
Market Consultation

To: Market Participants
From: Indices Department
Date: 5 November 2019
Subject: Naspers/Prosus Capping

1. Introduction

Following the September FTSE/JSE Index Series implementation of the Naspers capitalisation issue, various market participants have reiterated concern regarding the resultant combined weight of Naspers and Prosus in the FTSE/JSE Capped indices, specifically the Capped SWIX All Share index (J433), which has become the *de facto* benchmark for local equity funds in South Africa. The reason for applying capping in indices is to reduce single stock exposure. Since Naspers and Prosus are two separate companies, the capping is applied separately and their combined index weight is thus in excess of the capping level of 10%. However, both companies draw a significant portion of their value from an underlying holding in TenCent, and some index users believe that this should be considered when capping their index weights.

2. Background

On 25 March 2019 Naspers announced its intention to form a new global consumer internet group ("Prosus") comprising Naspers' international internet assets, and list Prosus on Euronext Amsterdam. Prosus also has a secondary, inward listing on the JSE.

Prosus comprises all of the old Naspers' internet interests outside of South Africa including, among others, its companies and investments in the online classifieds, payments, food delivery, retail, travel, education and social and internet platforms sectors. Prosus is currently 74% owned by Naspers and has a free float of 9.91% in the FTSE/JSE Index Series, based on the proportion of its shareholder base accounted for on the South African (Strate) share register.

Although FTSE/JSE typically aligns the company free float for new foreign listings at the first quarterly review post a spin off event, the free float for this event was estimated at the September review based on three key inputs:

- The published election results
- The resident / non-resident split of Naspers on the Strate Register as at the end of August, on the basis that SA resident Naspers shareholders would receive their Prosus allocation on the Strate Register and non-residents will not
- The Naspers cross-holding in Prosus is considered restricted and therefore excluded from the free float calculation

On the same day as the Naspers announcement FTSE/JSE released an Index Change Advice (ICA) [notice](#), noting the Naspers announcement. Following the publication of the Naspers [circular](#) on 29 May 2019, FTSE/JSE published an [Informative Notice](#) on 13 June 2019 setting out the proposed index treatment of the event. Following the

extension of the indicative dates associated with the transaction further ICA notices were published on [24 June 2019](#), [29 July 2019](#), [4 September 2019](#) and [16 September 2019](#).

3. Treatment in Capped Indices

From market open on 11 September, the effective date of the capitalisation issue, Prosus was added to all indices that Naspers was a constituent of. Prosus entered the index with a synthetic opening price, determined through a process of broker consensus and the company valuation made available. Furthermore, due to the 1:1 terms of the event, Prosus mirrored the shares in issue and free float of Naspers in the Index Series. In the capped indices, Prosus had the same capping factor as Naspers. Therefore, Prosus was added to the indices with the same index metrics as Naspers, e.g. free float, ICB and capping factor. The value of Prosus was removed from Naspers through an index opening price reduction, equal to the synthetic opening price for Prosus. The standard FTSE/JSE spin-off treatment is designed to replicate what happens to the index tracker, ideally resulting in no additional trading required.

On 16 September a further notice was published confirming the update to Prosus shares in issue and investability weight to incorporate the shares held by Naspers, its foreign company status, and the decrease in index shares in accordance with the election results. A concurrent shares in issue update was applied to Naspers (to counter the decrease in Prosus per election results). These changes were effective on 23 September, and incorporated into the September quarterly index review changes in order to reduce unnecessary index turnover, and to align the changes with an existing liquidity event. From market open on 23 September, Naspers obtained a new capping factor in the capped indices, but Prosus was now uncapped, due to the company's weight being below 10%.

The two tables below set out the changes in the All Share index variants at market close on 11 September, the day Prosus entered the Index Series, and 23 September, the September review effective date.

Market Close on 11 September:

Instrument	Shares	Price	Gross MCAP (Rb)	Free Float	Index Weight			
					ALSI (J203)	Capped ALSI (J303)	SWIX ALSI (J403)	Capped SWIX ALSI (J433)
Naspers	438,656,059	2,465	1,081.29	97%	14.44%	7.48%	18.03%	7.51%
Prosus	438,656,059	1,203	527.55	97%	7.04%	3.65%	8.80%	3.66%
Total					21.48	11.13	26.83	11.17

Market Close on 23 September:

Instrument	Shares	Price	Gross MCAP (Rb)	Free Float	Index Weight			
					ALSI (J203)	Capped ALSI (J303)	SWIX ALSI (J403)	Capped SWIX ALSI (J433)
Naspers	444,667,763	2,385	1,060.55	97%	14.69%	9.78%	18.75%	9.74%
Prosus	1,624,652,070	1,138	1,848.90	10%	2.62%	2.77%	3.34%	3.71%
Total					17.31	12.55	22.09	13.45

An investment concern in the indices would be a single large exposure to an entity. After the completion of the transaction, investors ultimately have a large exposure to TenCent and the other internet assets, through separate holdings in both Naspers and Prosus. In the capped indices, Naspers is down-weighted to 10% at each quarterly review, by applying a cap. However, with both Naspers and Prosus included in the indices the current weighting of the two entities combined is **11.14%** in the Capped All Share (J303) and **12.02%** in the Capped SWIX All Share (J433), since they are treated as two separate companies (data as at 31 October). Many market participants would have seen the Capped SWIX All Share Index launch as a means to reduce the weight of Naspers in the main market benchmark index to 10%, and would reasonably question having an increased weight, above the capping level.

4. Further Considerations

As at 31 March 2019, the 31.1% interest of Naspers in TenCent was worth approximately US\$136.2 billion (Rb2,027) and Naspers had a reliance on TenCent for 79% of its revenue. As a result of the relative size of the Group's investment in TenCent, the market value of TenCent shares will continue to have a material impact on the Group and will have a material impact on the market price of the N Ordinary Shares.

Naspers holds a 74% majority stake in Prosus. Considering a 31 October Prosus market capitalisation of Rb1,707, the theoretical market value of this holding is Rb1,264. This market value exceeds the current Naspers market capitalisation of Rb954, reflecting the discount reflected in the holding structure. Importantly, it also indicates the extent to which the valuation of Naspers is dominated by its holding in Prosus. This supports the view that a holding in Naspers effectively provides a synthetic holding in Prosus, and that this should be taken into account when restricting access to single instrument exposure. The general principle here considers a holding company whose valuation is almost exclusively dominated by its holding in a listed subsidiary. A subsidiary that is majority owned or controlled, but is not a dominant contributor to the valuation of the parent holding company would not be a concern from a capping perspective.

The table below provides the resident and non-resident split for both Naspers and Prosus.

Alpha	Instrument	Shares in Issue	SA Holding	Foreign Holding	Total Strate %
NPN	Naspers	444,667,763	175,779,609	267,519,123	99.69%
PRX	Prosus	1,624,652,070	152,338,817	6,167,100	9.76%

5. Index Principles

Market benchmarks and indices in general must be anchored in a consistent and transparent methodology. Wherever possible, index methodology should remain stable over time, and it is seldom appropriate to regularly tweak index rules in response to specific corporate actions or events. Methodology should be based on sound principles that reflect the objectives of the benchmark within the regulatory context in which it is offered.

In this context, there may be a proposal that Naspers and Prosus are treated as a single entity for index capping purposes, despite them being two separate listed entities. There are two specific questions that have to be considered:

- What is the most appropriate way to define a rule that considers Naspers and Prosus as a single entity for capping purposes? There needs to be an unambiguous rule that the market can clearly understand, interpret and predict, both for current constituents and future cross-holdings. There are a number of ways to look at this rule, for instance:

- Market capitalisation of parent company relative to the market value of its holding in the subsidiary
- Proportion of revenue for the parent company that is directly derived from its holding in the subsidiary
- Requirement for a controlling stake in the subsidiary

In each case, it is necessary to consider the practical implications of obtaining the required data for all index constituents, the potential lag in using accounting data as well as complexities with accounting and reporting standards. FTSE/JSE is not in favour of relying on annual company financial statements to construct broad market benchmark indices due to concerns around lagged implementation, accounting standards and consideration for ad hoc events.

- The necessity to *future proof* the definition of when two independent companies are treated as a single entity for index purposes. For example, consider a rule worded as follows:

Where an index constituent has a controlling stake in another index constituent, and the market value of that stake is greater than 75% of the prevailing market capitalisation of the subsidiary company, then the two companies shall be considered two classes of share of the same company for all index capping purposes.

The parent company may diversify its earnings base away from the subsidiary with the result that the subsidiary valuation falls to 74% of the holding company market capitalisation. In this event, the index methodology would then immediately consider the two instruments to be separate companies again. A market price movement may cause the ratio to exceed 75% at the subsequent quarter, resulting in a reversal of the treatment.

FTSE/JSE is not aware of any global precedent in terms of capping methodology whereby two separate listed instruments are capped as a single entity. Any implementation of such a rule in the South African context would thus lead to a divergence from global practice.

6. Proposal

Treating Naspers and Prosus as one entity for capping purposes only in the FTSE/JSE capped indices, would alleviate the single large exposure risk to TenCent. The principle would be to construct a Ground Rule that will resolve any future large single stock exposures by looking at how much the valuation of the subsidiary company holding contributes to the parent company's gross market capitalisation

To meet the requirements for capping two entities together, on review cut date:

- Both the parent company and subsidiary company have to be JSE listed
- The parent company shareholding in the subsidiary company is restricted for free float purposes (cross-holding)
- Consider the gross market cap of the holding company and the percentage of the subsidiary gross market cap held by the parent company
- If this holding is 75% or higher, the two companies will be considered as a single entity for capping purposes in all capped indices where they are both constituents
- If this holding falls to 65% or below at a subsequent quarterly review, the two entities will no longer be capped as one entity

Example:

- Gross market cap of holding company – Rb954
- Gross market cap of subsidiary company – Rb1,707
- Restricted holding of parent company in subsidiary – 74% (Rb1,264)

$$x = \frac{Rb1,707 \times 74\%}{Rb954} = 132\% > 75\%$$

The two tables below illustrate the current weight of Naspers and Prosus in the Capped SWIX All Share and Capped SWIX Top 40 indices, as well as the index weights after implementing the proposal of capping Naspers and Prosus as one entity. It is important to note that capping takes place on a quarterly basis and during the course of the quarter the combined weights can move above or below the 10% capping level, due to price movements.

Alpha	Instrument	Index	Current Index Weight	Proposed Index Weight
NPN	Naspers	Capped SWIX All Share (J433)	8.64%	8.45%
PRX	Prosus	Capped SWIX All Share (J433)	3.38%	1.55%
Total Weight			12.02%	10.00%

Alpha	Instrument	Index	Current Index Weight	Proposed Index Weight
NPN	Naspers	Capped SWIX Top 40 (J430)	8.63%	8.45%
PRX	Prosus	Capped SWIX Top 40 (J430)	4.49%	1.55%
Total Weight			13.12%	10.00%

The proposed treatment would impact the following FTSE/JSE Capped indices where the combined Naspers and Prosus weightings are currently in excess of the capping level:

Code	Index
J300	Capped Top 40
J303	Capped All Share
J311	Capped Indi
J430	Capped SWIX Top 40
J433	Capped SWIX All Share

Note that this proposal would have no impact on any of the uncapped indices in the FTSE/JSE Africa Index Series, and in particular would not impact the way that companies are selected for index inclusion purposes. The core objective of this proposal is to improve the quality of the capped indices in the series as a benchmark for local equity funds.

7. Responding to the Consultation

It is important to FTSE/JSE to be aware of the impact to clients as well as any unintended consequences of the weighting concentration of Naspers and Prosus in the FTSE/JSE Index Series. FTSE/JSE is committed to providing market benchmarks that are credible and consistent, and the purpose of this market consultation is to obtain feedback from index users regarding their concerns around the proposed solution.

The feedback received from this consultation will be presented to the FTSE/JSE Advisory Committee at the December 2019 meeting after which the proposal will be presented to the FTSE Russell Governance structures. Further announcements will be made as due course. This change will not be applied at the December 2019 quarterly index review.

Please provide us with your comments and suggestions by Friday, 22 November 2019 to the following email address: indices@jse.co.za

When determining the timeline for the implementation of any decision, FTSE/JSE is mindful of the broad usage of these indices in the market and the need to provide appropriate notice. This document is not confidential and should be distributed as widely as possible to all stakeholders.