

Benefit Analysis of Tencent's Acquisition of Sogou Company

Jiakai Chen *

No. 2 Middle School, Beijing, China

* Corresponding Author Email: 12102143@chnenergy.com.cn

Abstract. With the popularization of the Internet, the importance of traditional Internet search engine business is becoming increasingly prominent. While the search engine market is still dominated by the old giant companies (e.g., Baidu, 360) occupying most of the market share. Tencent's acquisition of Sogou means that Tencent is entering the search engine field, which may have a significant impact on the search engine market. By comparing the changes of Tencent's assets and receivables before and after the acquisition and the rise and fall of Sogou's PC market share, this study analyzes the economic benefits of Tencent's merger and acquisition, and puts forward feasible suggestions for the future construction of Sogou. Tencent's merger and acquisition had a significant weakening effect on Sogou's market competitiveness, while the expenditure of merger and acquisition had no significant impact on Tencent's income, cost, and profit. So far, the positive effect of this acquisition has not been seen. In the future, Tencent may need to increase investment in Sogou's capital, technology and management, and combine the heritage of traditional search engine companies for development and business expansion. This case is one of the biggest merges & acquisitions cases in recent years, hence this paper try to discover the pros and cons within and after the acquisition.

Keywords: Tencent; Sogou; M&A; Search Engine.

1. Introduction

In the digital era, the Internet still maintains a rapid development trend. The Internet has gradually penetrated into all aspects of public life [1, 2]. According to the 51st Statistical Report on the Development of the Internet in China, as of December 2022, the number of Internet users in China reached 1.067 billion, an increase of 35.49 million over December 2021, and the Internet penetration rate reached 75.6%. An increase of 2.6 percentage points from December 2021 [2]. The continuous expansion of the scale of Internet users has further stimulated the vitality of the Internet industry.

Since the emergence of search engines in 1990, it has been more than 30 years of development history. As a traditional information search method in the Internet, it is still the most commonly used information search tool. According to statistics, in 2017, China's search engine utilization rate was 82.8%, and the user scale reached 620 million [3]. By 2022, there will be 829 million search engine users in China. China's ultra-high usage rate and the increase of network users, so that the search engine market continues to expand. People can't live without search engines on the Internet.

Mobile Internet is increasingly in the form of mobile search as the user demand is growing, the market requirements for products are also getting higher and higher, and search engine enterprises need to continue to innovate and develop [4]. As an important means of marketing for Internet enterprises, search engine can obtain more traffic and potential users for Internet enterprises and improve brand influence and visibility. The search engine industry is also more competitive. But today, the search engine industry in China's Internet market is heavily monopolized, mainly controlled by a few leading enterprises. At present, Baidu, Sogou, and 360 hold the majority of the search engine market. According to statistics, the 2023 search engine PC Baidu China market share of Baidu is 33.13%; Sogou came second, with a market share of 26.71%; Bing was third with 26.12% of the market. The PE side of Baidu's Chinese market share is 75.57%; YANDEX came in second with 7.42% of the market. Google is third, with a market share of 4.24% [5]. Baidu can be seen in the market share of the absolute advantage. However, in 2020, Sogou's share hovered around 16 percent, and Sogou's market share has rebounded in the past two years, which may be related to Tencent's acquisition.

Due to the delisting of Sogou, its financial reports are not open to the public, so the company's financial situation after the merger is not easy to probe. This paper compares the development situation of Sogou with the development report from multiple angles, and obtains a more accurate profit situation of Sogou from merger and acquisition. On the other hand, by collecting Tencent's financial data, using a variety of valuation methods and comparing data from multiple angles, this paper obtains its development status in search engine. Finally, the conclusions of both companies are integrated, and the performance of this merger case in the past three years is summarized and evaluated. In this paper, the latest data of 2023 is used to compare the market and the company's financial data from multiple angles to evaluate the merger case, which is comprehensive and rigorous.

2. Company Background Overview

Tencent is a veteran Internet enterprise accompanying the development of China's Internet industry. Its business covers email, instant messaging, online games and advertising, e-commerce and search engines, etc., and its service content is available on both PC and mobile terminals. Among them, QQ and wechat have become star products, with hundreds of millions of users. Tencent's service projects have a great impact on both the Internet and real social life, creating countless values [6]. In recent years, Tencent has maintained a relatively stable development trend as always. According to Fig. 1, from the perspective of market value, the market value of Tencent in 19-21 surpassed Alibaba and regained the status of China's Internet leading enterprises [7, 8]. At the end of 21 years, Tencent's market value of 35,000 trillion is far more than Jingdong, Pinduoduo and other new e-commerce enterprises with a strong rise, proving its deep corporate heritage and strong ability to innovate and develop [9].

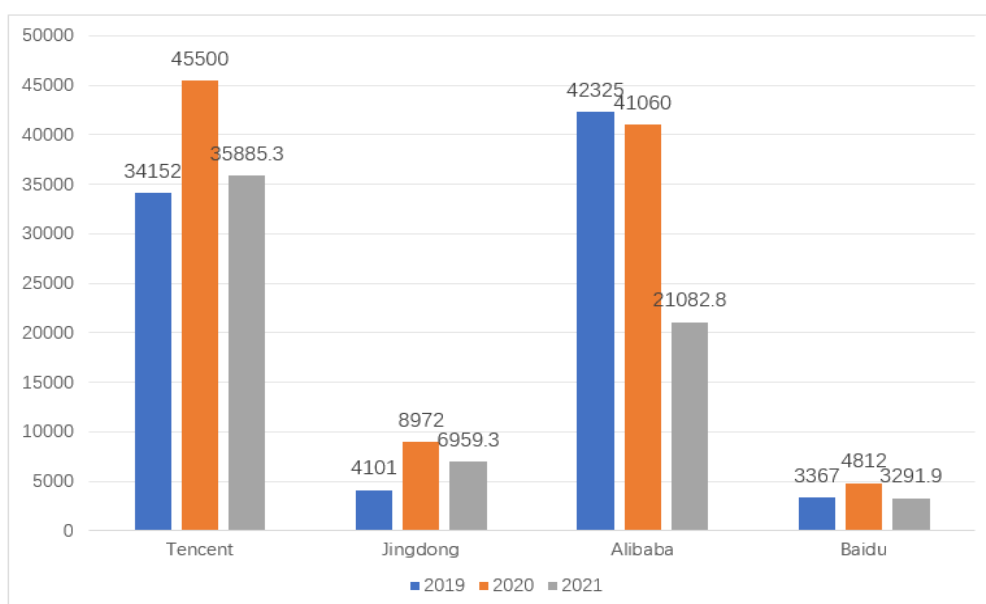


Fig 1. 2019-2021 Market Value of China's Major Internet Enterprises /10thouands yuan.

Since September 2013, Tencent exchanged about 40% of Sogou's equity for 448 million US dollars and divestiture of related assets, Sogou has been trying to carry out scientific and technological innovation in various fields and use new technologies such as artificial intelligence to enable traditional search engines, but the results are not good [10]. According to Table 1, from June 2020 to June 2021, Sogou's current assets decreased from 1.332 billion yuan to 1.05 billion yuan, a decrease of about 20%. It can be concluded that Sogou has obvious problems such as cash flow reduction, profit reduction and operation efficiency decline. Although Sogou is tenacious in the era of the epidemic, it has also lost the possibility of development through its own reform and increased investment and borrowing. Therefore, Sogou is also looking for buyers who can buy the company to provide new funds and opportunities for the transformation and development of Sogou [11].

Table 1. Asset status of Sogou one year before acquisition.

	20Q2	20Q3	20FY	21Q1	21Q2
Current assets	13.32	12.14	11.87	10.93	10.50
Non-current assets	2.23	2.19	2.08	2.72	3.37
Total assets	15.56	14.33	13.95	13.66	13.87

3. Process

On July 13, 2021, the State Administration for Market Regulation unconditionally approved Tencent Holdings Limited's acquisition of Sogou's equity. In the early morning of September 24, 2021, Sogou Company issued an announcement announcing the completion of the merger with Tencent, Sogou will become an indirect wholly-owned subsidiary of Tencent Holdings, and complete the delisting. On October 4, 2021, Sogou officially completed its privatization and delisted from the New York Stock Exchange. The overall merger and acquisition process is relatively smooth, it can be seen that Tencent and Sogou should have reached a greater consensus, Tencent's merger and acquisition is strong, and Sogou has sufficient motivation to sell.

4. Acquisition Benefit Analysis

According to the data of Tencent income and expenditure during 2021,2022 and 2023 from Fig. 2, one can see that the acquisition of Sogou did not immediately have a positive impact on Tencent's earnings. On the contrary, in 2022, Tencent's total cost increased from 1144 to 161.2 billion yuan, which may be related to the capital investment in the reconstruction of Sogou company [12]. This change in data is also consistent with half of the post-merger company operations. Meanwhile, from another perspective, Tencent's total profit recovered to 281.4 billion yuan after a short decline, and the acquisition did not affect Tencent's growing market value and market share. By the end of 2022, Tencent's market value reached 530 billion yuan, exceeding Alibaba, the second largest in the Internet industry, by 2 trillion yuan. This high and sustained market value growth figure means that the acquisition has little negative impact, Tencent still maintains a rapid pace of development, and profitability continues to strengthen in the next quarter. Entering 2023, Tencent's total cost stabilized at 160 billion yuan, while total revenue rose to 296.9 billion yuan, gross profit increased, and profit efficiency further. It can be believed that the incorporation of Sogou search engine has supplemented and strengthened Tencent's further expansion of business and profitability [13, 14].

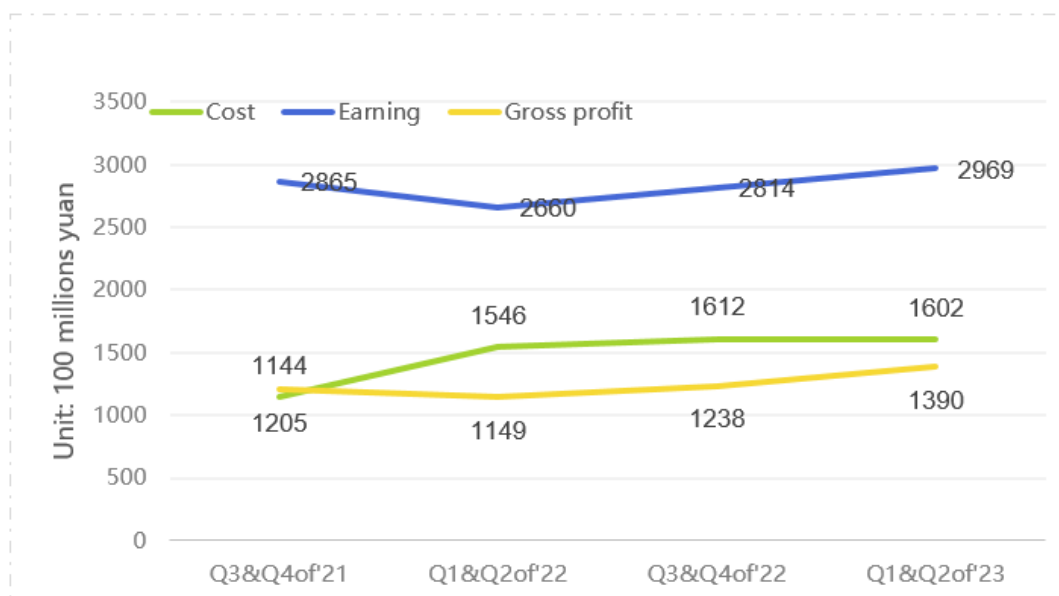


Fig 2. Tencent 2021Q3-2023Q2 income and expenditure data.

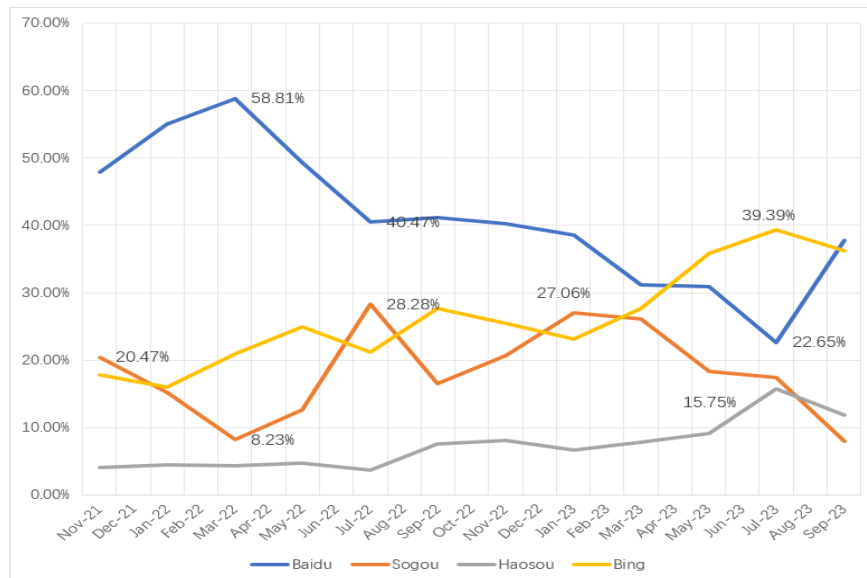


Fig 3. Desktop&Tablet Search Engine Market Share of China.

According to the statistics of Statcounter in Fig. 3, the market share of computer search engines in China from November 21 to September 23, this paper combs some key information. First of all, the market share of Sogou from May to August in 21 was more than 50%, and in the year and a half before the merger and acquisition, to March 22, the proportion of Sogou search engine fell rapidly, from about 20% of the proportion reached a minimum of 8.23%. Such a large market share decline should be directly related to the transition of work management. From March 22 to July, it recovered and exceeded the level of the acquisition month, once reaching nearly 30% of the market in July 22, but it still did not exceed the high value before the acquisition. It shows that Tencent's investment in Sogou's reconstruction has a great effect, which makes Sogou's search engine more competitive and its usage increase. The improvement of Sogou's attractiveness and competitiveness has impacted Baidu's giant status in PC search engines to a certain extent. Second, Sogou entered 23 years with a market share of 27.06%, but it has entered a continuous downward trend. Comparing the development of its competitors, the paper sees that the Bing search engine has continued to grow in usage, while Haosou, which previously had a stable small share, also began to expand in 2023. The strength of a number of competitors to seize about half of the market, so that Sogou's market share began to decline again. By July 23, Baidu, which had previously shrunk all the way, also bottomed out and nearly doubled in a short time. Sogou's old problem of weakness in competition re-emerged, and the market share fell rapidly.

5. Suggestions and Implications

The decline of Sogou's market share needs to start from two aspects: internal and external causes. First of all, Tencent also needs to increase its attention to Sogou, whether it is talent, technology, management or capital, it needs to increase support, so as to solve Sogou's own problems of weak business innovation and declining service competitiveness. At the same time, in view of the fierce competition in the PC search engine market, Tencent is also a mobile network enterprise, which may guide Sogou to enter the mobile search engine and obtain more development opportunities. For the Internet industry, Tencent's acquisition of Sogou is a reminder of the way other Internet companies are opening up markets in unfamiliar areas.

6. Conclusion

Combined with the comparative study of the relevant data of Tencent and Sogou search engine, this paper draws the following conclusions. First of all, Tencent's own development after the

acquisition has not been affected by large investment expenditures, and through its continuous growth of income and receivables, it can be believed that the addition of Sogou engine has improved Tencent's income and profit space. Second, after the incorporation of Tencent, the use of Sogou search engine decreased significantly, although there is a rebound, but still not better. In the search engine market fierce competition into the inferior position. Therefore, this paper puts forward some suggestions for Tencent to help guide the operation of Sogou subsidiaries. The simplest and most basic point is that the parent company can tilt the resources of the subsidiary to enhance the technical talent capital. In addition, in view of Tencent's wider business scope in mobile phones and more mature technology, it can help Sogou open up the mobile market, try new development directions, and better cooperate with the business development of Tencent's parent company. Tencent can learn from the operation mode and strategy of Sogou before the acquisition, sum up experience, and combine the existing corporate structure and work mode to improve, rather than complete reform.

There are two limitations to this article. First, Sogou's financial data and Tencent's internal information are unclear, and the insufficient collection of data and information leads to insufficient in-depth and accurate analysis. Second, the research time span is short, the long-term benefits are not obvious, and 1 for the specific management and operation mode, this paper has no in-depth understanding and research. This study's goal is to conclude the experiences and lessons from the case and to provide reference for other Internet companies' mergers and acquisitions. This paper is of reference significance for the evaluation and analysis of the benefits of general mergers and acquisitions in the Internet industry, and it is of reading and research value for Internet enterprises considering mergers and acquisitions.

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