Lasanoz Finance

Lasanoz networks its way to the top

Lasanoz Finance, an advisory firm specialising in mergers and world renowned Russian Internet holding company Digital Sky

Alex Neuber

Naspers Limited, a South African media company listed in London and Johannesburg, acquired the 28.7% stake in DST for cash consideration of US$388m plus the contribution of its 39.3% stake in mail.ru, a DST subsidiary. Lasanoz Finance advised Naspers in connection with the transaction.

DST is valued at around US$3bn, reflecting a USD 300m private placement of new shares to Hong Kong-listed Tencent, a Naspers affiliate.

In this prominent transaction, Lasanoz Finance (LF) acted as a main financial advisor to Naspers, alongside Citi, with a particular focus on commercial due diligence and valuation aspects. This deal marks the seventh time LF has worked with Naspers, including advising on the successful acquisitions of Polish Internet properties GG Networks (2007), Allegro.pl (2008) and Bankier.pl (2009).

Alex Neuber, LF team leader on the deal, said the transaction means Naspers will now have a 29% stake in a larger group, giving it a more diversified shareholding in the Russian Internet.

Neuber said: "Considering people in the US now spend more time on the Internet than they do watching TV, it is a great market to tap into. As eyeballs move to the Internet, so do advertising budgets, and DST owns a premier selection of Internet properties in Russia and the CIS, as well as significant minority shareholdings in US Internet powerhouses Facebook and Zynga."

Naspers and DST have worked closely together over the past three years as co-owners of mail.ru, and the transaction is expected to further strengthen their relationship. Mail.ru is a communication and entertainment platform in the Russian-speaking Internet world, with over 50m registered email accounts, a leading market share in massive multi-player online (MMO) games and one of the leading social networks in Russia. As the deal stands, DST will now own over 99% of mail.ru.

Neuber said although Naspers and DST knew each other very well before the deal, LF's challenge was to analyse the financial benefits of the potential swap-up investment. LF looked at DST's social networking sites in Russia, Poland and the Baltics, including: Vkontakte (vkontakte.ru), with nearly 18m monthly active users in January in 2010; NK.pl, with 13.5m monthly active users in March 2010; Odnoklassniki, with 10m daily active users (odnoklassniki.ru); and One.lt and One.lv, with over 1m monthly active users, according to comScore. Following a recently-announced group restructuring, DST owns a 25% stake in Vkontakte and 100% in Odnoklassniki as well as the two Baltic social networks through Forticom, an investment vehicle.

The biggest challenge in analysing these businesses was to determine whether they will be able to sufficiently monetise their extensive user bases – in other words, they may be market-leading social networks, but would they be a good investment for Naspers?

Neuber said: "The big questions was – can the business make money on a sustained basis? We tried to get a better understanding by looking at track records of other social networking services (SNS) operating in other countries. How do they make their money? Facebook is obviously the standout in this arena and DST has an estimated 10% shareholding in it, making it the second-largest shareholder after the founder, Mark Zuckerberg."

"Looking at Facebook, it seems that 80% of their revenue stems from advertising, even though it is a social networking site," Neuber continued. "However, in Russia and the Far East, people are more prepared to pay for gaming and social networking usage, making user fees a more prominent element of the SNS business model and thus reducing the importance of advertising."

Neuber said: "Russian Internet users have exhibited a willingness to pay for access, pay to play games, and pay for virtual goods as well, especially if this means it will lead to a better gaming experience. DST has been a pioneer in Russia in promoting user fees and virtual goods, similarly to Tencent in China."

Neuber added that this has the potential to become very profitable: "For example, in the US, social gamers pay real cash, say US$7 a month for every fifth person who plays online games. Keeping in mind that in a growing number of markets (including the US, UK, as well as Russia), over 25% of Internet users play social games, if every fifth person was paying this fee it would amount to a very significant revenue pull."

The best way to position for this revenue stream seems to be to capture market share and then, later on, monetise the user base. SNS operators first need to expand the market though, and this is where many difficulties lie.

In the past few years there have been a number of well-known failures of social networking sites. The two standouts are MySpace, owned by News Corp., and Bebo, owned until recently by AOL.

In the case of MySpace, News Corp. has failed to pull in more users and many of its original audience have left the site for more appealing social networking pro-

DETAILS

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acquisitions and debt advice, recently aided Naspers in securing a 29% stake in Technologies (DST).

grams such as Facebook.

It is a similar case with Bebo. AOL acquired the social network for US$850m two years ago but recently sold it for a fraction of this price, realizing a significant loss. Neuber noted it was important for LF to examine these and other market failings, in order to draw appropriate conclusions about what works and what doesn't work in making a social network profitable.

Neuber said: "We needed to look at these cases to see whether the deal would be a likely winner in this battle, rather than fail like some other sites have. In the case of MySpace and Bebo it seems that they failed because of poor execution."

Neuber said it was important to also look at whether there is a domestic market for social networking sites. If users would rather use international sites such as Facebook, what hope would a domestic social networking site have? This question was particularly relevant for the transaction, where DST's social networks in Russia, the CIS, the Baltics and Poland still dominate but Facebook is growing fast.

So how can Internet businesses maintain their user base? Neuber outlined some key areas that SNS operators should keep in mind: "It's important to keep innovating and trying new things, whilst at the same time listening to users. It's also important to have strong management team and create an engaging environment that draws users back to the site each day. It should turn into a basic need for them."

Neuber noted that at present 50% of advertising spending is still on television, but statistics show young people are now more likely to spend more time on the Internet than in front of the television.

"Tapping into these social networking sites is therefore a great way for advertisers to target young people," Neuber said.

Naspers is a leading emerging market media group operating in 129 countries. It is listed on the Johannesburg Securities Exchange, with an American Deposit Receipt listing on the London Stock Exchange. The group's principal operations are in Internet platforms, pay-television and the provision of related technologies and print media. With its acquirement in DST, Naspers will be able to further develop its Internet arm of the company.

Naspers has a knack for spotting promising companies. In 2001 it acquired a 46.5% stake in Tencent Inc., which was a little-known Chinese Internet start-up at the time. Today, Tencent has grown into China's largest and most used Internet service portal. The company is listed on the Hong Kong Stock Exchange with a market capitalisation of over US$ 33.5 billion. Naspers still has a 30% stake.

Neuber said: "Naspers has successfully picked winners before and its experience of working with Tencent will further allow it to develop DST into a fast-growing and profitable company."

DST itself was founded in 2005 and is one of the largest Internet companies in the Russian-speaking and Eastern European markets and one of the leading investment groups globally to exclusively focus on Internet related companies. The transaction with Naspers will enable both groups to benefit from each other's extensive experience in owning and managing Internet companies in developing markets.

Making the deal happen was a large task that required full commercial due diligence and a comprehensive valuation exercise. LF, which specialises in sectors including Internet, telephony, infrastructure and energy, said its unique model helped to give Naspers a thorough view of all information relevant to the deal.

Neuber said: "We went into an exact analysis of each product and service and built up demand projections bottom-up. This then allowed us to conduct top-down cross checks to make sure our projections were reasonable and supportable with analogous data from other markets. We've found over the past three years of using this system with Naspers that it is a very good methodology."

"It gives a good level of comfort to our clients and really works for financial models," he continued.

Together with Neuber, Associate Partner Mateusz van Wollen worked as project manager and industry analyst for the deal. Aleksander Skołożyński was an analyst on the deal and focused on modelling and presentations. Wojtek Jezierski conducted financial analysis and Ewa Kacprzak-Olszewska coordinated commercial, legal, and financial due diligence.

Neuber said LF specialises in debt advisory and mergers and acquisitions and is able to serve its clients throughout central Eastern Europe and Russia from its headquarters in Warsaw, Poland.

Neuber said: "We are an independent and small firm that is committed to the highest standards of quality and first-class service. We have sound knowledge about the sectors in which we specialise and I think it is largely because of this, and our attention to detail, that we enjoy repeat business from clients such as Naspers."