

Elena M. Rogova, Varvara V. Nazarova

YANDEX NV – A PERFECT INVESTMENT OPPORTUNITY?

This case was written by Elena M. Rogova (Professor, Department of Finance, Graduate School of Business of Higher School of Economics) and Varvara V. Nazarova (Associate Professor, Department of Financial Management, Graduate School of Business of Higher School of Economics).

For questions about access to materials from the collection of educational cases of the Higher School of Business of the National Research University Higher School of Economics, please contact us by email (cases@hse.ru).

© National Research University "Higher School of Economics", 2021

Shortly after completing his 6-month probationary period as an investment analyst at Freedom Finance, a leading Russian / Kazakh investment company, Alexey Kovalev was given his first full, fee income generating assignment. For a graduate, fresh out of St Petersburg State University, this was a pleasing endorsement of his potential, but the pressure was on to demonstrate his capability to deliver to Renat Subaey, the Head of the St. Petersburg office.

The assignment was to prepare a suitability report for an important client of Freedom Finance, who was considering diversification of her investment portfolio to include investment in emerging markets, through purchase of shares in Yandex NV. She had discounted investment in oil and gas giants based in Russia, in favour of Yandex, which she thought would offer her better returns in the long term. The client planned to receive an income of at least 15% per year by investing 3 million rubbles. The client has never risked her investments too much and followed the principle of a moderate investor: a balanced portfolio is the key to stability and profitability, and a moderate degree of risk with stable capital growth

Renat reported the client's belief in the potential of ESG investments to "pay-off" and a "dark green" attitude towards investment selection. He did not elaborate upon the nature of investments that her "dark green" attitude would rule out, nor the manner in which she expected her investments to pay off over time.

Alexey had a feeling that Renat was deliberately withholding information about the client to put him to the test. At first glance, there appeared to be some conflicting forces at play that would need to be examined. Alexey realised that asking the right questions and having good listening skills was critical to the success of any investment adviser. These dimensions to the task in hand complicated the process to be undertaken but added to its appeal. Alexey was up for the challenge.

Unbeknown to Renat, Alexey had two friends he could call upon to help him prepare the suitability report. Igor Petrenko, a fellow graduate of St Petersburg State University, was working in a similar role, as a financial analyst, at BCS, another large Russian investment company. Anna Smirnova was a PhD student in the Department of Finance at the university. She earned income as a part-time teaching assistant on a 'Corporate Finance' course whilst undertaking research for her thesis. The topic was exploring the concept of Socially Responsible Investment. Alexey was fortunate to be able to call upon such friends to share ideas. They met in a café for a cup of coffee.

BACKGROUND INFORMATION

Yandex is the largest technology company in Russia; it is on 48th place in the list of the world largest internet companies and on 24th in the list of the fastest-growing businesses in the world according to Fortune, 2019. Yandex quickly became Russia's market leader in the search and portal segment. By 2020 it held a market share of 58.8%, with Google trailing behind by 39.4%.

Yandex creates a monopoly ecosystem that surrounds the user from all sides. Through 'Alice', a voice assistant, its customers receive all of the services it offers. Sectors in which it operates include taxi services, media and e-commerce. Yandex Market is seen as the Russian equivalent of Amazon. In its quest for growth, Yandex finds and supports

development of start-up enterprises, which it often acquires and integrates into its own service propositions.

Yandex generates most of its revenue through advertising on search portals and ad networks, but the pattern is changing. Figure 1 highlights the trends of its revenue generation, with the proportion of revenue from advertisements falling, whilst other sectors are growing. In 2020, the company's revenues grew by 24% over the previous year.



Figure 1. Yandex Revenue Breakdown, MM RUB, %

Source: Yandex report for 2020¹

STOCK MOVEMENT

Yandex is listed on the MOEX, NASDAQ, MSCI, and ca. 97% of shares are in free float, with foreign institutional investors as the major stockholders².

Prior to his investment assignment, Alexey's only recollection of Yandex's stock price was linked to awareness of its Initial Public Offering in 2011. He quickly noticed the volatility of its share price movement, often linked to news about the company (Figure 2). A recent example was the announcement in September 2020 of an acquisition of Tinkoff Bank (the largest Russian online bank) in a \$5.5 billion cash-and-shares deal. Immediately after the announcement, shares of both companies jumped up: Yandex by 4%, TCS (the holding company of Tinkoff Bank) by 7%³. The reverse reaction was observed in October,

¹ Yandex report for 2020. Supplementary materials. Available from: https://ir-docs.s3.yandex.net/financials/2020/Q4_2020_Yandex_Quarterly_Supplementary.pdf [Accessed 5/2/22]

² Could The Yandex N.V. (NASDAQ:YNDX) Ownership Structure Tell Us Something Useful? Simply Wall St. February 24, 2021. Available from: https://finance.yahoo.com/news/could-yandex-n-v-nasdaq-105652748.html?guccounter=1&guce_referrer=aHR0cHM6Ly95YW5kZkZlYXVv&guce_referrer_sig=AQAA AIBDCoGU6Q6FZw5cTgmIyKJcfMJwKgUDxrcTFwcnIt1RNbb5YsDmjfqm4A-IyGv3zE5f0bi2TFMHNQNscShZliuWl1_b18_2bPxhgDs5BLiMlc5QDCCzd0EjXhkeW4Qui0pSZKF7yCNM92fcgkAIIYJBAXmo_A8jiw6EG49VqMA [Accessed 5/2/22]

³ Saigol, Lina. Russia's 'Google' Yandex joins super-app race with \$5.5 billion offer for online bank Tinkoff. The MarketWatch. September 23, 2020. Available from: <https://www.marketwatch.com/story/russias-google-yandex-joins-super-app-race-with-55-billion-offer-for-online-bank-tinkoff-2020-09-23> [Accessed 5/2/22].

when the parties announced that they could not reach a mutually beneficial working agreement.

From a historical perspective, the share price has grown significantly. The average annual price for 2020 was almost double that for 2011, the year when the company went public (Figure 3)⁴. Moreover, the annual return for 2020 was higher than the average return for the American market (62.4% vs 53.9%). It is highly esteemed by investors comparing with its major peers (Table 1).

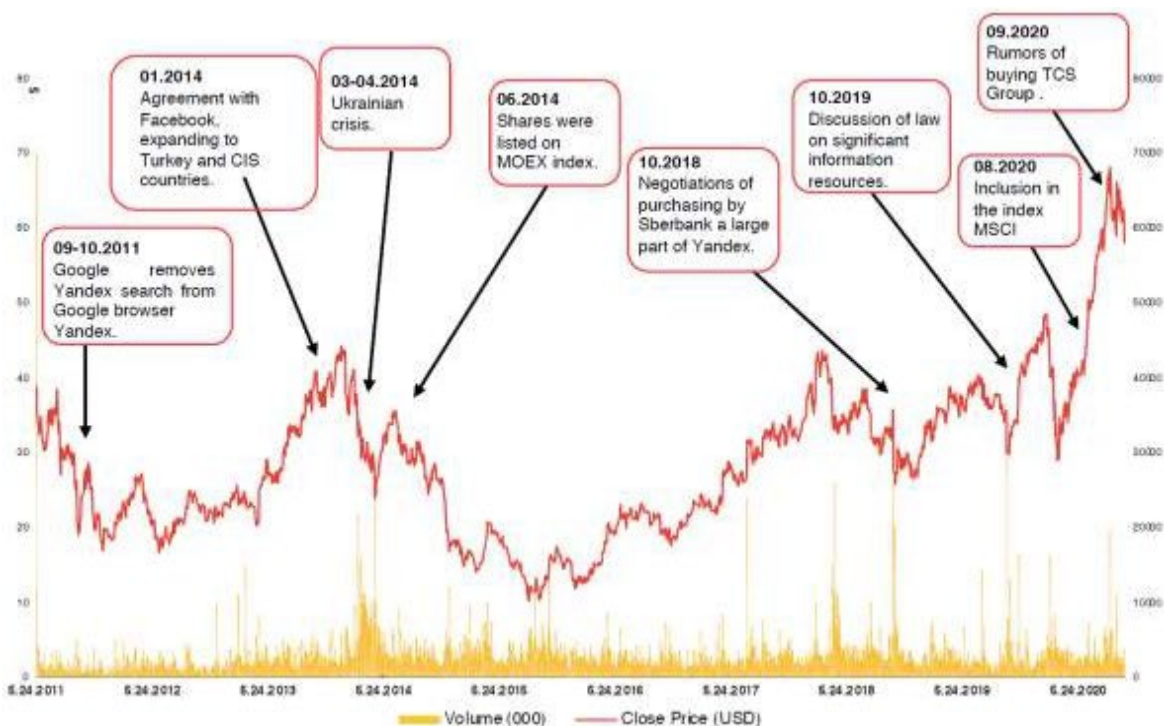


Figure 2. The relationship between changes in company quotes and external economic factors

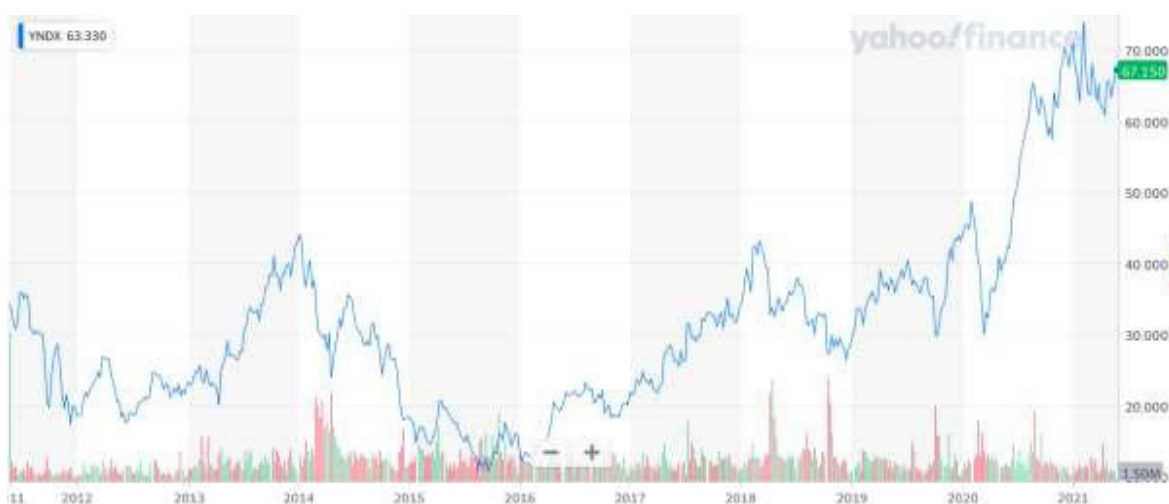


Figure 3. Historical Data of Yandex shares: 9 years

⁴ Yandex – stock price history. Macrotrends. Available from:

<https://www.macrotrends.net/stocks/charts/YNDX/yandex/stock-price-history> [Accessed 5/2/22]

	EV/EBITDA	EV/S	P/E	P/FCF	P/S
Alphabet	22,3	6,2	33,9	45,5	6,9
Amazon	30,7	4,5	92,8	150,6	4,6
Apple	26,5	7,5	36,4	43,0	7,4
Facebook	20,8	9,3	32,8	46,0	10,0
Mail.ru Group	23,7	5,2		76,1	5,1
Microsoft	22,6	10,6	34,5	58,8	11,0
Twitter	79,8	9,5		-24,9	10,8
Median	25,1	8,4	35,5	52,4	8,7
Yandex	45,4	8,7	73,8	92,1	9,3

Table 1. Comparison of companies by multipliers

IS IT EASY?

“So, - Alexey concluded, - these are my reasons. The company looks very successful in different aspects. First, it is customers’ attraction and retaining. You can do almost everything in your life using Yandex’ services. The company is following Apple and Amazon and rapidly creates a large ecosystem with quick and clear interaction between services”.

“Sounds good,” Igor echoed, “but isn’t a focus on development of such an ecosystem too risky? Look, they are trying to monopolize the Russian market, but it is already highly monopolized. And we still do not know how the new services will be monetized”.

Alexey considered this. “As for the financial risks,” he answered, “I am convinced that by diversification and innovation Yandex will shape the market and ensure the solid financial prospects. I am sure that Yandex’s strategic investments in the past few years have increased the company’s value. What I am going to write in my report is that Yandex.Taxi, Yandex.Cloud and Yandex.Drive will contribute to a significant increase in the company’s shareholder value over the next few years. And then, there is an unmanned taxi service! Unmanned vehicles will play a key role in ensuring the sustainable development of cities and towns. New technologies are the future, and investors believe in such a future based on innovation and IT. Look at Amazon, Tesla!”

“This is true”, Igor answered, “but new technologies attract huge players to this highly competitive market. Remember, you deal with a foreign client? Who guarantees that Yandex will always be a leader even at the Russian market? Others are also creating their ecosystems here, and Google is growing despite the protectionist barriers”.

‘Yes, Google is growing fast’. Anna joined in, “They increased revenues by 23% in 2020 and closely trail Yandex in Russia. As for Yandex, consider how they are developing if compared with industry peers; aren’t they underperforming?”

“If I were in your shoes, I would also look at the dynamics of emerging market indices, they show well the dynamics of the market and investors’ expectations”, - added Anna (Figure 4).

Perhaps is it necessary to present Yandex as a Russian analogue of "Big tech"? - suggested Igor, "Yandex is becoming an analogue of companies such as Apple, Google, Amazon and Microsoft. I recently collected information on high-tech companies and prepared such a graph - can it help you? (Figure 5). From my point of view, the shares of such companies are now highly valued by the market, and maybe even overvalued ... Your investor may fee an enthusiasm of participating in such kind of business with a huge potential"



Figure 4. Stock market indices dynamics

BVSP- Latin America

MOEX- Russia NIFTY- India

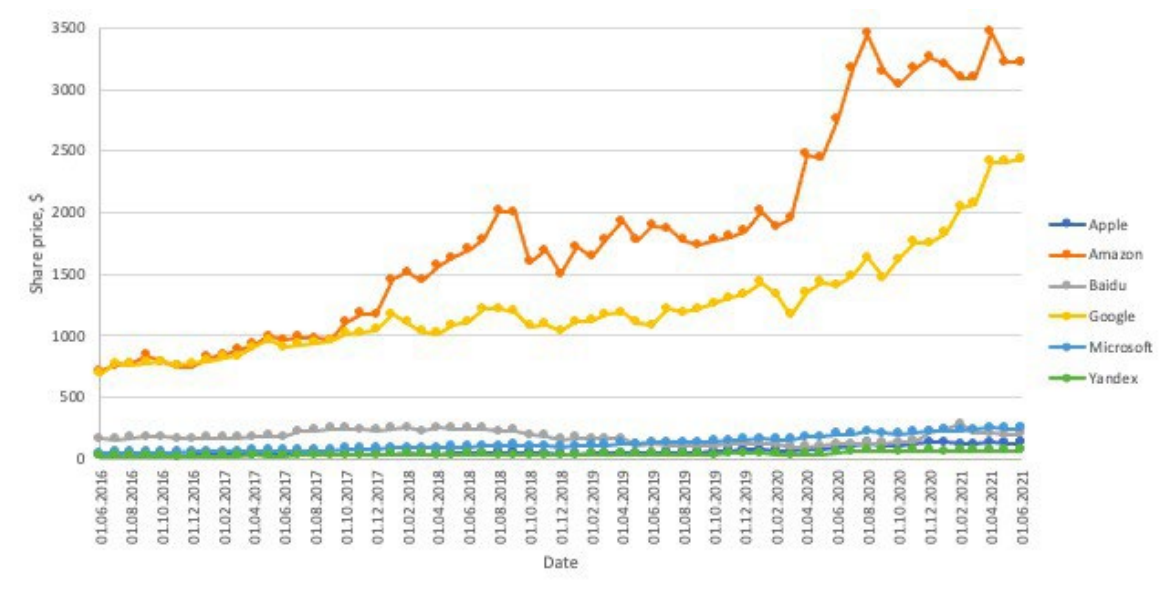


Figure 5. Share price movements of big tech companies and Yandex

"You have mentioned that your client is keen on ESG issues", Anna continued, "do you remember this? What do you think about ESG integration in your report?"

"I did not forget this", Alexey said cautiously, "but here I see some contradictions.

Yandex looks good from the viewpoint of corporate governance, at least compared to Russian peers. According to Forbes, the company is the best employer in Russia in 2020, with a high focus on the development and retention of personnel. And you know, IT is a highly HR-dependent industry, so I think it is very important. Yandex is also involved in different social projects. But they have moderate ESG scores in different rankings and they do not reveal their ESG reports. Why, what do you think?”

“Probably, they are so much keen on taxis and car-sharing”, Anna answered. They also were mentioned as a company that is involved in animal testing. But in general, their scores are not bad, they are better than those of many peers and at the same level as Facebook”.

“Well, it is not so easy to decide whether your client will be happy with such an explanation”, Anna said. But I see some contradictions: even in the Russian ratings, Yandex is not at the leading positions, it is only 85th from the ecology side, and the situation is only slightly better for other two scores - I can show you this⁵”.

“What about Google, then”? Alexey asked, “Their ESG score is better, but why?” “We cannot explain this with certainty”, Anna answered, “Yandex does not disclose the information about the components of ESG score”.

“So, what should I recommend to the client?” Alexey felt himself still uncertain.

“It’s your decision”, Igor said. “I think you have done a good job and you are able to make a decision. Just consider our questions - would the answers change anything? Cheer up, old guy, you are on the right way!”

“But still, remember that your client has some demands, and this is your first serious assignment, - so, be honest and persuasive”, Anna added.

A NOT SO EVIDENT DECISION

After Anna and Igor had left, Alexey looked again in his notes. Everything witnessed that he was right in his optimism, and his readiness to recommend Yandex was well reasoned. But the questions remained open. Alexey decided to order some meals, as he had finished his latte long ago, and the evening promised to become long. He looked again at Yandex stock price movement - everything seemed very attractive compared to peers. The financials looked promising, but there were some concerns, and ESG issues also arose. Will the client be satisfied with his explanations about ESG positions?

However, his recommendations were awaited tomorrow. So, what could he write in the resuming part of his report?

⁵ Yandex positions in ratings - RAEX rating reviews. Available from: <https://raex-rr.com/database/contender/10007229> [Assessed 5/2/22].