent, about 20-million people were using QQ.

Ma (called Pony Ma because his first name translates as "horse") and his team were not happy with their investors, and wanted a stable financial and strategic partner, Hawinkels tells the FM. At the time, Naspers was far from sold on the idea.

"The executive management team [at MIH and Naspers] had reservations about investing in Tencent. Most of them were against putting more money into Chinese internet ventures," says Hawinkels.

At that stage in 2001, Naspers had already forked out $80m on deals Hawinkels and his team had brought to the table. It might not sound like a lot by today's standards, but the Cape Town-based company's market capitalisation was a humble R4bn at the time.

"I was adamant that it was a good opportunity. [Bekker] was able to convince the team that we should invest," he adds.

Had the company opted for discretion, it would have been the investment equivalent of failing to sign the Beatles. It was, looking back 20 years later, the deal of the century. According to some metrics, Naspers's investment in Tencent is actually the best investment in any company, ever.

Naspers paid R274m for 46.5% of Tencent in 2001. Today, even though Naspers has reduced its stake to 28%, its investment in Tencent is worth R3-trillion. Tencent, the Chinese company that launched QQ, WeChat and a host of best-selling computer games, now dwarfs the value of Naspers, and the rest of the JSE. It's worth more than the world's top 10 mining companies together.

A couple of trillion rands can, of course, solve a lot of problems. But as Bekker's successor Bob van Dijk knows all too well, it can cause a few too.

The nightmare discount

These days Naspers holds its stake in Tencent through Prosus, an Amsterdam-listed company it created two years ago.

But Van Dijk has spent a good deal of his seven years as Naspers CEO grappling with the most enviable of dilemmas: how to handle a windfall so big that it is tearing at the financial fabric of an entire nation.

The "problem" is this: Naspers, thanks to its soaring investment in Tencent, has not only wildly outperformed the JSE, it has effectively outgrown it.

Over the past decade, Naspers has delivered a total return to shareholders of 1,130% – far exceeding the rise in the JSE's all share index of 115% during that time.

Asset managers, which invest pensions, have consistently been forced to sell their Naspers shares, as their mandate doesn't allow them to hold more than 10% of their portfolio in any one stock.

As a result of this "forced selling", analysts say (and Van Dijk admits it too), Naspers's shares trade at a discount to just its stake in Tencent. In other words, Naspers's investors aren't getting full value for their shares.

In real terms, Naspers is valued at R1.3-trillion but its 28% stake in Tencent is worth R3-trillion. It means that not only is every other asset in Naspers – its stake in Takealot, Media24 and e-classified business OLX, for example – not reflected in the share price, it is being valued at less than zero. The speed of the wealth creation in Tencent has left Naspers far behind.

What it means: **Naspers, thanks to its soaring investment in Tencent, has not only wildly outperformed the JSE, it has effectively outgrown it**

SA has, in many respects, become an economic basket case in the past decade as most of its fundamentals – infrastructure, human capital, competitiveness – have lost ground. But its international investment position, counter-intuitively, has improved.

All of which has left Van Dijk with a huge headache that he just can't seem to fix.

Two years ago, he bundled together all Naspers's internet assets – including the Tencent stake – into a new company called Prosus, and listed those shares on the Euronext exchange in Amsterdam. This, he hoped, would woo new European investors, and reduce the Naspers discount.

Only, it didn't work.

Now he's trying another manoeuvre to try to smooth out the distortions caused by the success of the Tencent investment. This new machination, announced last week, will help Prosus buy 45.4% of Naspers N shares – reducing Naspers's weighting on the JSE – and, fingers crossed, narrowing the discount.

(For those new to Naspers, it has two classes of shares: A shares, which hold most of the voting power; and N shares, which hold the economic interest. Regular Joes, like you, me and your pension fund, own N shares. Controlling Joes, like chair Bekker and friends, own A shares.)

But Prosus swapping its own stock for shares in its parent company? If it sounds complex, it is.

In a nutshell: Naspers will still control Prosus (and that all-valuable stake in Tencent), while Prosus is offering 2.27 of its shares for each Naspers N share; more of Prosus's shares will be listed on the Euronext; and Naspers's weighting on the JSE weighted index will fall from 23% to 15%.

It's not about tax, Van Dijk tells the FM.

"Some people are making the assumption that by moving some of the market cap, the tax base also somehow moves," he says. "The idea that we structure heavily to avoid tax in certain jurisdictions is simply not true. It is about addressing the discount and getting Naspers to a more sustainable size on the bourse."

You can, of course, see where this misconception comes from: other tech giants, such as Apple, shift their headquarters around to dodge tax. But not Naspers, the company insists.

Van Dijk believes that *not* taking this step to effectively reduce Naspers's size on the JSE would mean it would swell to account for more than 50% of the local stock exchange within the next few years.

"And I don't think that would be good for anybody," he says.

In that case, asset managers would have to sell more of their Naspers shares, and that gaping discount would yawn ever wider.

Van Dijk reckons this new gambit will lure more international investors, and create immediate value for Naspers and Prosus shareholders. The full details will be contained in a prospectus, but the swap is expected to be finalised between July and October.

One implication is that Prosus will become a far more "international" company,

with more overseas shareholders. If it seems as if this shifts Naspers — a company that opened its doors in Cape Town in 1915 and launched newspapers like Die Burger and Beeld — incrementally away from SA, it is by force of circumstance designed to deal with the unexpected consequence of buying the golden goose, Tencent.

Reinvention of a chat giant

"One very interesting thing is that the revenue that Tencent had 20 years ago does not exist any more," says Stanlib analyst Graeme Teeling-Smith.

The company Naspers invested in all those years ago was simply a chatting platform. But the world was going mobile and, before long, Ma had stitched together a deal with China Mobile for a sliver of the receipts from the data traffic when QQ users connected to each other with their phones.

"Mobile phone and internet penetration at the time was significantly lower. Thanks to this revenue stream Tencent could soon profit from China's significant growth in its internet user base and its mobile user base," recalls Hawkinkels.

It was, even then, a tidy little business but hardly something that would change the world. And besides, it was tethered to the whims of telecoms giant China Mobile.

"The company was beholden to the telecoms company for collecting the revenue," says Avior Capital Markets veteran analyst Kevin Mattison. "It had to diversify its sources of income as a matter of urgency."

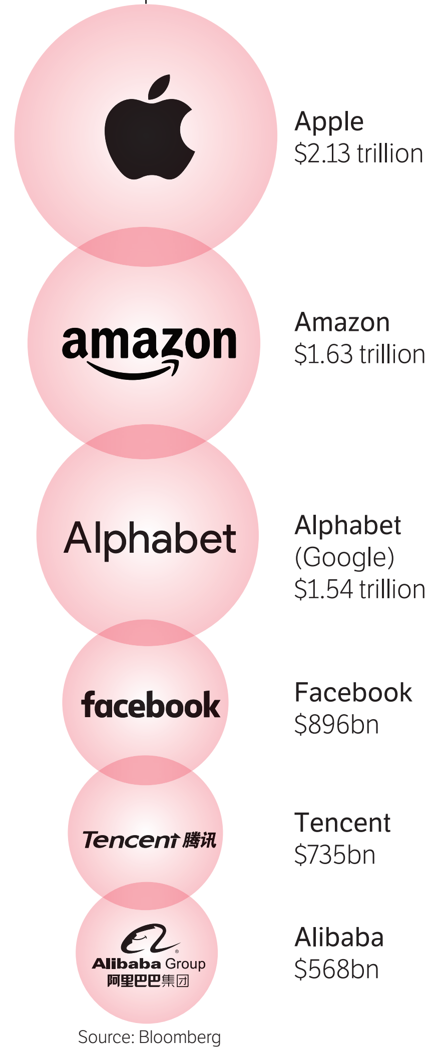
This was a priority. The history of technology is littered with the corpses of the Kodaks, Netscapes and MySpaces which failed to do this. But the way Tencent did it — and the reason Teeling-Smith likes the company so much — is that it has been able to continuously evolve its business model into new revenue streams.

A few years after QQ, in 2011, Tencent launched WeChat, a super-platform that took off quickly on smartphones and now forms an integral part of everyday life for users in the world's most populous nation. At last count, it had 1.2-billion active monthly users.

Nor did Tencent stop there. After launching WeChat, the company built an entire ecosystem that facilitates a large volume of small transactions, says Peregrine Capital analyst Justin Cousins.

It also did something that few analysts expected, but is something of a holy grail for tech companies.

"It not only increased its number of users, but also the average revenue it generates per user," says Teeling-Smith. It is this growth in paying users that is propelling Tencent's



profit and consequent stock-price rise.

In 2020, its revenue grew 28% to 482-billion yuan ($73.9bn), but its profit growth exceeded that, climbing 67% to 160-billion yuan ($24.5bn). This is similar to Facebook (revenue of $84bn and profit of $29bn), but it far exceeds many other internet companies, which often struggle to monetise users.

Tencent has also been quite careful to not exhaust its patrons with too much advertising or too many pop-ups and add-ons — it is a delicate game that Ma and his team play at an expert level.

It is also constantly looking for new frontiers. Though it makes most of its money in China, it has branched out abroad. In online gaming, the company is a world leader, with mega-hits such as *Fortnite* and *Honour of Kings* produced by its subsidiaries.

When Van Dijk took the reins at Naspers, Tencent earned most of its profit from games. Since then, it has built other lucrative pillars too.

"The new growth centres for Tencent are in fintech, health care, education and in the enterprise space," says Teeling-Smith.

Cousins says there's more value in Tencent than simply the cash it generates from its services. "Over the past few years, it has built up an impressive portfolio of other investments, mostly in the form of minority stakes in promising startups," he adds.

It has, in effect, evolved into one of the world's largest venture capital investors.

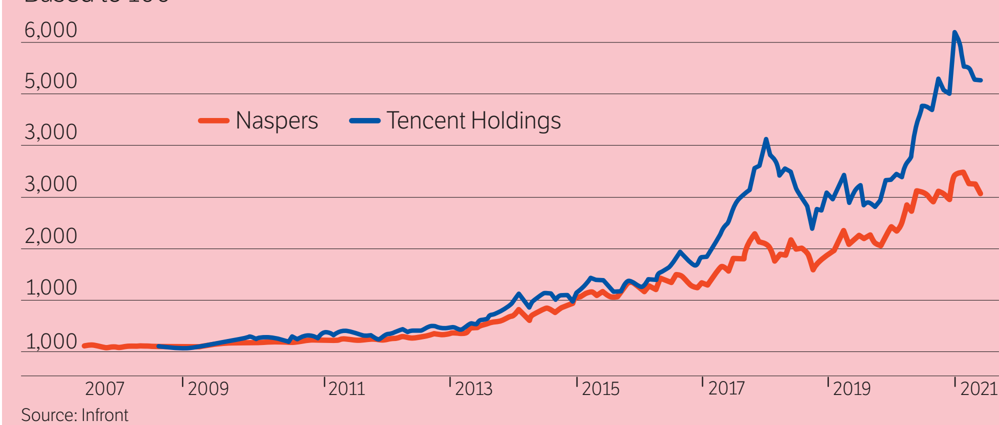
"In addition to providing capital to these businesses, Tencent actively helps [them] by providing access to their massive user traffic, their cloud infrastructure and their payments business," says Cousins.

To some extent, this is a defensive ploy, investing in technologies that could pose a threat to its other businesses. But if any of these take off (as Tencent did for Naspers), there is potentially immense value, he adds.

Here, because of Tencent's scale, it could be a matter of trillions rather than billions. And that should be good news for Naspers — if it's happy to just sit back and rake in the returns as a passive shareholder.

Reinvention of a media giant

But Van Dijk doesn't like to be seen as a passive investor. So Naspers has been doing some reinventing of its own.



Much of the revenue Naspers had 20 years ago does not exist any more. Print media has become more of a conjurer's trick in cost-cutting than a money-spinner in itself. And the profitable pay-TV business was spun out in 2019 and listed separately as MultiChoice.

Since the early 2000s, the Cape Town-based company has been trying to diversify away from the asset on which it was built: print media. Tencent was an exceptional start, but generally it's been a steady pivot away from readers and watchers, to buyers, sellers and transactors.

Armed with cash, first from its media assets, and later also from Tencent's dividend, Naspers embarked on an acquisition spree that has increased in size and intensity. At first, it felt around in the dark, trying to pin a tail on a unicorn. It dabbled in "e-tail", making decent profits from Allegro in Eastern Europe and Flipkart in India. But in the past few years, Naspers has built its future on three spheres of investment: e-classifieds, online payments and food delivery. The company has recently also pushed deeper into education technology.

This hasn't happened without criticism. Naspers executives often call Tencent one of the very best investments in the world, but to finance its other ventures, it has had to sell part of this stake.

Three years ago, it sold 2% of Tencent for $10bn; and last month, it sold another 2% for nearly $15bn.

Was this wise? Surely by doing nothing for three years, Naspers could have pocketed $5bn more from the initial sale?

The truth is a bit more complicated.

The money was used not only to capitalise food delivery start-ups and cash-guzzling marketplace businesses, but also to double down on winners such as Europe's Delivery Hero, which has created substantial value.

In food delivery, Naspers (through Prosus) has made a few very savvy allocations with some real potential. Brazil's iFood and India's Swiggy are good examples, and the upside could be immense if they get it right in such populous markets.

But where the company crosses paths

Shenzhen: Has more skyscrapers than New York

Getty Images/Daniel Berehulak

Inside China's own 'Silicon Valley'

Shenzhen is probably the world's youngest megacity. Four decades ago, Deng Xiaoping, then premier of China, tapped the dusty settlement at the mouth of the Pearl River to be a special economic zone (SEZ).

The location was picked due to its proximity to Hong Kong, one of Asia's most important financial sectors and at that point under British rule. There were three more SEZs, each close to more developed areas on China's border: Zhuhai, next to Macau (then governed by Portugal); and Shantou and Xiamen — both a short hop from Taiwan.

The SEZs became havens where Communist China could dip a toe in the waters of capitalism. In Asia, there was hardly a better place to build a city than next to Hong Kong.

Some would compare it to San Francisco and its surrounds in California, which in the 1970s got a shot in the arm thanks to venture capital floating around in the area. It created the Silicon Valley we know today.

Back in the 1980s Shenzhen was a backwater compared with Hong Kong. Still, it had the buzz of a boomtown and that was partly the reason Tencent founder Pony Ma's parents moved there, says Ma biographer Leng Hu.

Shenzhen soon became an electronics manufacturing hub. Though estimates vary, it's safe to say that a substantial part of the world's hardware is made in the city. But cheap manufacturing is only a phase when it comes to building wealth. The real money is in the application of the hardware.

So it wasn't long before the city started building tertiary education institutions in Shenzhen. Today, it has eight universities.

Ma, along with Zhang Zhidong, Xu Chenye and Chen Yidan all attended university in the city. They went on to start Tencent in 1998.

By then, some of the other big players in town were already up and running. Smartphone-maker ZTE, for example, had been established in Shenzhen in 1985, and Huawei followed in 1987. But Tencent took it to the next level, becoming the poster child for China's internet economy, and turning Ma and his co-founders into billionaires many times over.

In 40 years, the city has grown from 300,000 people to more than 12-million. Shenzhen, these days, has more skyscrapers than New York. One of those belongs to Tencent. x

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with real tech giants, risks abound.

Facebook's Marketplace has pulled the rug from under quite a few e-classified businesses, relegating Prosus to niches such as car sales.

And, as Cousins points out, Naspers is not exactly in the top tier of venture investors.

"[It is] just below that. For young businesses, they offer some strategic benefits as an investor, but not necessarily as an operator. It is tough to compete with the billions of eyeballs the likes of Facebook and Google have access to without having to spend money on marketing," he says.

"Hunting for Unicorns" was the headline of the FM's cover story on Naspers two years ago. Whether Van Dijk has found any is still not clear.

Though there are increasing signs that revenue from Prosus's other assets are outpacing earnings growth at Tencent, investors still do not get a detailed enough picture from Prosus's financial reporting to make a fully informed decision, says Teeling-Smith.

Estimates on the value of Prosus's portfolio of assets (which include OLX, PayU and Letgo) vary. In total it will be a couple of hundred billion rand, still very much overshadowed by the R3-trillion Tencent stake.

When (or if) these businesses start feeding a steady stream of profit through to Prosus and Naspers, the discount is expected to narrow. But whether it will close entirely, ever, is anyone's guess.

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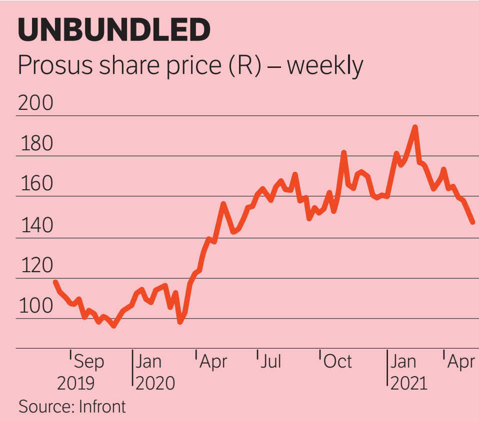
Prosus share price (R) – weekly



Source: Infront

One effective way to narrow the discount, says Teeling-Smith, would be to give a signal to the market that the full dividend from Tencent will flow through to shareholders.

But that seems unlikely, as Naspers is adamant that it is not merely a passive holder of Tencent. Passing the dividend through, without shaving a bit off for other ventures, would not fit the narrative of trying to find another Tencent.

Chicken or the egg?

Naspers likes to claim a bit of credit for not only latching on to Tencent when it did, but for getting it where it is now.

Bekker and Charles Searle, Naspers's head of internet investments, are both long-time board members of the Chinese company. And there has certainly been some cross-pollination.

"Obviously we don't tell Tencent what to do. They are a very capable and competent management team and they stand on their own two feet," Naspers and Prosus CFO Basil Sgourdos tells the FM.

"Think about it, right: 10 years ago Tencent was just a gaming and social network company. They had no e-commerce, they had no payments. We actually started investing in those spaces ahead of them."

Naspers first saw the gap in food delivery in China, he points out.

"Though Naspers started branching out into other e-commerce businesses perhaps earlier than Tencent, it has not always been successful. And in recent years, it has probably gained a lot by learning from Tencent's model in, for example, food delivery," says Cousins.

Though Naspers/Prosus is pivoting towards it, it was Tencent that first got going on this front by investing in online food delivery platform Meituan.

Naspers, until recently, has kept a firm grip on that [Tencent] stake. They did extremely well not to sell, despite constant pressure ... to unlock value

Kevin Mattison

The Chinese company was also quicker to identify other e-commerce opportunities.

Still, there was a time when Naspers was probably the senior partner.

"Of course, when Tencent picked us [as partners], in its very early stages of development, it picked us because it needed us to help it with certain things: to get to scale, to become a public company, to put in the right governance frameworks, all those type of things. To help it think a little bit about the future," says Sgourdos.

Interestingly, in a call to investors last month, Tencent's head of strategy James Mitchell said Bekker had helped Tencent a lot when it comes to regulatory focus.

Bekker, he said, spends a lot of time pushing Tencent to assess ways in which society is evolving, and consider how those changes will affect Tencent's business.

Predictions can go either way, though. Tencent might not know what the future holds, but it is clear what it wants: to grow its share of China's internet economy in the next decade, says Teeling-Smith.

The virtue of doing nothing

If that's the future, Naspers must have done something right to achieve such titanic success over two decades. It followed some advice from, well, *Titanic*: it never let go.

"Naspers, until recently, has kept a firm grip on that [Tencent] stake. They did extremely well not to sell, despite constant pressure ... to unlock value," says Mattison.

The ghost of another investment haunted the company for a long time. Naspers invested a pretty penny in a US-based interactive entertainment venture, OpenTV. It listed it, saw it climb, then held on as it fizzled out.

There were these fears with Tencent, too. After the share was floated on the Hong Kong Stock Exchange, some investors feared Naspers would again hold on for too long.

Some hats have certainly been eaten since.

After all, Bekker might not have bet the house on the Tencent investment that Hawinkels brought to him back in 2001 — but it wasn't nothing.

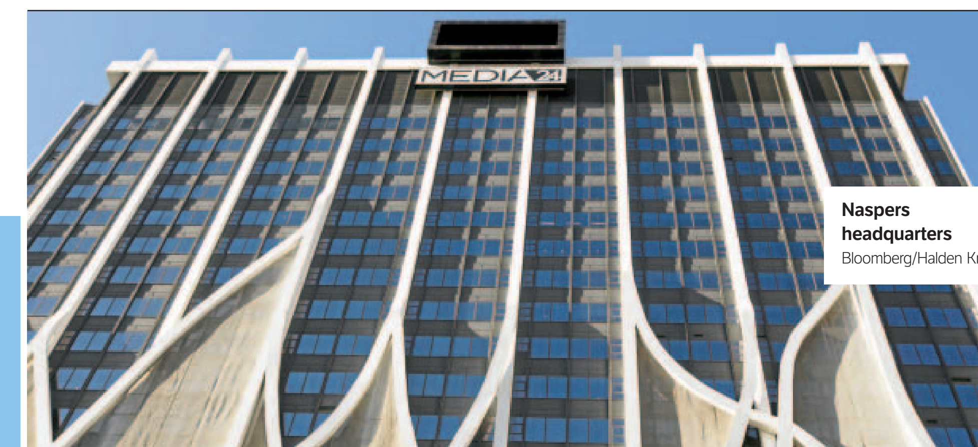
And at the time, it was a pretty risky investment for Naspers.

"Naspers's market cap had bottomed out at R2bn after the dot-com crash [of 2000], so making the [R274m] investment in Tencent meant committing a substantial portion of the company's assets," says Mattison.

Still, the executive team saw the potential, and managed the relationship with Tencent very well over the years, he adds.

Or, as Hawinkels puts it: "The Tencent team, from our earliest discussions, were happy with the Naspers investment philosophy and the way we thought about our role as shareholders."

Two decades and a few trillion rand later, those shareholders are certainly happy with Tencent too. x



Naspers headquarters Bloomberg/Halden Krog

The big misses

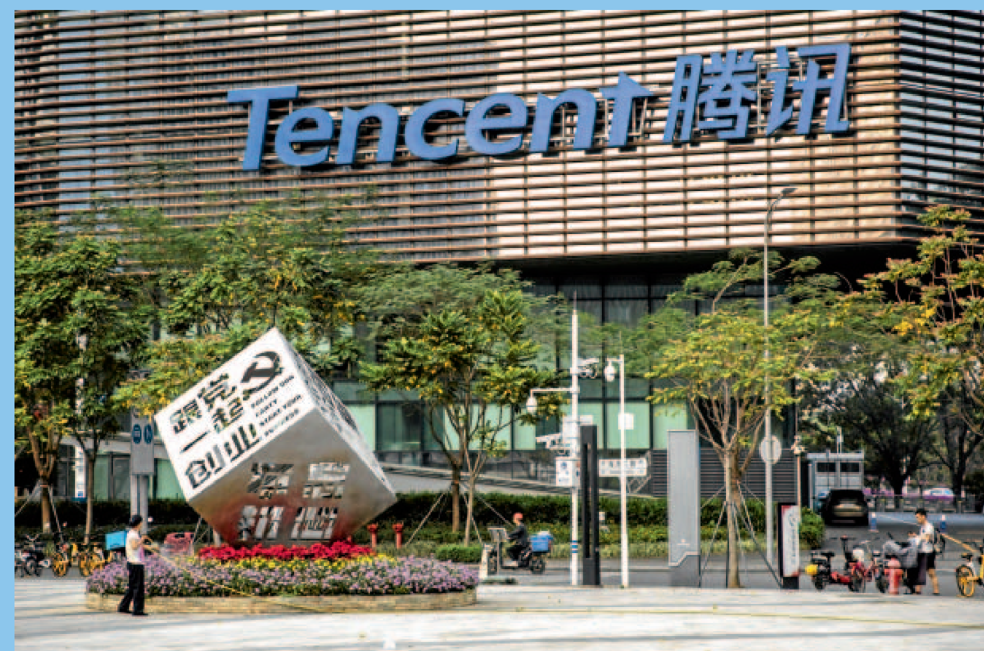
If Naspers bought the stock of the century in Tencent, who was unlucky enough to sell it?

Two investors exited Tencent in 2001: IDG Technology Venture Investments (which is now part of IDG Capital and was an early venture capital player in China) and PCCW, a Hong Kong-based telecoms company.

IDG Capital, through its founder Patrick McGovern and subsidiary International Data Group (IDG), has a history in publishing in common with Naspers. In the 1960s it launched Computerworld, the first news weekly for the IT industry.

IDG followed with more publications, such as InfoWorld (1978), PC World (1983) and Macworld (1984). The group eventually reached 90 countries with 300 print publications and 450 websites.

In the 1990s it started the popular "Dummies" series of how-to books (*Windows 95 for Dummies*, for instance). Ironically, it would later publish *Doing Business in China for Dummies*.



Tencent Holdings headquarters Bloomberg/Halden Krog

IDG Capital and PCCW held equal stakes in Tencent. It's not clear how much IDG Capital initially paid for its stake of nearly 25% in Tencent. But it was happy to exit in 2001, according to former Naspers executive Hans Hawinkels — provided PCCW also sold its stake.

For months, Hawinkels tried to get the telecoms provider to sell. Eventually he was offered the stake at a company valuation of $66m, "no due diligence, take it or leave it".

Naspers took it.

PCCW and IDG Capital each got $16.5m for their stake in Tencent. PCCW today has a market cap of $4bn; Tencent's is north of $730bn. It's a big miss.

But Naspers has also passed on deals that, in retrospect, would have been good.

"We had significant discussions about acquiring a stake in NetEase," says Hawinkels. But Naspers wanted a more sizeable stake than the 10% on offer, so it never invested. Today the Chinese online content provider is worth about R1-trillion.

Naspers also had an investment in 21Vianet, a web-hosting start-up that has pivoted to provide data centre services.

But the euphoria for tech stocks that dominated markets at the turn of the century didn't last. After the dot-com bubble burst, Naspers exited investments in start-ups such as 21Vianet, which is now worth more than R50bn.

In 2002, Naspers chair Koos Bekker decided not to renew Hawinkels's contract. But Tencent will be remembered as the greatest find an SA company has made abroad. x

Staying in the game

The greatest thing Naspers has done with its Tencent stake has been to hold on to it.

Naspers initially acquired 46.5% of Tencent in May 2001.

According to a filing with the US Securities & Exchange Commission, Tencent bought back some of its own shares in August 2003, resulting in Naspers owning 50% of the share capital of the company, and the founding members owning the rest.

When Tencent listed in Hong Kong in 2004 by issuing new shares, Naspers was diluted to a 36% shareholding.

And in the years since, it has been diluted further, though only slightly, due to employee share incentive schemes at Tencent.

By 2018, Naspers's stake had inched down to 33.2%. Then it sold 2% of Tencent for $9.8bn and agreed to a three-year lockup before it disposed of any more shares.

Last month, Naspers flogged another 2% of Tencent, for $14.6bn.

"By selling down the stake as soon as it was allowed to, Naspers has created the expectation that it will continue to do so," says Avior Capital Markets MD and veteran investor Kevin Mattison.

"Management now has to show that the capital it raised from the sale can create more value in Naspers by deploying it to other businesses than in Tencent." x