

Performance Evaluation of Feirongda Merger and Acquisition of Bowei Communication under Performance Commitment

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Abstract: In order to obtain a higher valuation and premium, the controlling shareholders will generally sign a higher performance acceptance agreement when the listed companies conduct mergers and acquisitions. Performance commitments will be compensated if they are not met. Taking Fei Rongda's acquisition of 51% of Bowei Communications as an example, this paper intends to use the event study method to discuss the impact of performance commitment and compensation on M&A performance from a short-term perspective. The results show that performance commitment has a positive impact on the short-term performance of M&A. Based on this, this paper proposes that the acquirer should reasonably set the amount of performance commitment and strengthen government supervision to evaluate performance commitment.

Keywords: M&A Performance; Performance Commitment.

1. Introduction

Mergers and acquisitions are a strategic way for listed companies to complete rapid transformation and seize market share, and also a shortcut for non-listed companies with high growth potential to quickly land in the A-share market. Therefore, mergers and acquisitions are very active in the capital market in recent years. However, due to the information asymmetry in the capital market, the value of the target assets cannot be accurately measured. In order to protect the legitimate rights and interests of the acquirer and promote the successful acquisition of high-quality assets, the signing of performance commitments by the acquirer and the acquirer has become the preferred way for the majority of investors and shareholders of listed companies to avoid risks. However, in practice, some acquired parties will deliberately increase their own valuation by making too high performance commitments, resulting in failure to realize performance commitments. Taking Feirongda's acquisition of Bowei Communications as an example, this paper analyzes the impact of signing performance commitment and failing to fulfill performance commitment on M&A performance.

2. Case Study

2.1 Basic information of the merger and acquisition parties

Fei Rongda Company is a national high-tech company which mainly produces electromagnetic protection materials and equipment, thermal conductivity materials and equipment and other electronic equipment. The company has passed a number of domestic and foreign management system including quality, environment, hazardous substances and occupational health authority certification. Guangdong Bowei Communication Technology Co., Ltd. is a Hong Kong based manufacturer of mobile communication antenna systems. The main products are base station antennas

2.2 M&A motivation

With the acquisition of Bo Wei Communication, Feilongda can complement each other's advantages in business structure and integrate resources for technology research and development and product marketing to achieve economies of scale. After the merger and acquisition, Feirongda's business scope is wider, and its competitiveness in antenna research and development, production and

sales has been improved, providing opportunities for the implementation of the extension strategy.

2.3 M&A process

On August 3, 2018, Feilongda signed the acquisition agreement with the shareholders of Bronovate Communications, as well as a performance commitment and compensation agreement. If the net profit actually realized by Weaver Communications is less than 90% of the promised net profit at the end of the current period, Party A shall have the right to claim compensation from Party B according to the calculation standard agreed herein.

2.4 The realization of performance commitment and performance compensation.

Table 1 Implementation of performance commitments for 2018-2020 (Unit: Ten thousand Yuan)

YEAR	2018	2019	2020	CUMULATIVE
PERFORMANCE COMMITMENTS	100	2800	4300	7200
AMOUNT OF PERFORMANCE REALIZED	-494.31	1418.55	1515.33	2439.57
PERFORMANCE REALIZED DIFFERENCE	-594.31	-1381.45	-2784.67	-4760.43
COMPLETION RATE	-4.94%	50.66%	35.24%	33.88%

As of the date of the announcement, Feirongda has not received the compensation. The relevant shareholders of Feirongda and Bowei Communication have adjusted the compensation method of performance commitment from "cash compensation" to "cash compensation combined with the equity compensation of the target company held by the original shareholders". As of November 30, 2021, the compensation of performance commitment has been fulfilled.

3. The impact of performance commitment on the market performance of the acquirer

3.1 Calculation of market performance

Step 1 Determine the event date and window period. The three event dates are August 6, 2018, April 27, 2021 and December 1, 2021 respectively, which are defined as (T_0) . The window period is set to 15 trading days before and after the event. Non-trading such as weekends or statutory closed days are not included.

Step 2 Determine the actual rate of return R_t in the window period.

Step 3 Determine the broad market return R_m for the window period. This paper selects the market return rate of CSI 300 as the market return rate.

Step 4 Calculate the abnormal return AR in the window period.

$$\text{Excess return rate} = \text{Window real rate of return} - \text{Window market yield}$$

Step 5 Calculate the cumulative excess return (CAR) during the window period. Where, $[T_1, T_2]$ denotes the window period of the sample.

$$CAR[T_1, T_2] = \sum_{T_1}^{T_2} AR$$

3.2 Analysis on the impact of M&A on short-term performance when performance commitment is made

3.2.1 In terms of stock prices

Fei Rongda had released the announcement about the content of performance commitment, and the stock price continued to rise. This shows that Feirongda's performance pledge signing behavior has been recognized by the stock market, which strengthens investors' confidence in Feirongda's 5G business layout.

3.2.2 In terms of excess return.

As can be seen from Figure 2, AR reached 2.67% on the announcement date. CAR reached 33.4% on the third trading day after the announcement, indicating that the promised information of M&A performance may be lagging behind. However, during the window period ^[4,15], AR fluctuated continuously, and some of them were negative, indicating that the market had mixed opinions on the performance commitment of this M&A transaction.

3.3 Analysis on the impact of short-term performance of M&A when the performance commitment is not up to the standard

3.3.1 In terms of stock prices

Fei Rongda's share price began to fall after the company issued a statement to the outside world that it had fulfilled its performance promises for three years in a row. The sharp drop in Fei Rongda's share price in the trading day before and after the announcement is a sign of strong negative sentiment among investors. At this time, Fei Rongda also had to set aside the impairment reserve for the large amount of goodwill formed by its premium acquisition, which negatively stimulated the performance of the enterprise.

3.3.2 Excess return

As can be seen from two trading days before the announcement, the announcement day and one trading day after the announcement, there were cliff drops, and CAR continued to be negative. During the window period [-2,1], AR decreased to a negative value and fell to -8.07% on the announcement day, indicating that investors paid close attention to the performance of Oliver Wyman Communications on the announcement day and made quick reactions, with obvious negative sentiment.

3.4 Impact analysis on short-term performance of merger and acquisition after performance commitment compensation is fulfilled

3.4.1 In terms of stock prices

When the performance promise failed to reach the standard and the purchaser fulfilled the performance promise compensation, the stock price of Fei Rongda rose, but the positive market reaction was very short lasting only 3 trading days.

3.4.2 In terms of excess return

AR and CAR rose rapidly on the day of the announcement of the completion of the performance promise compensation, but after the announcement, they began to fall rapidly, and AR even showed a negative value, which indicates that the event of the substandard performance of the company still produced a large negative effect on the market, dragging down the overall performance of the company.

4. Conclusions and Suggestions

Through the study of three important event nodes of both sides of the merger and acquisition transaction, this paper finds that the merger does promote the development of various capabilities of Feirongda, but the effect is limited. Especially when the performance commitment cannot be realized, the capabilities of Feirongda are negatively affected, and the performance commitment compensation cannot be saved.

4.1 Set a reasonable amount of performance commitment

The amount of performance commitment should not be excessively higher or lower than the normal profit level of the target company. Only in this way can the rights and interests of the listed company be protected to the maximum extent and the positive role of performance commitment be played.

4.2 We will strengthen government oversight

Government regulatory departments should strengthen the supervision and management of the events related to performance commitment compensation in M&A and reorganization transactions, increase the attention to insider trading, and strengthen the supervision and punishment of insider speculation, disclosure of trading information and other issues.

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