



On Point.

Newsletter, Edition 2 - 2026



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Note from the MD: Beyond prediction

Alyssa Viljoen



Ahead of the Reserve Bank's July meeting, Polymarket priced an 81 percent chance of a 25 basis point hike. Seventeen of the twenty economists surveyed by Bloomberg expected the same. I did too.

The Reserve Bank held the repo rate at 7 percent, and the rand became the world's worst performing currency that day. Think about that. People with real money at risk, professional economists and I all got a binary decision about our own central bank wrong, days before the announcement, with the relevant data already public.

There is now a price on everything

Prediction markets are no longer a novelty. Billions of dollars are traded every month on outcomes ranging from interest rate decisions and elections to sporting results and global temperatures. In theory these should be efficient forecasting tools. Prices update continuously and participants lose real money when they are wrong.

That is why the Reserve Bank miss matters. If this machinery could not price a decision one week out, how much confidence should we place in a two-year forecast for oil, the Fed or the rand?

A bet needs one particular future to arrive

This question goes to the heart of how we invest. The difference between a bet and an investment is not always the instrument. It is whether you need one particular version of the future to arrive before you can make money. Judged on that test, a good deal of what is described as investing turns out to be closer to a bet than it first appears.

Quality is what you own when you cannot forecast

At Merchant West Investments, we would rather own businesses that do not depend on one particular version of the future. Companies with pricing power, strong returns on capital and balance sheets that can withstand difficult periods are able to compound across many possible outcomes rather than a single one. That is what quality means to us. It requires a high standard, disciplined valuation and the willingness to say no, even while the market rewards whatever happens to be popular.

An index cannot say no. It has no view on valuation and no ability to step away from a crowded trade, which means passive exposure can quietly become a concentrated bet of its own.

We applied the same discipline to our own business this year. In July we completed the amalgamation of two of our multi-asset funds into the Merchant West SCI Balanced Plus Fund and the Merchant West SCI Cautious Fund. A focused range rather than having many funds in a single category.

We will not pretend to know exactly what the Reserve Bank, the rand or the oil price will do next. Our responsibility is not to predict every outcome. It is to build portfolios that can endure when those predictions are wrong.

That means owning quality businesses at sensible prices, remaining disciplined when markets become crowded and avoiding investments that depend on a single version of the future. We may not always know what comes next, but we can be deliberate about what we own.

That is how we invest beyond prediction.

Letter from the Chief Investment officer

Real Decisions: Are you making them?

Raymond Shapiro



I love second hand bookstores. I love the treasure hunt for valuable knowledge or insight *selling at bargain prices*. My investment approach is similar! While rummaging through a local charity bookstore a title caught my eye: "Overcoming Indecisiveness: *The eight stages of effective decision-making*" by Theodore Isaac Rubin, M.D. I couldn't recall seeing a book about making decisions before, certainly not one written by a psychoanalyst. Surprising, as making good decisions is clearly essential to happiness and success. What could be more important? In investing nothing is more constructive to success than making good decisions.

As the author states: "Decisions put us in charge of our lives. Every time we make a real decision, we find out who we really are, because we make use of our priorities and values."

As investment managers our priority is to be sound stewards of our investors' capital to generate the most attractive returns we can, while responsibly controlling the risks. To do this we need to make decisions – *real decisions* – but what is a *real* decision?

Dr Rubin defines a real decision as a free, unconditional and total commitment to a chosen option – discarding other options not chosen. A full commitment to one road only – the road that leads to the favoured choice. By doing this we are empowered to integrate, unify and fully mobilise all our assets and resources to achieve our goals. To transform choice into action and action into success and fulfilment. Real decisions endow ownership – ownership of outcome and ownership of self. True decision-making produces growth and taps inner resources.

Making real decisions is especially important in the current investment environment.

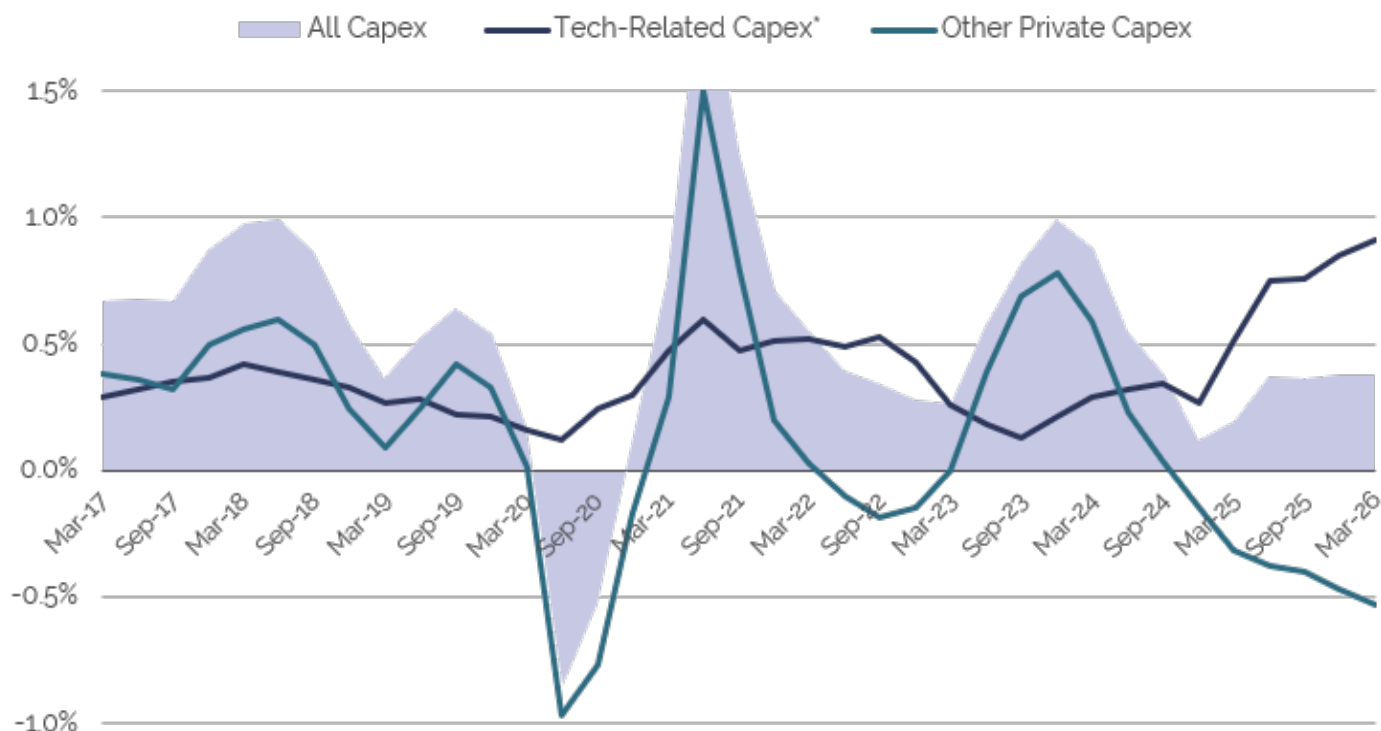
Real Decisions in the Age of AI

Spend on the current Artificial Intelligence build-out is set to exceed a massive \$800bn in 2026, growth of 80% on 2025 spending. It is then expected to grow to more than a trillion dollars per annum from 2027 for several years, thereafter is anyone's guess. This spending has become the largest driver of US economic growth. Depending on the definition, Technology and AI-related investment spending is estimated to have contributed between 0.6 and 1.3 percentage points to the 2.0% annualised US growth in the first quarter of 2026. Remove technology and AI-related capital expenditures and the rest of US capital investment looks to be in recession (see Exhibit 1). Whether AI capex is crowding out other forms of investment is unclear. What is clear is that the US economy has exchanged a broad base of investment spending, carrying modest, well-understood returns, for a narrow one whose returns are highly uncertain and incredibly difficult to forecast.

The critical point is that the largest economy in the world, which underpins global growth, now has as its primary growth engine a driver concentrated in a singular theme – AI investment and its potential returns. Furthermore, this new AI growth driver is far riskier than the previous diversified set of drivers, which carried expected returns within a predictable range.

The risk inherent in US economic growth, and in global growth, has significantly increased. When risk inflects sharply real decisions need to be made – and diversification should be a key consideration in those decisions.

Exhibit 1: Technology spending is driving US Growth
Capex Contribution to U.S. GDP Growth
(LTM, %pts)



Source: U.S. Bureau of Economic Analysis, Haver Analytics, KKR. *Tech-related capex includes technology equipment spending, software IP spending and data centre construction spending. Net imports of technology goods are deducted from technology capex. Data as at 28/5/2026.

Your Index is not diversified

By our calculations (at time of writing) approximately 40% of the market value of the broad global market benchmarks, the MSCI World and MSCI All Country World Indices, is comprised of AI-driven stocks. For the US market's S&P 500 Index this weight is closer to 50% – compared to approximately 25% when ChatGPT was launched 2022. I would note we have not included various 'second-order benefit' stocks affected by the AI build-out, such as power infrastructure and energy providers, utilities, industrial equipment suppliers, etc. So, the true exposure to the AI driver could be even higher.

An investor who bought a global tracker fund just a few years ago bought a decently diversified spread of return drivers. The same investor today has his/her returns dominated by one theme. These broad indices are no longer diversifying investors; they are concentrating them. Silently, without any real decision being taken.

Benjamin Graham put our obligation plainly: "The essence of investment management is the management of risks, not returns."

Given the very significant concentration risks now present in global markets and indices I am of the strong view that real decisions need to be made. One can no longer depend on an unconscious index to make the decision for you.

Our approach to investing in AI

Whether the 19th century railroad boom, the 1920's electrification buildout or the internet revolution at the turn of the millennium, the lesson is clear: the ultimate beneficiaries of these transformative developments were those who capitalised on the benefits offered by the new technologies, as opposed to those who built or created them. Those who used them to maximise efficiencies, improve goods and services or to create entirely new products.

This is where we are hunting. For instance, there are opportunities in businesses where a falling cost of automation and intelligence drops straight to margin and the market prices none of it. Examples include property and casualty insurers we own, such as Progressive Group and Kinsale Capital in the US and Santam and OUTsurance in South Africa, where AI can help better price risk and reduce administrative costs. Proprietary data and workflow franchises such as S&P Global and Visa can leverage AI to enhance the value of their products or reduce transaction costs. These would not be called AI stocks. That is the point. They are unrecognised future beneficiaries of AI. We own several others and are hard at work to unearth more.

Of course, as with any investment boom the principal source of risk comes from overinvestment – investing and not generating an attractive return. That has been the painful lesson of the builders (spenders) of past booms.

Currently the large hyperscalers or cloud providers are the major spenders in this AI boom – Amazon, Alphabet, Microsoft, Meta Platforms. Given their rapidly increasing spending we have been reducing exposure to these businesses. Importantly however, they do possess multiple powerful features that makes them different from builders of past booms. They are at once builders of the infrastructure (data centres), providers of critical services (cloud and AI models) and users of AI technology in their own business. In areas ranging from online retail and advertising to logistics and robotics, autonomous driving technology, business productivity applications and customer support. These companies are not simple builders of railroads. They possess competitive advantages beyond technology, in many cases strengthened by AI technology. For this reason, we are careful not to underestimate the opportunities offered by these businesses. Carefully monitoring trends in their return on spend, while keeping a close eye on capital discipline.

Keep this in mind: the hyperscalers have the power to make real decisions. Much of the forecasted billions in capex is not actually contracted. Company guidance of spend typically does not extend beyond 2027. They can cut capex at any time. They hold the decision rights. Most other players and suppliers in the AI complex hold no such option. Our focus is on assessing whether companies are making wise decisions with their capital. To evaluate the effect of those decisions, on their futures and those of their suppliers and customers.

Our responsibility

Daily we wrestle with the trade-off between risk and return. That is our job as investment managers. We build robust portfolios, not gamble on binary outcomes, nor accept a passive status quo. Sensible diversification is at the core of our responsibility.

Every real decision carries a price. We accept that bill knowingly and would rather pay it than the alternative of abdication.

Thank you for your continued partnership and trust.

Warehouses to Watts: Prologis' £14bn SEGRO deal bets big on data centres



Richard Henwood

The largest US and UK logistics landlords agree terms after a month of public back-and-forth – and a shared bet on the global data centre boom.

After a month of public back-and-forth, the largest logistics property deal in years is close to the finish line. On 22 July, Prologis (PLD US), the world's largest, high-quality logistics real estate company, tabled a "best and final" £14bn offer for SEGRO (SGRO LN), the UK's largest listed industrial and logistics landlord – and this time, the SEGRO board said yes.

For clients tracking the read-across to global listed real estate and industrial supply chains, the transaction is worth understanding on three levels: how we got here, why the two portfolios fit together, and what the deal signals about the next phase of growth in logistics real estate – namely, data centres.

A Month of Escalating Offers

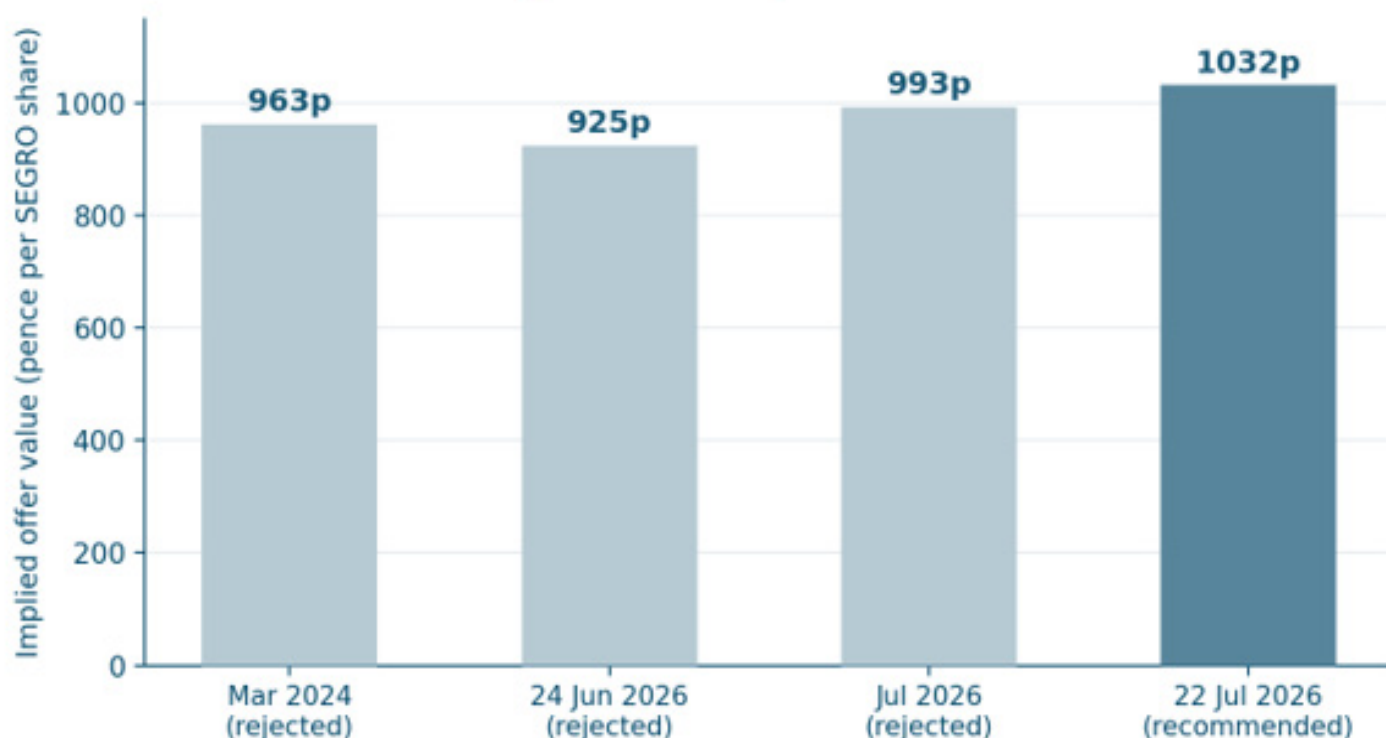
Prologis's interest in SEGRO is not new. The company first approached SEGRO's board in March 2024 with an offer of 963 pence per share; SEGRO's board rejected it outright, calling the approach "opportunistically timed" and unwelcome.

Prologis returned in June 2026 with a fresh, indicative all-share proposal worth 925 pence per SEGRO share – a 24.6% premium to SEGRO's undisturbed share price – valuing the company at roughly £12.6bn. SEGRO's board again rejected the approach unanimously, arguing the bid undervalued a business with a "unique and irreplicable portfolio" and understated the value locked up in its development and data centre pipeline.

What followed was an unusually public tug-of-war. Prologis published detailed investor presentations laying out its case directly to SEGRO shareholders, arguing that SEGRO's standalone growth outlook lagged its European peers and that its higher cost of capital and persistent share-price discount to net asset value limited its ability to fund its own pipeline. SEGRO countered with its own presentations, arguing its portfolio – heavily weighted toward supply-constrained urban markets like Park Royal, Heathrow and Slough – was simply not replicable, and unveiled a run of announcements to demonstrate it could unlock value independently, including a proposed £2.9bn UK big-box joint venture and a second data centre joint venture with Pure Data Centres Group in Paris.

Three rejected proposals later, Prologis returned on 22 July with an improved and final offer: 0.0920 new Prologis shares for each SEGRO share, plus a partial cash alternative of up to £3.5bn at a fixed price of 1031.7 pence per share. That values SEGRO at approximately £14bn – a 14% premium to its net asset value and roughly 39% above its share price before Prologis's approach began. This time, SEGRO's board has signalled it is inclined to recommend the offer, with Prologis agreeing to explore a secondary London Stock Exchange listing as part of the deal.

Prologis' Four Proposals for SEGRO

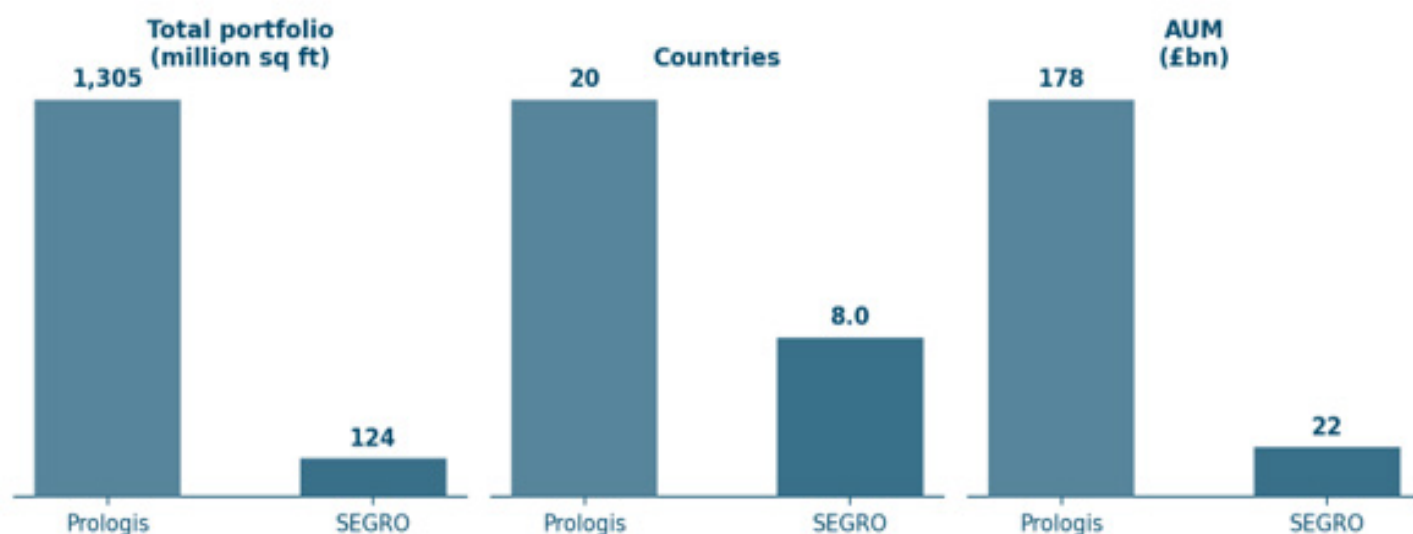


Implied offer value per SEGRO share across Prologis's four proposals, March 2024 – July 2026.

Two Portfolios, Different Specialisations

The commercial logic is straightforward: Prologis is the global scale player, with a high-quality logistics platform of roughly 1.3bn square feet across 20 countries and an asset base of some c.\$235bn (£178bn) under management, built overwhelmingly around large-format US logistics space serving companies like Amazon, Walmart and FedEx. SEGRO, by contrast, is a European specialist with a smaller but equally high-quality, more concentrated footprint – around 124m square feet, roughly two-thirds of it in urban, supply-constrained submarkets across London, Paris and other major European cities, complemented by a big-box logistics arm along key distribution corridors.

Prologis vs. SEGRO: Scale Before the Deal



Source: Prologis and SEGRO company filings

The two portfolios are more complementary than competitive. Combining them would more than triple SEGRO's European operating footprint and materially expand its development pipeline. Prologis argues its scale, credit rating and access to a £49bn third-party capital platform can fund growth that SEGRO – carrying higher leverage and trading at a persistent discount to net asset value – has struggled to finance on its own.

The Data Centre Race

Perhaps the more interesting long-term thread is what this deal says about where logistics landlords see their next leg of growth: digital infrastructure. Both companies have spent recent years building data centre platforms alongside their traditional warehouse businesses, betting that the rapid growth in AI and cloud computing will keep pushing demand for power-secured sites in supply-constrained locations – the same skill set that built their logistics businesses in the first place.

SEGRO has built what it calls Europe's largest data centre cluster over two decades, anchored by its position at Slough Trading Estate – one of London's most important data centre locations and the UK's only Simplified Planning Zone with secured development rights to 2035. The company has also struck joint ventures with Pure Data Centres Group, including a fully fitted Paris facility targeting a pre-let with a global hyperscaler, and points to a near-to-mid-term power pipeline of 1.4 gigavolt-amperes across its European land bank.

Prologis, for its part, points to a combined power pipeline of 5.6 gigawatts secured or in advanced stages – dwarfing SEGRO's on its own – along with a dedicated in-house team of data centre, energy and development specialists it argues SEGRO cannot match standalone. The company's own data centre starts have already exceeded full-year guidance in 2026, backed by roughly \$4bn of new developments this year alone.

What It Means for Shareholders

For SEGRO shareholders, the transaction – assuming it completes – offers a clean, near-term realisation of value at a meaningful premium, in exchange for a smaller ongoing stake in a considerably larger, globally diversified platform. For Prologis shareholders, the deal brings modest dilution from the new shares issued to fund the acquisition, offset by access to SEGRO's European development and data centre pipeline and the balance sheet capacity to fund it. For the broader listed real estate sector, it is a reminder that scale, balance sheet strength and access to capital are becoming decisive differentiators, particularly for the capital-intensive build-out of data centre infrastructure, where the winners will likely be those able to fund multi-billion-dollar pipelines without diluting existing shareholders.

Completion of the deal remains subject to shareholder votes and regulatory approval under the UK Takeover Code, and we will continue to monitor developments as the transaction progresses.

Defending the aisle: Why we still back Clicks as Dis-Chem goes on the attack



Bianca Lakha

The competitive dynamic in South African pharmacy retail has shifted. One player is attacking, the other is defending, and we think the defender still holds the stronger hand.

For most of the past decade, Clicks and Dis-Chem grew alongside each other without ever really colliding. Clicks led on pharmacy and everyday health and beauty, Dis-Chem owned the destination format and the enthusiast shopper, and both compounded nicely. That comfortable coexistence has ended. Dis-Chem has gone on the attack, spending heavily to reset the loyalty and pricing battleground, and Clicks is now defending share on its own turf. The question I set out to answer is whether that shift structurally threatens Clicks or whether the market has overpriced the disruption. The market has already taken a side. As the chart below shows, Dis-Chem's shares began to run a few months after Better Rewards launched in October 2025, pulling away from Clicks and rerating to a premium. Investors handed the strategy a good deal of credit upfront, well before there was much in the results to prove it had worked.

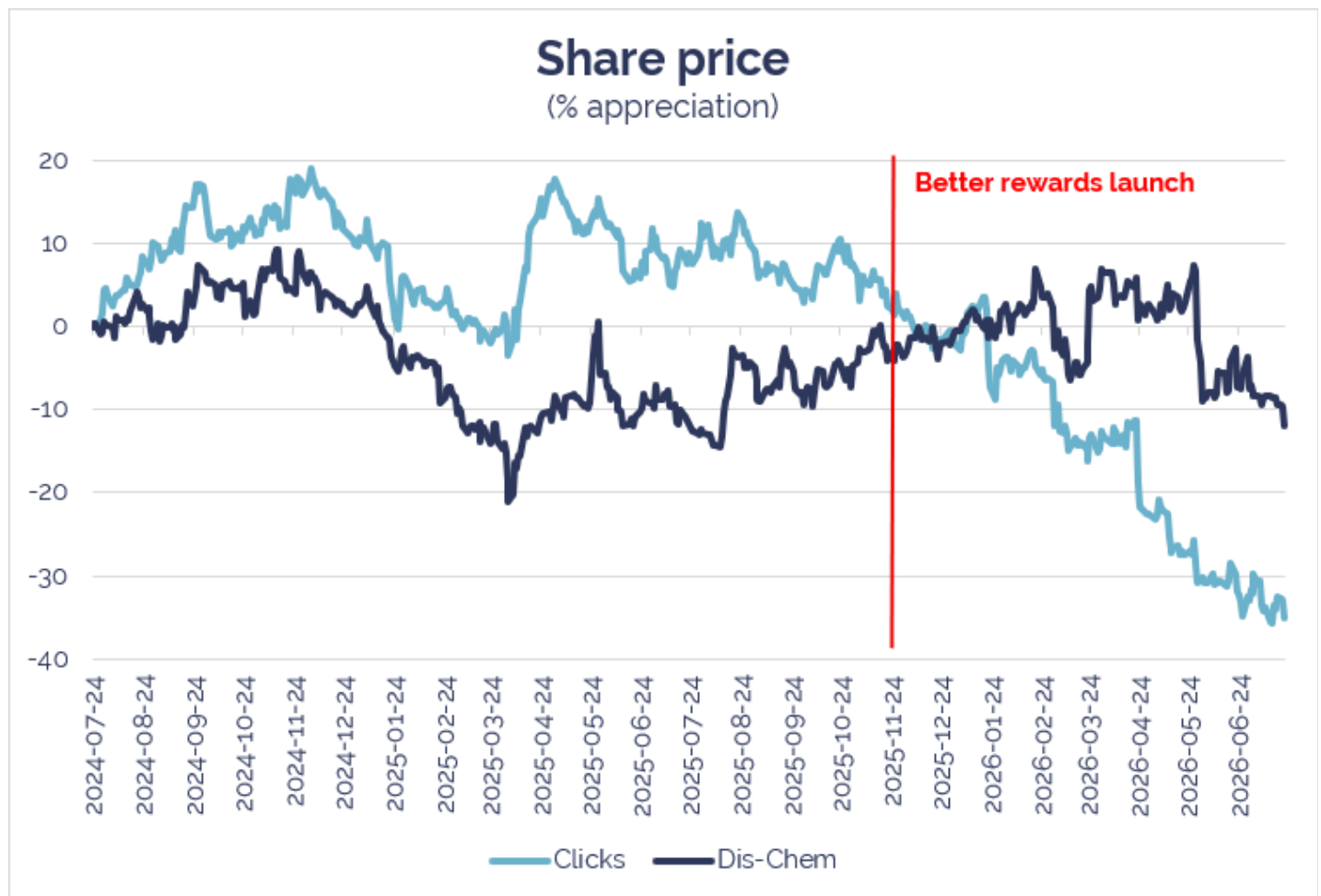


Chart 1 (Source: Bloomberg, MWI)

Dis-chem goes on the attack

Dis-Chem retired the Benefit card it had run for 23 years and replaced it with Better Rewards in October 2025. The new programme swaps a slow points system for an instant discount at the till, a base of around 10% that scales higher as the customer pays with Capitec, fills a script, or links a healthcare policy. Behind the offer sits a new data engine the group calls X,bigly Labs. Building that engine and overhauling the rewards programme did not come cheap: Better Rewards cost around R115m to launch and X,bigly around R330m to build. This is a business deliberately spending to change how it competes rather than tweaking at the margin.

Following the money

A price cut is simple to announce. The interesting question is who actually pays for it. A substantial share of the base discount is not carried by Dis-Chem at all. It is funded by suppliers, negotiated into signed 12-month contracts, and it reaches the income statement as other income rather than as a lower selling price. The balance is met by Dis-Chem itself and by partners such as Capitec. The effect is that the shelf price falls while total income holds up, because a good part of the giveaway is being paid for by someone other than Dis-Chem. That is a different model from simply cutting price and wearing the margin, and it is what makes the strategy interesting rather than reckless.

Retiring the old scheme also handed Dis-Chem a one-off benefit that is easy to miss. Points that members never got round to redeeming inside the six-month window lapse in the group's favour, giving the early discounts a bit of extra funding. The size is not disclosed, but the nature of it is clear enough, and it does not repeat. From here the model must stand on suppliers and volume.

The cost of the pivot is already visible in the results. Dis-Chem's FY2026 earnings per share fell 17.1% and headline earnings 17.3%, weighed down by around R445m of ecosystem investment. Strip that spend out and core retail profit before tax still grew strongly, helped by topline growth of 9.3% and a 1.1 percentage point gain in volume market share. The fall in earnings is the price of a deliberate choice rather than evidence of a business in trouble. Whether that choice pays off is the open question.

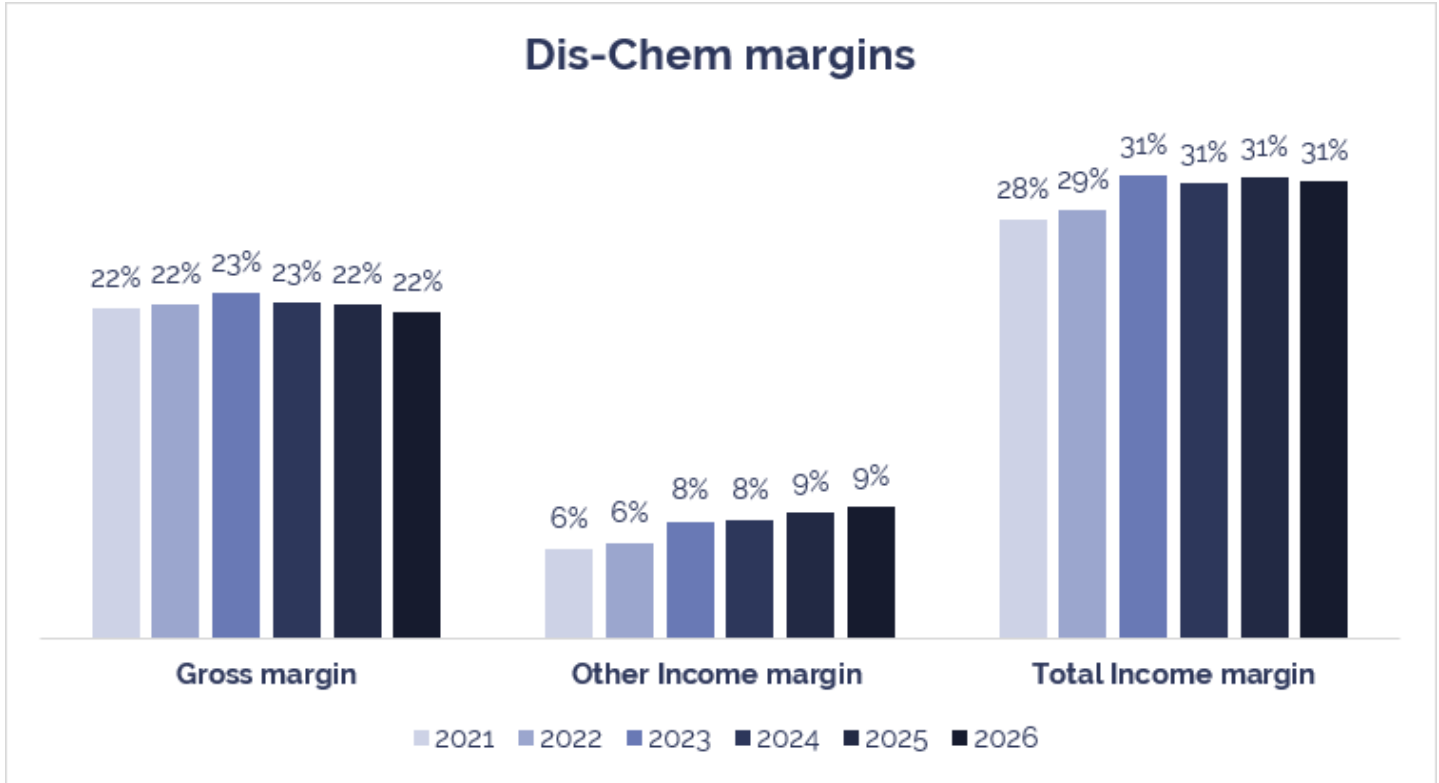


Chart 2 (Source: Bloomberg, MWI)

The bill is clear, the payoff is not

The harder question is whether the model lasts. Its cleverness carries a catch: a discount funded by suppliers, by Capitec, and by the promise of better data only holds up while all three keep paying in. Supplier contracts run for twelve months and have to be renewed on the same terms. Capitec's top-up lasts only as long as that partnership does. And the data engine still must earn its keep, turning cheaper prices into richer customer information and, eventually, into higher-margin sales. None of that is guaranteed, and most of it cannot be judged until the discount has been the everyday price for several years rather than a launch novelty. Which leaves the question that matters most: does a discount buy customers or just rent them? For now, the results show the cost of the strategy far more clearly than the payoff, and that gap is what keeps us cautious on Dis-Chem.

There is a condition attached to the supplier-funded discount: volume. Suppliers underwrite the discount in exchange for turnover on their brands, so those twelve-month deals renew on the same terms only for as long as Dis-Chem keeps delivering the volumes that justify them. So far, the signs are good, though we only have 17 weeks of trading under the new programme to go on. In that short window, participating-brand volumes grew strongly and around 550 000 shoppers who had gone quiet came back. Sustaining it is the real task. The clearest lever is the size of the membership base, and here Dis-Chem made a bold move, replacing its old loyalty scheme outright and shifting roughly nine million members onto Better Rewards. Whether that base grows from here is something we will watch closely, because more members mean more households buying the discounted brands, which widens participation and feeds the volume the suppliers are funding. If membership stalls, the argument for keeping the supplier money flowing gets harder to make.

Clicks is responding, not rebuilding

Clicks has not tried to copy the model, and it did not need to. Its response has been measured: it shortened the ClubCard cashback cycle from two months to one and layered on deep-cut deals. These are temporary price reductions on selected lines on top of the usual rewards. The difference is in how the two retailers pay for the cut. Where Dis-Chem leans on suppliers and other income, Clicks funds its discounts at the till by leaning on private label, its own higher-margin ranges. Because those products carry a fatter margin to begin with, Clicks can give some of it away on promotion and still protect its overall profitability, without having to build a Dis-Chem-style other-income engine of its own. The chart below shows how far private label penetration has climbed, and it is the quiet reason Clicks can defend on price from a position of strength.

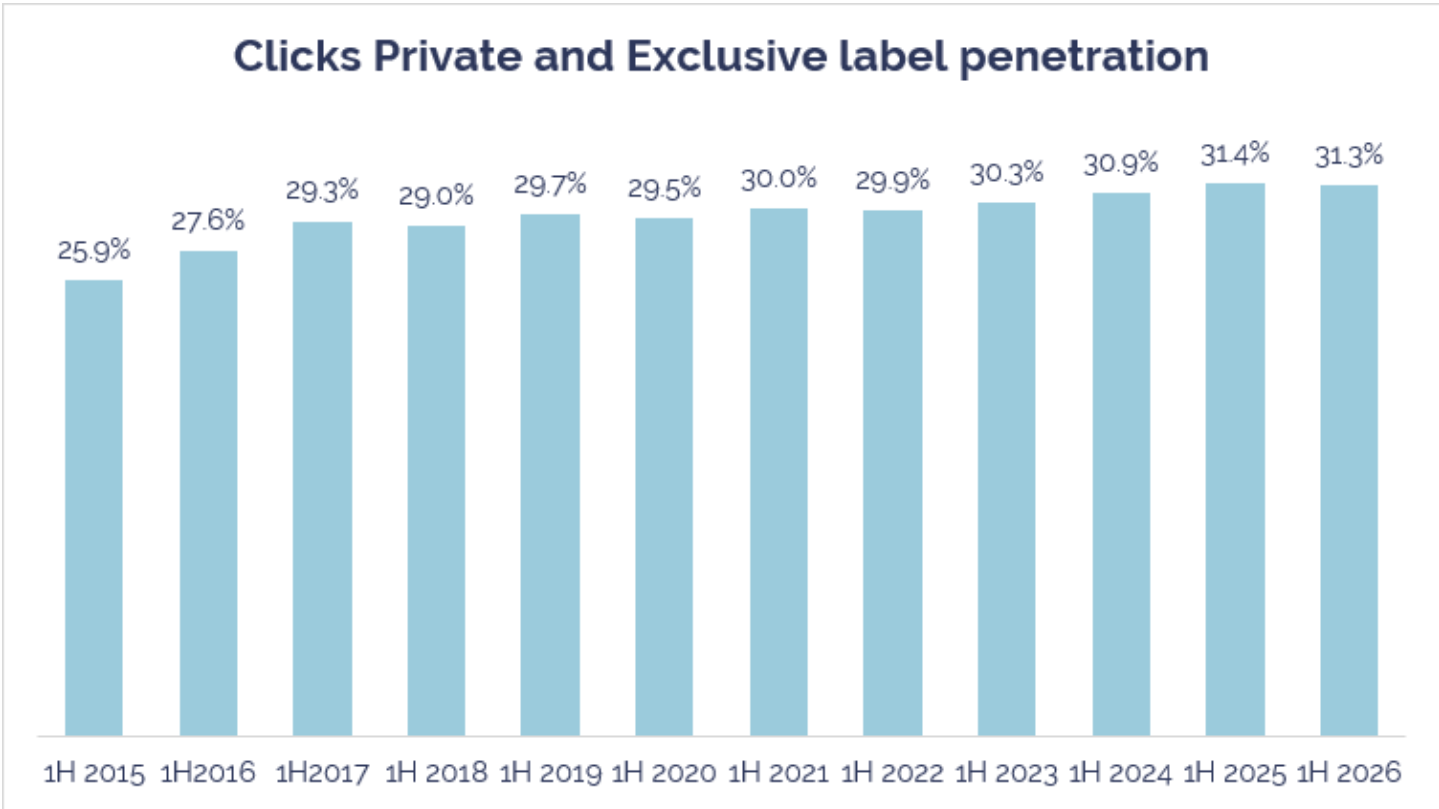


Chart 3 (Source: Company data)

None of this is Clicks scrambling to keep up. It goes into the fight as the higher-quality and historically stronger retailer, with a structural anchor its rival cannot easily replicate: a commanding 24.9% share of the retail pharmacy market, a ClubCard base of 12.9 million active members, and a medium-term target of 1 200 stores. The single thing that most needs to go right is unglamorous but real, and it is getting pharmacy licences and store openings through at the planned pace.

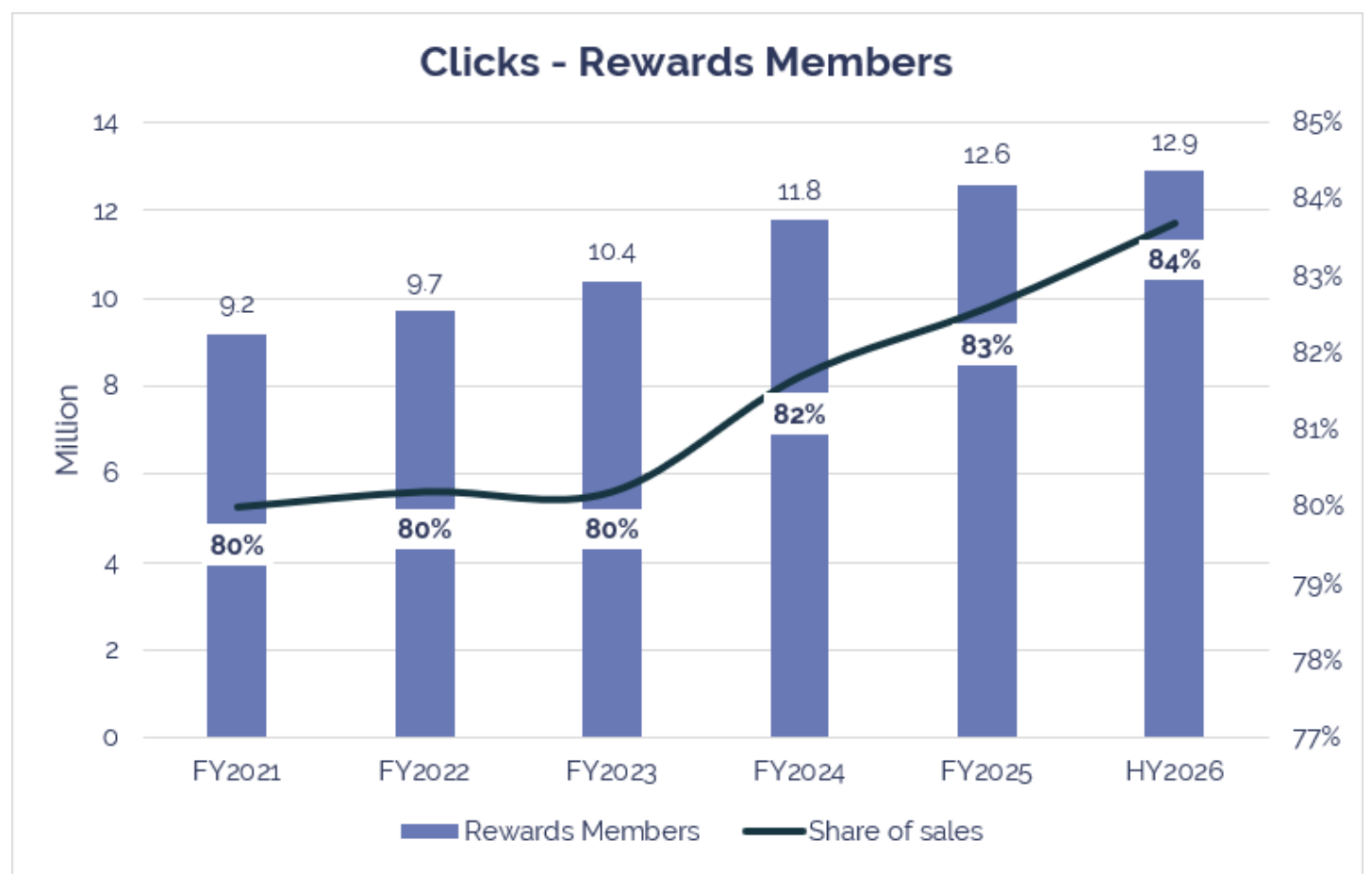


Chart 4 (Source: Company data)

Our conviction is still with Clicks

Clicks is not the exciting story here, and we are comfortable with that. Its recent softness looks cyclical to us, the product of weak selling-price inflation and a cautious consumer rather than a business losing its grip. Dis-Chem is the more interesting company, but the more interesting company is not always the better investment. Much of what it is building is already in the price, paid for with a heavy investment bill and a slice of share it bought with a discount, and there is little in the results yet to show the strategy has worked. We would rather own the proven operator defending from strength than pay up front for optionality that still has to prove itself.

Is pharmacy retail still worth owning?

It is fair to ask whether the category is still worth the trouble now that its two leaders are fighting over it. The live debate is whether the Clicks slowdown is cyclical, driven by low selling-price inflation and softer demand, or structural, driven by Dis-Chem's loyalty shift, Shoprite's on-demand push into personal care, and pure-play online competitors. If it proves structural, the near-term case for Clicks weakens. Our view is that pharmacy retail remains an attractive place to be invested, but selectively. Health and script demand is sticky, the demographics are supportive, and the category is not going away. What has changed is that the easy years of comfortable coexistence are over, so it pays more than ever to own the quality operator with the deepest moat.

Under my umbrella: What Santam teaches us about quality compounding



Joshua Viljoen

Santam has been listed on the JSE since 1964 and writing insurance since 1918. There is a concept called the Lindy effect: the longer something has already survived, the longer its remaining life expectancy tends to be. Santam is a useful illustration of this concept. The business has weathered multiple South African currency crises, several catastrophe cycles (KZN floods and COVID-19 business interruption claims), and at least three distinct economic regimes. And yet, over a century in, it is still compounding shareholder capital at a pace few businesses on the JSE can match. That combination, endurance plus compounding, is the essence of the quality investing argument.

What we mean by "Quality"

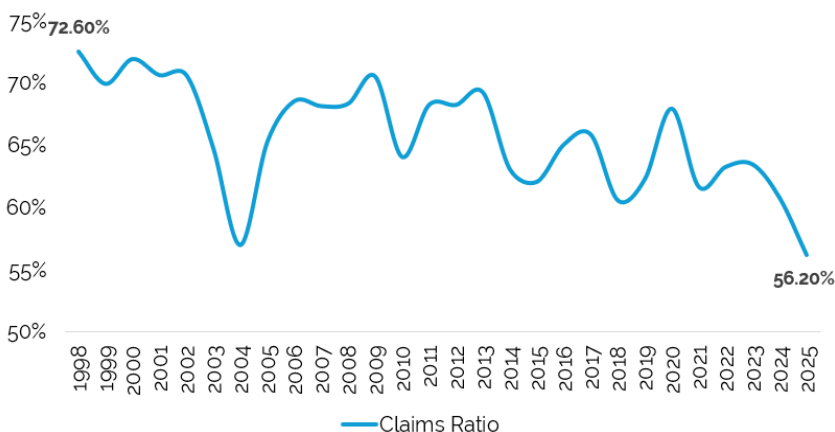
At MWI our approach is quality-at-a-reasonable-price or QARP: we look for businesses with durable competitive advantages, disciplined capital allocation, aligned management teams, and resilience through cycles rather than growth stories dependent on a single favourable environment. We can hold Santam up against each of these directly, and it scores well on all four.

A moat that is widening, not just persisting

Santam is South Africa's largest short-term insurer, holding roughly 23% of the market based on insurance revenue and the number one position in commercial and specialty lines. That scale shows up directly in underwriting economics: more data means sharper risk pricing, greater purchasing power means better reinsurance terms, and together they produce an expense ratio that leads the industry given Santam's scale. The Sanlam relationship (Sanlam owns 59.4% of Santam) adds capital stability and distribution reach that pure-play, personal-lines competitors like OUTsurance cannot easily replicate.

The clearest evidence that the moat is widening rather than merely holding is the claims ratio trend which measures how much Santam pays out in claims versus how much policyholders pay to Santam in premiums annually. Since 1996, Santam's claims ratio has drifted down from the low 70s to the low 60s, direct evidence that better data and sharper risk selection are steadily lowering the cost of underwriting the same pool of risk. Geocoding technology is a good example of that data advantage in practice. Geocoding prices a property or vehicle risk off its precise mapped location rather than a broad postal-code average, so flood, fire and crime exposure are priced closer to their true risk to an insurer. Santam has credited the accelerated roll-out of geocoding with helping prevent more than R150 million in losses in a single reporting period.

Santam Claims Ratio



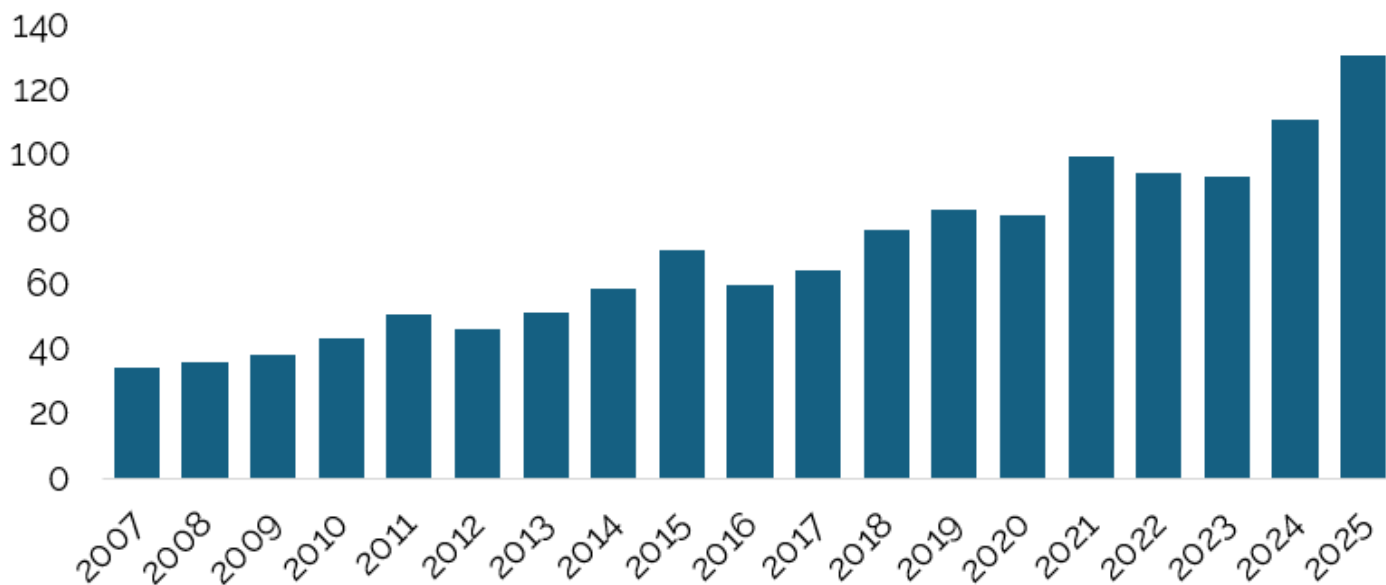
Source: Bloomberg and Merchant West Investments

Capital allocation as the real compounding engine

Santam's return on equity has averaged around 25% over the past 18 years. Even in the worst year on record over the past two decades, the COVID-disrupted 2020 period, ROE fell to 8%, not negative, highlighting the resilience of the business. Ordinary dividends per share have compounded at 11% annually over 25 years, on a 40-50% payout ratio, with special dividends layered on top whenever the capital coverage ratio exceeds the upper end of the target range.

Santam's share price over the past decade has been driven almost entirely by book value per share growth, not by a re-rating of the multiple. The price-to-book ratio has actually compressed over that period, while book value has more than doubled. This is what quality compounding looks like in practice: earnings reinvested at high returns, book value rising steadily, and the share price following.

Santam Book Value Per Share



Source: Bloomberg and Merchant West Investments

Since 1995, Santam has delivered an annualised total return of roughly 17.6% in rand, with a beta to the market of only 0.6. Lower volatility and a superior long-run return are precisely the trade-off quality investing is designed to capture: patience over excitement. Businesses like Santam, durable compounders that survive cycles and allocate capital with discipline, sit at the heart of how we construct portfolios at MWI. The most reliable source of long-term return is often the least exciting one

Source: MWI and Bloomberg

Tencent: Reacceleration meets a reasonable price?



Neal Hoogwerf

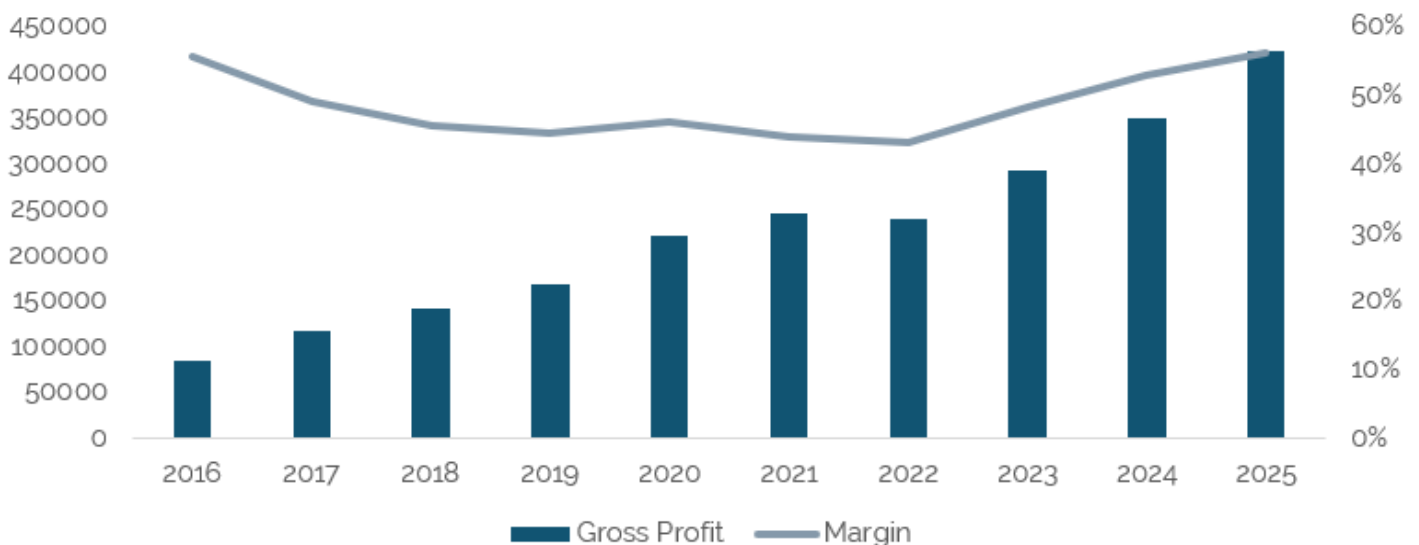
After a bruising stretch that ran from the 2021 regulatory clampdown through the 2022 earnings trough, Tencent has quietly returned to the front foot. Full-year 2025 revenue reached CNY 752 billion, up 14% year-on-year, with growth broad-based across the group's four engines. More telling than the headline number is the shape of it. After group revenue growth bottomed near zero in 2022, every major segment has reaccelerated, and the market has yet to fully re-rate the business back to the quality it has always been. We remain constructive on the holding and view the current price as offering an attractive entry into a wide-moat compounder that is once again growing at double digits.

The reacceleration is real, and it is diversified

The most important structural story at Tencent over the past decade is not a single product. It is the deliberate reduction of concentration risk. Domestic gaming, which accounted for roughly 55% of revenue in 2013, is now 22%. In its place, FinTech and Business Services has grown from nothing in 2016 to 31% of the group, international gaming from nothing to 10%, and marketing services from 8% to 19%. That diversification does two things: it lowers the group's exposure to any single regulatory or macro shock, and it steadily shifts the revenue mix toward higher-margin, higher-quality income.

The financial evidence of that mix shift is the margin line. Group gross margin has expanded from a 2022 trough to 56.2% for FY2025, roughly a ten-percentage-point improvement, with the fourth quarter running at 55.7% against 45.5% two years earlier. Every segment contributed: value-added services reached 60.2% for the year, marketing services 57.5%, and FinTech and Business Services 50.8%. That last figure is up from below 40% only two years ago as the mix tilts toward higher-value cloud and payments revenue over low-margin resale.

Gross Profit



Source: Bloomberg and Merchant West Investments

Gaming: domestic strength, international breakout

Gaming remains the cash engine, and the quality of the franchise is difficult to overstate. Tencent holds roughly half the Chinese market and owns or backs a studio roster (TiMi, Riot, Lightspeed, Supercell) that few competitors anywhere can match. Honor of Kings, League of Legends and PUBG Mobile are multi-decade franchises with world-leading live-operations capability and low incremental content cost.

The newer story is international. Overseas titles now account for nearly a third of games revenue and grew 43% in FY2025, comfortably the group's fastest-growing line, as Tencent's portfolio approach and its Level Infinite publishing arm gain traction in developed and emerging markets alike. Domestically, the regulatory backdrop has also eased. Game approvals accelerated to roughly 1 050 titles by August 2025, against about 850 in the comparable period a year earlier, restoring the pipeline that the 2021 to 2022 freeze had choked off.

Advertising and the WeChat monetisation runway

Marketing services grew 19% to CNY 145 billion, and we think the runway here is underappreciated. WeChat reaches 1.38 billion monthly active users, effectively co-extensive with China's online population, yet its advertising load remains deliberately light. Moments shows a maximum of one advertisement per user per day, against roughly four for Douyin, and users still spend meaningfully less time in-app than they do on ByteDance's platform. That gap is the point: it represents monetisation headroom that Tencent can unlock gradually, aided by Video Accounts (its short-video surface, still early in its advertising life) and AI-enhanced targeting with closed-loop measurement through Mini Programs. The competitive threat from ByteDance in advertising is genuine and we do not dismiss it, but Tencent is monetising from a position of restraint rather than saturation.

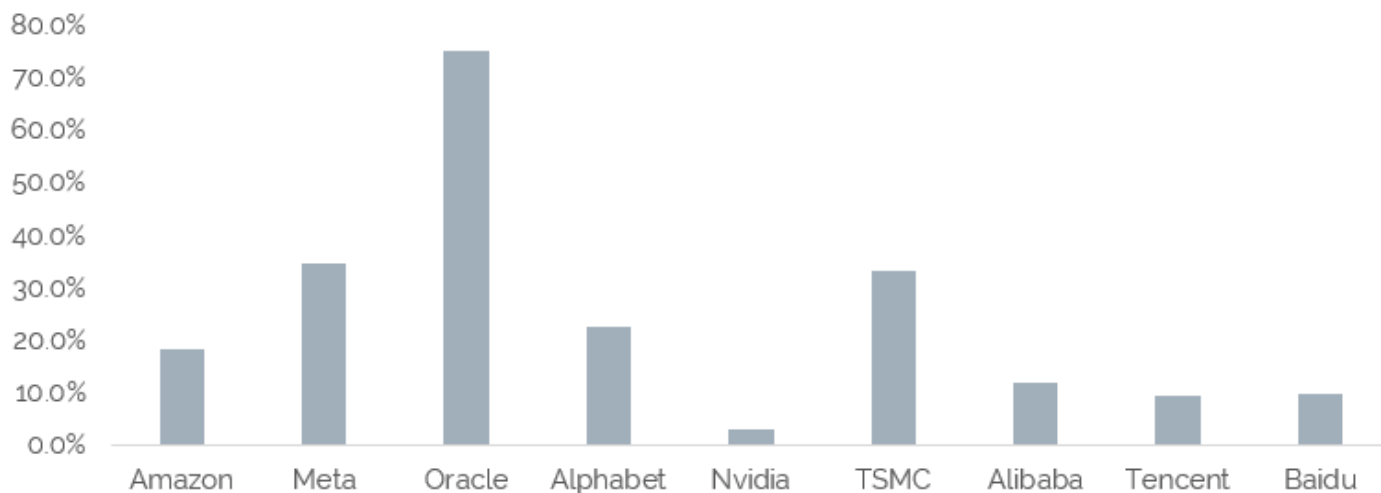
FinTech, cash generation and a disciplined AI ramp

FinTech and Business Services grew 8% to CNY 229 billion, the group's largest single segment, spanning WeChat Pay, wealth management, consumer credit, insurance and Tencent Cloud. Cloud remains the one area where Tencent is clearly subscale, roughly third with a 15% share against Alibaba's 35%, but the payments business sits in a comfortable duopoly, and rising margins across the segment point to operating leverage finally coming through.

Underpinning all of this is one of the strongest balance sheets in the sector. Tencent ended FY2025 in a net cash position of CNY 107 billion, holds an A1/S&P A+ rating, and carries a long-term investment portfolio worth roughly USD 96 billion in listed holdings plus a further USD 52 billion unlisted. Capital returns have been substantial: around HKD 80 billion of shares repurchased in FY2025 and a proposed dividend of HKD 5.30 per share, up 18%.

The nuance for 2026 is capital allocation. Management has signalled it will likely moderate buybacks relative to 2025 to fund AI investment while continuing to grow the dividend. We view this as sensible rather than concerning. Crucially, Tencent's capital intensity remains modest. Capex has run at roughly 9% of revenue, a fraction of the levels seen at US hyperscalers. Even on our forecasts, which assume the AI build lifts capex toward the low teens as a share of revenue before easing, Tencent invests with markedly more discipline than its Western peers, and does so from a position of self-funding strength.

FY25 Capex as % of Revenue



Source: Bloomberg and Merchant West Investments

A wide moat at a below-average price

This is, at its core, a quality story. The network effects around WeChat are among the strongest of any business globally. Switching costs, spanning the social graph, transaction history, business relationships and government integration, are close to prohibitive. Gaming intellectual property is a genuine intangible asset with multi-decade durability. It is a wide-moat franchise on any reasonable assessment, and returns on invested capital, having stumbled during the regulatory episode, are recovering.

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Glossary

- **Annualised Returns** - Annualised return is the weighted average compound growth rate over the period measured.
- **Asset Allocation** - Refers to the mixture of investments and each investment value in an investor's portfolio.
- **Asset Class** - An investment instrument or category. Asset class types include cash, equity, listed property, and bonds.
- **Bonds** - A type of financial investment that involves lending money to an institution for a fixed period of time.
- **Commodities** - Raw materials (wheat, oil, gold) used to create consumer products. Investors monitor these products to predict price changes.
- **Cumulative Returns** - Cumulative return is the aggregate return of the portfolio for a specified period.
- **Diversification** - Diversification is a technique that reduces risk by allocating investments among various financial instruments, industries, and other categories. It aims to maximize return by investing in different areas that should each react differently to changes in market conditions.
- **Dividends** - Dividends are how a company rewards or pays out a portion of its profits to shareholders/ investors.
- **Equities** - Equity is money that is invested in a company by purchasing shares of that company in the stock market. These shares are typically traded on a stock exchange.
- **Fund Class** - Each class invests in the same portfolio of securities and has the same investment objectives and policies. But each class has different shareholder services and/or distribution arrangements with different fees and expenses.
- **GMGF** - Merchant West SCI Global Managed Growth Fund
- **Inflation** - Inflation is the weakening of a currency's purchasing power over a period of time. The rise in prices for goods and services means that a unit of currency effectively purchases less than it did in prior periods with the same value of currency.
- **Liquidity** - Liquidity refers to the ease with which an asset can be converted into cash without affecting its market price. The most liquid asset of all is cash itself.
- **Quality Investing** - Quality investing is an investment strategy based on a set of clearly defined Fundamental criteria that seek to identify companies with positive quality characteristics. The quality assessment is made based on soft and hard criteria.
- **Quality Investing Criteria** - Companies with attractive earnings and dividend growth prospects.
- **Shares** - Shares are the units of the ownership of a company, usually traded on the stock market. They are also known as stocks, or equities.
- **Stocks** - A stock (also known as an equity) is a security that represents the ownership of a fraction of a corporation. This entitles the owner of the stock to a proportion of the corporation's assets and profits equal to how much stock they own. Units of stock are called "shares."
- **Yield** - Yield refers to the earnings gained on an investment over a specific period of time.

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