To swap or not? SA investors weigh in on the new Naspers-Prosus deal

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The CEO of Prosus and Naspers, Bob van Dijk.
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- **Naspers shareholders will be offered the chance to swap their shares for newly created shares in Prosus.**
- **This is part of another attempt to boost the share prices of the companies, which are trading below the value of their holdings in Tencent and other businesses.**
- **But some local investors are not keen to take up the offer, believing that Naspers offers bigger future upside.**

Two years ago, with the creation of Prosus, investors voted overwhelmingly in favour of getting shares in the new tech firm, instead of more shares in Naspers.

In fact, investors who held 96% of the shares in Naspers opted for the Prosus shares.

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As part of a new proposal, they will now be offered Prosus shares again, this time in exchange for Naspers shares. But judging from the local investors Fin24 spoke to, a more lukewarm response can be expected.

Like the creation of Prosus, the new transaction is another attempt to shrink the gap between the market value of the companies, and the value of their 28% stake in tech behemoth Tencent, together with other investments.

The new plan – which still needs to be approved by Prosus shareholders – will, in essence, make Prosus bigger, and Naspers smaller. New shares will be created in Prosus, which will increase its free float in Amsterdam. Currently, only 25% of the shares in the company are available to trade, and this small free float excludes it from some of the most important stock-market indices. This, in turn, means that some large index funds who are tracking European indices, currently don't have to invest in Prosus. Following the deal, Prosus should be included in more indices thanks to a much bigger free float.

The deal may also help to shrink Naspers on the JSE.

Three years ago, Naspers' weighting on the JSE Shareholder Weighted Index (SWIX) was about 25%. This hurts its share price, because some large investment funds are not allowed to have so much exposure to a single share, and are forced to sell.

To help address this, and to shrink its discount, Naspers listed Prosus - which owns its international internet assets, including Tencent - on the Amsterdam Euronext. But this did not make much difference. Naspers' weighting on the SWIX has since climbed back to 23.3% as at April 2021.

"We've become really big on the JSE (…) we're still growing faster than the market. So, if we continue like this we will be 40%, 50% of the index in a few years' time and we don't think that's sustainable, we know that already we have concentration issues and they will get a lot worse," Naspers and Prosus CEO Bob van Dijk told Fin24 this week.

By offering Naspers shareholders the chance to swap their shares for Prosus shares, this could see Naspers move down to below 15% of SWIX.

But some local investment experts are not keen to give up their Naspers shares.

One reason is that Naspers is currently trading at a bigger discount to its investments.

Chantal Marx, head of investment research at FNB Wealth and Investments, said that their calculations show that in early May, Prosus was trading at a 29% discount to its underlying portfolio value of listed investments plus cash, while Naspers was trading at an 18% discount to Prosus and at a 42% discount to its listed assets plus cash.

“Because the Naspers shares trade at a deeper discount to Prosus, the eventual upside should be bigger. Holding the Naspers shares therefore could offer more value,” says Wilhelm Hertzog, founder and portfolio manager at Rozendal Partners.

“As long-term value investors, we are comfortable to keep exposure to the Naspers ‘rump’ through Naspers itself rather than through Prosus.”

Marx also noted that individual investors in Naspers may be discouraged from taking part in the swap if it triggers a capital gains event that makes the liable for tax.

This is indeed the case, with Naspers estimating that South African shareholders will have to pay between R2 billion and R4 billion in capital gains tax as part of the deal.

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“It’s important to note that CGT for SA shareholders as a result of this transaction is not an additional tax; it is tax they would always have to pay on their gains and brought forward when they exchange their shares for Prosus shares,” a Naspers spokesperson told Fin24.

Portfolio manager and strategist at PSG Invest Schalk Louw also believe that some Naspers shareholders might not think the share swap is worth it, if there is a capital gains event.

"I believe they (investors) already had the opportunity three years ago (with the listing of Prosus, and I would be quite surprised to see a lot more investors taking up this opportunity to take Prosus," he added.

Marx said that rationale of the transaction makes sense, but that it was adding more complexity to an already complex corporate structure. This may result in investors "staying away from it" or being more cautious to invest in the group of companies. "Investors do not like complexity, they like simple corporate structures and this just adds complexity to it."

Jean Pierre Verster, CEO at Protea Capital Management, also says that the transaction appeared to be quite "convoluted". Verster thinks that perhaps a simpler solution or transaction to address the discount gap, which may have incurred greater tax for the company, could have been considered instead.

The easiest way to reduce the discount gap is to unbundle the Tencent holding, but the group is not prepared to do that, said Louw.

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This is due to the massive capital gains tax bill that it could trigger: Naspers bought the stake – now worth $200 billion – for only $32 million in 2001.

Van Dijk, who estimates that the total tax bill could top $40 billion, says the unbundling of the Tencent holding would be a "bad idea" – and not only due to tax.

Naspers and Tencent want to keep their exposure to China, which is the largest internet market in the world, with more than a billion users.

"China is very important and in terms of business models and innovation, the most exciting internet market in the world. We have learned a lot from Tencent over the years that has helped us build the rest of our portfolio."

In addition, he adds, it would create a "very problematic situation" for Tencent if all the shares were suddenly offered in the market.

The share swap could create about $11 billion in value for Prosus and Naspers shareholders, he added.

Van Dijk said that the current transaction does not rule out future transactions that will benefit shareholders. "This does not stop us from doing 'good' things for shareholders in the future, whether they be buy-backs or listing companies, or any structural boosts," he said.

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According to Naspers, if the transaction is fully taken up by its shareholders, its holding of issued Prosus ordinary shares will reduce from 73.2% to 57.2%. Prosus will hold 49.5% of the issued Naspers ordinary shares, and it will have a 49.5% stake in Naspers.

But due to the creation of a new class of shares, Naspers will retain 70% of voting control of Naspers.

Prosus shareholders still have to vote on the share swap, but it will be voluntary for Naspers' shareholders to participate. Prosus will launch a share buy-back valued at $5 billion, once the transaction is complete.

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