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## EQUITY INSIGHTS

### Tencent's Investment Portfolio Keeps Growing

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*Stonehage Fleming (Equity Management, South Africa) holds Prosus, Naspers and Tencent for clients where appropriate.*

*This article explores Tencent's investment strategy, portfolio and prospects.*

At \$90 billion<sup>1</sup>, Tencent's investment portfolio now accounts for 20.9% of the company's market cap. Five years ago, the portfolio, then valued at \$3.5 billion, accounted for just 3.4% of market cap.

This impressive growth is largely due to Tencent's Open Platform, which enables businesses and third parties to develop and integrate apps into the WeChat and QQ Ecosystems, with sales processed via Tencent's payment gateway. This gives businesses the opportunity to rapidly grow their user traffic and revenue.

As the ecosystem experienced explosive growth, much of the value was developed and owned by third parties. Tencent's Open Platform now has more than three million developers and many more business applications.

Seeing the opportunity to add value to its own bottom line, Tencent set up an investment department in 2011, to invest in high potential businesses many of which have launched successful start-ups on Tencent's platforms.

This has allowed Tencent to compete for a larger share of the internet economy while continuing to focus on improving its core platforms and businesses. Tencent then supports the successful development of its investees through guidance on their boards, greater access to user traffic and additional capital for growth. Many of Tencent's 800 investments were partnered with in this fashion.

Today, the largest three listed investment stakes are worth \$28 billion<sup>2</sup>:

20% in Meituan Dianping the largest group-buying and food delivery business in China. Meituan recently became China's third most valuable internet company.

18% in JD.com and a 30% stake in Pinduoduo, respectively the #2 and #3 ecommerce businesses in China behind Alibaba. These companies are gaining market share in ecommerce, an industry growing at more than 20% per annum. Pinduoduo has rapidly built a customer base of 536m people, 75% of Alibaba's 693m.

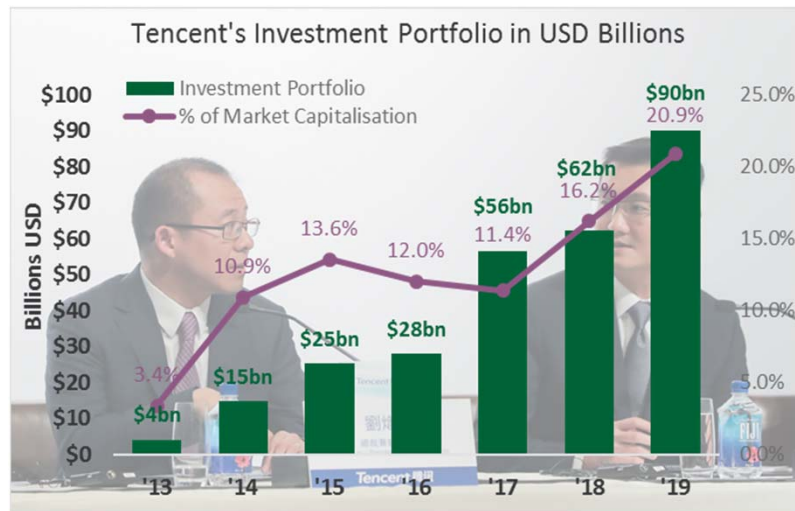
Highly successful unlisted investments include:

40% in Epic Games, the US game developer of Fortnite which has 250 million users globally.

A 30% stake in WeBank, China's largest digital bank and one of the world's largest unicorns with a 2018 valuation of \$21 billion (Euromoney, 2019).

Over the last 6 years, Tencent has produced \$88 billion<sup>3</sup> in cash flow from operations. Approximately 64% or \$56 billion has translated into free cash flow after core business capital needs have been met. Only \$6.8 billion has gone toward dividends and stock repurchases, with \$53 billion being deployed into investments<sup>3</sup>.

The investment portfolio itself has generated an estimated 21% return on investment per annum over this period, with total gains of \$42 billion.



Sources: Tencent Fact Sheet, Bloomberg 2019  
Martin Lau Chi-ping, President (left) and Pony Ma Huateng, Chairman and CEO (right).

To date, of the over 800 companies Tencent has invested in, 70 companies have been listed. Tencent owns the second most stakes in unicorns globally after Sequoia, and ahead of SoftBank and Google. Of these, 160 have become market unicorns with a market value of over \$1 billion, up from 122 announced in the prior year. Fifteen of the 800 firms have generated returns of at least USD1bn, 6 have generated returns of at least US\$5bn and 1 of them has generated a return of more than US\$10bn.

The portfolio includes businesses from across the internet economy, including gaming, ecommerce, food delivery, ride hailing, payments, video, music, social media, new retail, electric & autonomous vehicles, search, online services, financial services, education, health, robotics and AI.

#### What should investors expect from Tencent's investment portfolio?

As the majority of Tencent's 800 investments remain private businesses, we are likely to experience continued IPO's, which may be value enhancing. At the same time, continuing to strengthen their platforms, cloud and payments business will be key to the ongoing success of the investment portfolio and Tencent's ability to add value to investees.

On aggregate, the company's portfolio businesses are yet to reach sufficient scale or maturity to produce good returns on equity. This makes the investment portfolio riskier, which market values should reflect.

Tencent has indicated that they intend to continue with their investment strategy. Hence, the group is likely to deploy the majority of their future free cash flow over the next few years into investment opportunities. Martin Lau, who heads the Investment Department, has flagged smart retail, the Industrial Internet and overseas companies as focus areas. Meanwhile, Tencent's open platforms are continuing to increase in usefulness and user time spent, thus providing a growing pool of businesses to potentially invest in.

Sources:

1: Tencent, Q4 Results, 2019

2: Factset, 2020

3: Tencent Results, 2013-2019

FOR MORE INFORMATION PLEASE CONTACT:



JP DU PLESSIS

Director – Equity Management

t: +27 21 446 2106

e: [jp.duplessis@stonehagefleming.com](mailto:jp.duplessis@stonehagefleming.com)



JEREMY GORVEN, CFA

Senior Analyst – Equity Management

t: +27 21 446 2172

e: [jeremy.gorven@stonehagefleming.com](mailto:jeremy.gorven@stonehagefleming.com)



RYAN DE KOCK, CFA

Analyst – Equity Management

t: +27 21 446 2112

e: [ryan.dekock@stonehagefleming.com](mailto:ryan.dekock@stonehagefleming.com)

Stonehage Fleming Investment Management (South Africa) (Pty) Ltd,  
First Floor, North Block, Waterway House  
3 Dock Road, Victoria & Alfred Waterfront  
Cape Town 8001 South Africa  
t: +27 21 446 2100  
e: [enquiries@stonehagefleming.com](mailto:enquiries@stonehagefleming.com)  
[stonehagefleming.com](http://stonehagefleming.com)

*Jeremy Gorven and Ryan de Kock are representatives under FAIS supervision*

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