OPINION / COLUMNISTS

CHRIS REDDY: Naspers should come clean on Tencent stake sale and long-term strategy

Inconsistent message on the Tencent holding and reason for the placement raises questions

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Picture: BLOOMBERG

We recently wrote on Naspers ("Whether Naspers can solve what appears to be a structural issue is questionable", Business Day, February 11 2021) where we questioned the ability of the Naspers management to reduce the discount that Naspers and Prosus traded at, relative to its sum of the parts valuation.

With the recent announcement that Prosus has sold another 2% of its holding in Tencent, we felt it important to revisit the matter, given the impact these companies have on the SA investment industry.

At a combined benchmark weight of more than 25% in the JSE Shareholder Weighted index, a significant portion of SA's investments are exposed to the group. If we use the capped shareholder weighted index (the preferred benchmark for institutional investors), which limits the exposure to a single company to a maximum of 10%, the combined exposure reduces to just over 12%.

While this helps from a concentration perspective, it amplifies the challenges that the group faces by increasing the discount to Tencent. This is due to the strong performance of Tencent, which has led to an increase in the share prices of Naspers and Prosus. Given the 10% cap, investors have had to reduce their Naspers weight each quarter when the index position sizes are rebalanced as many institutional mandates cap the size of the active position that a fund can have vs the index.

Peter Lynch once said: “Selling your winners and holding your losers is like cutting the flowers and watering the weeds.” To put the recent sale into perspective, the 2% raised $15bn, and was the second-biggest block trade in capital markets. The first 2% placement done in March 2018 raised just under $10bn, where Naspers sold Tencent at HK$405 per share.

This recent placement was concluded at a price 47% higher than that, at HK$595. Taking currency into account, this translates into an increase of more than 80% in rand terms, due to the rand depreciation vs the Hong Kong dollar. The difference in sales proceeds equates to almost $5bn, or R73bn, at the current exchange rate-that is more than the current market cap of Nedbank, Aspen or Old Mutual.

This placement raises a few questions.

First, why was there an inconsistent message given regarding the Tencent holding? At an investor conference as recent as the beginning of March, the company had firmly committed to the Tencent stake and had suggested that they would be “leaving a lot on the table if they sold at these levels”. The timing of the sale at HK$595 is a 21% discount to the January 2021 Tencent high.

So, what fuelled the reason to sell down a stake now? If it were to fund a deal, alternative sources of funding could have been explored such as a bridge loan for example, which would then prevent a cash drag or opportunity cost on the assets sold.

Second, we question the consistency and confidence regarding the reason for the placement. Naspers CEO Bob van Dijk attributed the sale to supporting an “increase in the company’s financial flexibility, enabling it to invest in the significant growth potential across the group”, as well as in their stock. This was done in a media statement and left the door open to further share buybacks.

However, in the official announcement on the placement, no mention to a very important motivation such as a share buyback, was referenced. With heightened investor caution and sensitivity around the group’s future capital allocation, it is particularly concerning that the messaging is not consistent, at the very least. Clarity around the messaging would be exceptionally important given the questionable strategy into food delivery, online classifieds and payments, which are yet to inspire confidence of better growth relative to Tencent’s return.

Third, as per the company’s guidance, if it is to fund growth opportunities, given that the placement was at the higher end of the guidance, why not take advantage of conditions and place a larger portion of shares? There was certainly sufficient demand from investors with the placement being multiple times oversubscribed and, given Prosus’ renewed commitment to a three-year lock up for further selling, the existing placement would be opportunistic timing.

All the moves to date, current placement included, have done little to solve the Naspers/Prosus discount conundrum. Many foreign shareholders affirm that they prefer to invest directly with Tencent, rather than via Naspers and Prosus. This is fuelled due to a range of concerns, such as the leakage in underlying asset returns (primarily Tencent) not flowing through fully at the hold-co level; the supervoting control structure; and a questionable track record of capital allocations.

We are not downplaying the significant task ahead of reducing the discount to NAV, that both Prosus and Naspers trade at. We fully appreciate the complexity in structuring a suitable transaction across multiple geographies, business units and underlying investments, coupled with the tax implications and regulatory approvals required.

However, something meaningful needs to be done to curb the shareholder value destruction. Prosus and Naspers are trading at discounts to sum of the parts NAV of 33% and 49%, respectively. While it is not uncommon for a hold-co to trade at a discount, the sheer scale of Naspers means that its discount equates to almost R1.4-trillion. Translating that into a perspective that hits home, closing the discount would be the equivalent of a R24,000 grant being given to every South African.

US author Upton Sinclair said: “It is difficult to get a man to understand something, when his salary depends on his not understanding it.” This aptly captures Van Dijk’s problem of the difficulty in unlocking Naspers value. To justify the inflated remuneration packages that the group’s executives are being paid, without the heavyweight crown jewel of Tencent, would be a stretch. This draws into concern the ability and/or drive to make a case for a more drastic solution, such as larger sell downs or unbundlings of key assets, when a clear agency problem exists.

As shareholders and investors, our ask is a clearly articulated strategy on how value will be unlocked within the group. A series of incremental measures to reduce the discount, which in fact prove to be short-lived, is not going to cut it. A multi-stepped plan, flanked with guidance to timelines, is essential to provide comfort and clarity to investors in supporting the group’s long-term plans.

It is imperative that management and the board be more proactive in protecting the interests of shareholders, else we end up with a garden full of weeds and no flowers.

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