OVERBERG MARKET REPORT

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Global Report

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European Energy Crisis

The European energy crisis has been years in the making and a confluence of factors have brought it to a crescendo this winter. **European leaders are feverishly trying to find solutions to secure their energy sectors after years of neglect.**

Europe has been spearheading the drive for cleaner energy and leaders decided a decade ago that gas was going to be the bridge technology between the dirty fossil fuels, such as coal and oil, and the future of clean renewables. **Burning gas halves CO2 emissions compared to coal and it became central in achieving emission goals.** Around the same time nuclear power stations were being decommissioned around the world, following the Fukushima disaster of 2011.

Europe imported increasingly cheap oil and gas from Russia, laying pipelines to feed directly into storage facilities often owned by Gazprom, Russia's state-owned multinational energy corporation. Industries were built around cheap energy imports. **Europe wilfully became ever more reliant on Russian oil and gas, emboldening the Kremlin.** Warning signs were ignored when Russia annexed Crimea and by the time Russian tanks rolled into Ukraine it was too late.

The crippling sanctions on Russia, following the invasion of Ukraine, placed European gas supply at the mercy of the Kremlin. During the summer months when gas demand was low, Gazprom ran down the levels of its gas storage in Europe, mostly unnoticed. **At the end of August Putin shut the Nordstrom 1 pipeline, restricting a third of Russian gas supply to Europe, until sanctions are lifted.** Last year Europe imported 155bn cubic meters of Russian gas via pipelines, accounting for nearly 40% of its total supply. Since the closure of Nordstrom 1, that figure has fallen to 9% causing a major shortfall. As a result, gas prices have increased 10-fold compared to the average over the last decade.

Some European nations have it worse than others. It all depends on the energy mix and how your government has come to the rescue. The UK for instance derives 40% of its electricity from gas. Although the UK is not linked to Russian gas directly, it is still affected by the wholesale price of gas causing electricity prices to spike in the last year. In comparison, households are paying 30% more for electricity in the UK than Italy, the European nation with the costliest electricity. The UK government has recently announced some mitigating initiatives. It will cap the typical household bill for energy at £2,500 a year, for the next two years. However, support for businesses will only last for 6 months after which they will reassess and support only key industries. Furthermore, a provision will be made for a £40bn liquidity facility to assist power producers coming under increasing strain to provide margin in the futures market where they secure their energy pricing. The hit to the UK fiscus is estimated at £150bn.

France on the other hand, has a much lower reliance on gas. It has been Europe's nuclear champion since the seventies and has amassed a total of 56 reactors, many of which were earmarked for mothballing. Putting energy security front and centre, French president, Emmanuel Macron, is doing an about turn, talking of expanding and replacing the current fleet of reactors with next generation reactors. Macron has also called for aging reactors to be operated beyond their 40-year lifespan. **However, an unprecedented number of reactors have been taken out of service for maintenance this year, exacerbating the energy crisis.** There are also doubts that the French still have the skills to build new reactors, evident from the last reactor commissioned that is a decade late and four times over budget, mostly due to staff and skill shortage and regulatory blockages. In the meantime, the French government announced it will be capping electricity and gas price hikes at 15%, while also giving the most vulnerable of society energy cheques of between €100 and €200. The cost to the fiscus of €16bn will be partly offset by mechanisms built into contracts with renewable energy producers which allows the government to recoup funds once prices hit a certain level.

European leaders have proposed a similar windfall tax on non-gas energy producers which have been benefiting from record energy prices. The member states are expected to raise as much as €140bn, which will go some way to soften the blow this winter. Leaders will meet at the end of the month to agree on the proposal, knowing that there is a real threat that Putin could shut off all remaining gas flows to Europe this winter.

Local Report

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Naspers and Prosus

INTRODUCTION: **Tencent is the driving force behind Naspers and Prosus. Prosus owns 27.99% of Tencent. Any move in the price of Tencent will affect both Prosus and Naspers.** Year-To-Date (YTD) Tencent is down 33%. Naspers is down 6%, while Prosus is down 23%. The drop is a result of the Chinese crackdown on technology companies. In 2021 Chinese regulators froze all licensing activities for new computer games. Now, a year later, good news is coming out. Last week Tencent received its first game approval, "Défense of Health" since regulators froze licensing activities. Game approvals resumed in April, but Tencent and NetEase (a Chinese internet company) only featured in the fifth batch of games approved in September.

The drop in Tencent's price is not due to anything internally wrong at Tencent. If Tencent had internal problems, it would have been a red flag and a signal to sell the share. But Tencent is still a brilliant company. It is the biggest company in China. The drop in Prosus is also partly the result of the Russian invasion of Ukraine. Prosus acted quickly and decisively. It has ceased all its Russian operations. It is set to write down a $700 million (R10.7 billion) stake in Russia's biggest internet firm, VK Group. Prosus has also cut ties with its star classified Russian business, Avito.ru. Avito is the second biggest classifieds business site in the world.

KOOS BEKKER AND TENCENT: **Koos Bekker, chairperson of Naspers and Prosus, has experienced tough times in China before, and he survived. He invested $32 million in Tencent in 2001.** The rest is history. Tencent became the biggest company in China. Tencent was well on its way to become the first trillion-dollar company in China. A clampdown on technology companies put a stop to that.

Today the market capitalisation of Tencent is around $360 billion. Prosus owns 27.99% ($100 billion or R1.7 trillion) of that. It makes up 85% of the market capitalisation of Prosus.

BUY OR SELL: The question investors often ask is: “Do I sell Prosus and Naspers, or do I buy more”? There are occasional media “attacks” on Tencent. On 14 March 2022, the Wall Street Journal (one of the world's leading financial newspapers) reported that Tencent could face a “record fine for violating anti-money laundering rules”. Tencent shares fell nearly 10% on the news but recovered quickly. It is now six months later, and nothing has happened. It seems to be a case of fake news. **There are no internal issues at Tencent.** We rate Prosus and Naspers a buy.

GEOGRAPHICAL DIVERSIFICATION: **Prosus has built a world-class, global portfolio of attractive assets. Prosus is globally diversified - it now serves more than two billion users globally.** The four core divisions are Food Delivery, Fintech (PayU and BillDesk in India), Classifieds (OLX) and Education Technology (distance learning). In the event of political turmoil (like Russia and Ukraine), or economic turmoil (in China), Prosus is sufficiently geographically diversified to minimise the negative effects of most issues. It is also diversified around four big asset classes.

VALUATION: The drop in the YTD market prices of Naspers is -6% and Prosus -23%. The net asset value of Prosus is R1,721.30 per share. Prosus is currently trading at around R1,000.00 per share. This relates to a discount to NAV of 41.9%. Prosus is a smart way to buy Tencent. Naspers is trading at a historical average discount to NAV of 49.6%. **There is a big margin of safety - the downside risk is limited.**

BOTTOM LINE**: We feel Prosus, and Naspers, are undervalued. They still have robust growth potential**. They are victims of setbacks outside their control – like regulatory clampdowns and Russia’s invasion of Ukraine. There is nothing internally wrong with the companies. China regulators are perhaps doing the right thing and are ahead of the curve. It is possible that other countries can follow the lead set by China. We are not selling our Naspers and Prosus shares.

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