The Battle of Dragons – Recent Acquisitions and Investments in China amid the Rivalry between Alibaba and Tencent

Alibaba Group Holding Ltd. (NYSE:BABA) – market cap as of 20/04/2018: $462.0bn

Tencent Holdings Ltd. (HKG:0700) – market cap as of 20/04/2018: HK$3,780bn

Introduction

The first two weeks of April 2018 have seen a string of aggressive acquisitions and the announcement of financing rounds by companies backed by the Chinese technology giants Alibaba and Tencent. In what seems like a tit-for-tat approach, Tencent-backed delivery platform Meituan Dianping acquired bike-sharing service Mobike after Alibaba invested in its main competitor Ofo previously. Alibaba in turn then proceeded to strengthen its presence within the food delivery sector, the main revenue source of Tencent-backed Meituan Dianping, by acquiring the online platform Ele.me. Additionally, the tech giants are ramping up the competition to defeat the other in the online payments business. Alibaba-backed Ant Financial is reportedly seeking to raise $10bn in a late stage funding round which would value the company, that is best known for its Alipay service, at over $150bn.

Alibaba's Jack Ma and Tencent's Ma Huateng have, throughout the past years, implemented a strategy of expanding their respective company's presence in the consumer markets with the aim of providing customers with a holistic service encompassing brick-and-mortar stores, e-commerce, delivery and payment systems.

Meituan Dianping – Mobike (April 2018)

About Meituan Dianping

Meituan Dianping is the world's largest online and on-demand delivery platform for consumer products and retail services. It was formed in 2015 through the merger of the two online-to-offline websites Meituan and Dianping following an intense cash-burning competition among Chinese food delivery e-commerce rivals at that time. Today, with a average daily order number of 20m, food delivery still accounts for half of its $58bn gross merchandise value and is expected to rise further considering that take-out consumer numbers in China have barely reached 295 million and are growing at 23% year-on-year. After raising $4m in its series C funding round led by Tencent and Priceline, Meituan is now preparing for an initial public offering. With a valuation of $30bn reached in October 2017, Meituan Dianping is currently considered the world's fourth largest unicorn after Uber, Didi Chuxing and Xiaomi.

About Mobike

Founded in Shanghai in 2015, Mobike launched its first bicycle in April 2016 and has since gone through 6 rounds of financing amounting to a total of $1.1bn. The firm tells a success story that continues to inspire entrepreneurs in China today. The bicycle-sharing system currently operates over 4.5m bikes—each with a unique QR code lock—spinning their characteristic orange wheels in over 200 cities around the world. After its most recent round of funding led by Tencent in June 2017, it was valued at close to $3bn. Together with its rival Ofo, it distinguished itself from peers with its GPS function, gear drive and self-charging technology based on solar panels. However, the financial sustainability of bicycle-sharing business model has long been called into question. Critics argue that it is virtually impossible to maintain rent income high enough to cover operational and depreciation expenses to make a profit. The private company has not disclosed financials since its inception.

However, according to leaked information, its revenue during December 2017 amounted to $17.54m while mere operation costs per month reached $63.77m.

About the Deal

On 3 April 2018, the board of Mobike accepted Meituan's $2.7bn offer consisting of 65% in cash and 35% in stock. Furthermore, the debt of the target, estimated to be between $0.5bn to $1bn, will be taken on by Meituan and Mobike's management team will not be removed. Mobike experienced financial difficulties during the winter of 2017 due to a seasonal depression in demand. In the months leading up to the acquisition, Mobike reportedly incurred losses and hence an acquisition opportunity was created. The announcement was not expected by the market, with a majority of analysts believing that the war among bike-sharing firms would culminate in a merger between Ofo and Mobike, similar to the end to the competition between Didi and Kuaidi in the ride-sharing field. As for Meituan, the take-over of Mobike fits into its strategy to combine the complementary business of two-wheel and four-wheel sharing. Additionally, the recent active capital movements of Meituan are generally interpreted as a sign of a pre-IPO dash towards a higher valuation.

Alibaba – Ele.me (April 2018)

About Alibaba

Alibaba Group Holding Limited, through its subsidiaries, operates as an online and mobile commerce company in China and rest of the world. The company was founded by Jack Ma, who also serves as the company's Executive Chairman. The company operates in four segments: Core Commerce, Cloud Computing, Digital Media & Entertainment as well as Innovation Initiatives & Others. The company went public in 2014 and, as of April 2018, has a market capitalization of around $460bn. Alibaba is one of China's most important technology companies and has increasingly gained global significance over the past years. Under the Alibaba umbrella, the Group has extended its influence into fields like financial technology, cloud computing, e-payments and logistics. In January 2018, Alibaba became the second Asian company to break the $500bn valuation mark, after Tencent.

About Ele.me

Ele.me offers customer-to-customer meal ordering services via its website. It also acts as a communication platform between users and restaurants. Ele.me - which loosely translates as "Are you hungry?" - is one of China's most successful online-to-online (O2O) companies and has maintained a high profile since its inception in 2009. The company was founded by two Shanghai Jiao Tong University graduates and subsequently received financing from top venture capital firms such as Sequoia Capital, Matrix Partners and Tencent. In 2017, Ele.me served close to 10m people in China. The company has a footprint in more than 200 cities and delivers close to 1 million orders per day.

About the Deal

On April 1 2018, Alibaba acquired Ele.me for $9.5bn. Prior to the acquisition, Alibaba owned close to 43% of Ele.me's voting shares through previous investments and thus spent $9.5bn to buy out other investors. The acquisition of Ele.me is part of Alibaba's New Retail Concept, as pioneered by Alibaba founder Jack Ma Yun. The retail strategy focusses on the integration of online and offline experiences for consumers within different sub-fields such as online shopping, food delivery and buying groceries. Since 2017, Alibaba has invested heavily in both offline and online retail companies such as Suning, Intime Retail, Sanjiang Shopping Club, and Lianhua Supermarket. Correspondingly, Alibaba made a number of investments in logistics throughout the past years.

Ele.me's distribution network is hence expected to create value through integration in both the retail and logistics businesses.

Ant Financial and its Recent Financing

Ant Financial is a privately-held financial services company that operates within payment transfers, wealth management, and small business borrower (SMB) lending. Ant Financial's value is largely derived from Alipay – a service founded in 2004 by Alibaba. Alipay enables customers to buy goods more easily online, and was estimated by Credit Suisse to process roughly 60% of China's online payments and 78.3% of Alibaba's retail marketplace gross merchandise volume (GMV). In 2011, Alibaba spun off Alipay into a closely held corporation of which 46% is owned by Jack Ma. However, it did not disclose the asset transfer to shareholders and lacked Alibaba board approval. Alibaba's largest shareholders – Yahoo and Softbank – later sued Alibaba Group, which resulted in a $6 billion settlement. The two contested that the new arrangement – a profit sharing agreement whereby Alibaba would receive a royalty stream from Alipay (but no ownership) – had severely impaired their investment in Alibaba.

Since then a number of state-backed organizations, including China Investment Corporation (China's sovereign wealth fund) and China Development Bank have grown their stake in Ant Financial through a number of funding rounds. In June 2016, Ant raised $4.5bn in a late stage series B at a $60bn valuation. As of April 2018, reports have surfaced that Ant is seeking another pre-IPO round of financing. Purportedly, Ant is seeking to raise $10bn at a valuation of approximately $150bn implying it would become the world's largest fintech firm and start-up by valuation. The capital infusion would help Ant ramp up its consumer lending business in competition with Tencent's WePay. The backing of Singapore's sovereign investment company Temasek Holdings as lead investor could also be key as it seeks to promote the use of Alipay beyond China. General Atlantic, Silver Lake, Tiger Management, and Warburg Pincus are also purportedly interested in committing capital.

The funding rounds have also been accompanied by a new agreement between Ant and Alibaba in February 2018. In exchange for the IP rights and termination of the royalty stream, Alibaba will receive a 33% stake in Ant Financial. The simplification of the structure is suitable in the case of an Ant Financial IPO.

Conclusion

The recent developments must be seen in the context of Tencent's and Alibaba's online/offline retail strategy as well as the associated steady increase in the polarization of the Chinese commercial and tech landscape. As large players like Tencent and Alibaba scour the market for areas of potential growth, they have started to delve into sectors beyond their core business, gobbling up both established firms and start-ups along the way. The increased competition in the fields of daily travel and food delivery especially has seen the valuation of loss-making firms such as Mobike skyrocket and has underlined the elevated significance of both sectors for future growth within the larger fields of retail and logistics.