Performance Evaluation of China Literature Limited 'S Acquisition of New Classics Media

Tianyi Huang *

School of Nanjing University of Science and Technology, Nanjing, China

* Corresponding Author Email: huangtianyi11@outlook.com

Abstract. In 2016, China put forward the concept of "digital creative industry" for the first time, and took it as one of the five pillars of the development of China's strategic emerging industries, marking that China's cultural and creative industry has officially entered the digital era. At the same time, with the upgrading of the consumption mode, the traditional entertainment consumption mode has been unable to meet the needs of consumers, resulting in the ceiling of the traditional culture and entertainment segments in China. Therefore, under the guidance of policies and the promotion of changes in consumption environment, the concept of "new cultural creation" arises. China's entertainment enterprises have carried out merger and acquisition activities, trying to participate in the strategic layout of "new cultural innovation" by expanding the IP industry chain. This paper uses the method of case study to analyze the motivation and economic consequences of Chinese entertainment companies to lay out the "new cultural and creative" strategy. Specifically, this paper uses the event study method and index analysis method to evaluate the long-term and short-term performance of merger and acquisition activities. In addition, this paper discusses the motivation and risks of the merger, summarizes the lessons learned, and tries to provide reference for the cross-industry merger of China's cultural and entertainment enterprises

Keywords: China Literature Limited, New Classics Media, Merger and acquisition, M & A performance, M & A risk.

1. Introduction

China Literature Limited is one of Tencent's benchmark companies in the online literature industry, with well-known brands such as QQ Reader, Xiaoxiang Bookstore and Starting Point Chinese. New Classics Media is one of the highly competitive domestic companies of episodic and movie production and distribution. The works include Joy of Life and Ruyi's Royal Love in the Palace.

On August 13, 2018, China Literature Limited announced the merger and acquisition of New Classics Media, with a view to realizing the marketing of the IP it holds, breaking the revenue ceiling, and finding new earnings growth. According to the share purchase agreement, China Literature Limited purchased its 31.72% stake in New Classics Media from Tencent for a consideration of 5.3 billion yuan, which is payable upon completion of the merger. A 68.28% stake was acquired from other shareholders and management of New Classics Media for a consideration of 10.2 billion yuan. At the same time, the parties to the merger and acquisition entered into a performance commitment agreement, and the purchase consideration will be paid in the form of a mixture of cash payments and share-based payments. The merger was completed on October 31, 2018, and 100% of the shares of New Classics Media were held by China Literature Limited.

China Literature Limited's acquisition of New Classics Media is an M&A in the IP industry chain and is a high premium M&A, but the merger and acquisition performance is not satisfactory, in 2018 and 2019, New Classics Media did not complete the performance commitment, and in 2020, the sudden epidemic, the movie drama industry suffered a heavy blow, and China Literature Limited took the initiative to adjust the Valuation Adjustment Mechanism, and only then did New Classics Media reach the performance commitment. 2020, China Literature Limited suffered a significant goodwill impairment because of this and incurred a loss of 45 billion yuan.

2. M&A Motivation Analysis

2.1. Motivation of Mergers and Acquisitions

After years of development, China Literature Limited now has the largest online reading and writing platform in China. However, a single online reading revenue is not enough to support the further development of China Literature Limited. With the gradual disappearance of China's Internet dividend, the growth of the average number of monthly active users of China Literature Limited's own platform products has slowed down, and the number of paid users has even decreased.

Users are the core competitiveness of China Literature Limited. With the lack of growth in the online reading business and the limitation of advertising revenue for the stake of user experience, China Literature Limited can only expand its business by digging deep into the existing resources, creating new IPs for influential original works, and adapting them into new art forms such as movies, Netflix dramas, games and animations. However, China Literature Limited's participation in the adaptation of online literature is not high, and in most scenarios, it only sells copyrights to the adapters, and does not form a real ecological closed loop from the creation and production of IP to the expansion of audience groups to the adaptation into film, television, games and animation works.

China Literature Limited has rich novel resources, New Classics Media has strong film and television resources, these two are in the upstream and downstream of the whole industry chain of novels adapted to TV dramas, and both are benchmark enterprises in their respective fields. China Literature Limited wants to increase profit margins and extend the IP value chain, and the acquisition of New Classics Media is a wise choice for China Literature Limited.

2.2. Motivation of the acquired party

There has been a large competition in the film and television market, and the audience's demand for film and television works is getting higher and higher, which makes the production cost of film and television dramas also rise, combined with a long production cycle of film and television enterprises and a long time for the return of funds. New Classics Media is also facing the problem of difficult capital recovery. According to New Classics Media's prospectus in 2017, as of the end of 2016, New Classics had only 278 million yuan on its books, which is difficult to support the more than ten works that are expected to be developed after the end of the year, and according to the prediction, at least 2.5 billion yuan will need to be invested in the development of these works, which is difficult for New Classics to raise.

To 2018, New Classics Media's hopes for an IPO fade, combining the current domestic policy is to avoid funds circulating within the financial sector being diverted out of the real economy and to encourage the manufacturing industry. At this time, China Literature Limited proposed to acquire New Classics Media, bringing hope to New Classics Media, which can solve the problems faced by New Literature shareholders to withdraw and shortage of funds.

In order to maintain the leading position in the industry, New Classics Media can only choose to join forces with other powerful enterprises outside the industry for the urgent need for funds. At this time, China Literature Limited, which can provide financial help and has a high-quality original IP library, has become the best choice.

3. Performance Analysis of China Literature Limited's acquisition of New Classics Media

3.1. Short-term Market Reaction to China Literature Limited's acquisition of New Classics Media

This paper adopts the event study, calculating the fluctuation of stock price before and after the acquisition, and whether it will generate "excess return", in order to judge the degree of impact of this event on the company's market performance. If the excess return is positive, the market impact of the event is positive, and vice versa.

(1) Define the event date. This paper adopts the event study method to mainly analyze the market reflection brought by China Literature Limited's acquisition of New Classics Media, therefore, the date of China Literature Limited's acquisition announcement, August 13, 2018, is used as the event date, which is recorded as "0" time point.

(2) Define the event window. Define the 10 days before to 10 days after August 13, 2018, as the event window, recorded as [-10, 10], from July 30, 2018, to August 27, 2018, a total of 21 trading days.

(3) Define the estimation window. The 140 trading days before the event window is chosen as the estimation window, i.e., from January 2, 2018, to July 27, 2018.

(4) Variable fit test and significance test. One-way linear regression of independent and dependent variables is conducted to test the fit and significance.

(5) Calculate the abnormal returns and cumulative abnormal returns.

Based on the data collected, the fit of the independent variable, i.e., the return of the Hang Seng index (HSI), Rmt, to the dependent variable, i.e., the expected return of China Literature Limited, Rit', during the estimation period is examined, and the results are shown below, with the R2 of 0.776, which indicates that this model is able to fit the return on the company's share price well

Table 1. goodness of fit

Multiple R	0.880888023
R Square	0.77596371
Adjusted R Square	0.774340258
standard error	0.009707125
Observations	140

As shown in the figure below, the F value of this regression is 477.97, and the Significance F value is small, which indicates that the regression model is highly significant, and the linear relationship between China Literature Limited's return and the market's return is very significant during the estimation period.

Table 2. analysis of variance

	df	ss	MS	F	Significance F
Regression analysis	1	0.045038439	0.045038439	477.971635	1.14E-46
Residuals	138	0.013003501	9.42283E-05		
Total	139	0.05804194			

Through regression, α is calculated to be -0.0008 and β to be 0.7575, yielding an expected return model of

Rit' = 0.7575*Rmt -0.0008

The data for the event period is displayed in the table below:

Table 3. Excess Returns and Cumulative Excess Returns

Event window	Rmt	Rit	Rit’	ARit	CARit
-10	-0.25%	-1.35%	-0.27%	-1.08%	-1.08%
-9	-0.52%	-5.40%	-0.47%	-4.93%	-6.01%
-8	-0.85%	3.35%	-0.72%	4.07%	-1.93%
-7	-2.21%	-2.95%	-1.75%	-1.20%	-3.13%
-6	-0.14%	-3.04%	-0.19%	-2.85%	-5.98%
-5	0.52%	-1.72%	0.31%	-2.03%	-8.02%
-4	1.54%	3.82%	1.09%	2.73%	-5.28%
-3	0.39%	2.15%	0.22%	1.93%	-3.35%
-2	0.88%	2.85%	0.59%	2.26%	-1.09%
-1	-0.84%	-1.24%	-0.72%	-0.52%	-1.61%
0	-1.52%	-0.89%	-1.23%	0.34%	-1.27%
1	-0.66%	-17.01%	-0.58%	-16.43%	-17.70%
2	-1.55%	-5.40%	-1.25%	-4.15%	-21.84%
3	-0.82%	-5.23%	-0.70%	-4.53%	-26.37%
4	0.42%	0.30%	0.24%	0.06%	-26.31%
5	1.41%	-1.00%	0.99%	-1.99%	-28.30%
6	0.56%	9.09%	0.34%	8.75%	-19.55%
7	0.63%	0.93%	0.40%	0.53%	-19.02%
8	-0.49%	-0.92%	-0.45%	-0.47%	-19.49%
9	-0.43%	-2.22%	-0.41%	-1.81%	-21.30%
10	2.17%	2.37%	1.56%	0.81%	-20.50%

Compiling the excess return with the cumulative excess return as shown in the chart below, it can be seen that China Literature Limited's excess return hovered around 0 for the ten trading days prior to August 13, indicating that the market's expectations for the company are very stable. On the first day after the event day, August 14, the excess return declined significantly, from 0.34% to -16.43%, a drop of nearly 17 percentage points, and the excess return was near -5% for the next two days, and the CAR line has been below -20% for almost all of the ten consecutive trading days since then.

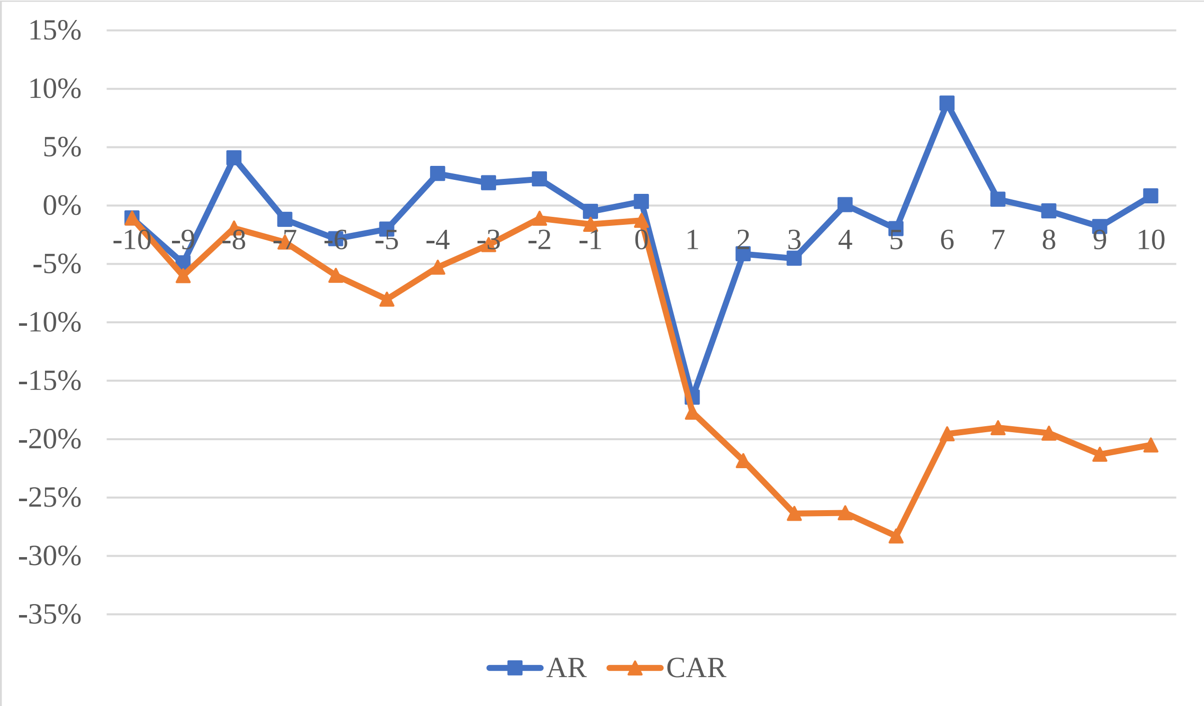

Fig. 1 Excess Returns and Cumulative Excess Returns of Event Window

Meanwhile, before August 13, 2018, China Literature Limited's share price had been stable between HK$60-70, and even though the market yield of the Hang Seng Index had a significant lowering trend from August 11-13, China Literature Limited's share price was unaffected by it and stabilized. However, after the announcement of the acquisition of New Classics Media, China Literature Limited's share price fell from HK$67 to HK$55.6, a 17% year-on-year decline.

Through the analysis of the above events, it can be seen from the changes in share price, excess return and cumulative excess return that this merger and acquisition has brought negative impact on China Literature Limited's market performance, investors do not think this merger and acquisition is beneficial to the development of China Literature Limited, and the market is not optimistic about the merger and acquisition event.

3.2. Analysis of China Literature Limited's Financial Indicators

This paper mainly uses the financial indicator method to analyze the long-term financial performance of China Literature Limited's mergers and acquisitions. The M&A activities took place in 2018, so this paper chooses the financial data of China Literature Limited from the first two years to the last three years of the M&A, i.e., from 2016 to 2021, as the basis to start the analysis.

In order to realize the horizontal comparison of China Literature Limited's M&A performance, this paper chooses Ireader Technology, the second largest listed company in China with online reading as its main business, as the comparative object.

3.2.1 Analysis of Profitability

The profitability of China Literature Limited from 2016-2021 is shown in Table 4.

Table 4. China Literature Limited Profitability Financial Indicators, 2016-2021

	Return on net assets (%)	Net margin on total assets (%)	Gross Profit Margin on Sales (%)	Net sales margin (%)
2016.6	-	-	40.83	-0.24
2016.12	0.77	0.54	41.26	1.19
2017.6	7.53	5.46	50.00	11.09
2017.12	6.25	4.99	50.68	13.74
2018.6	7.81	6.58	52.41	22.09
2018.12	5.87	4.24	50.77	18.11
2019.6	4.22	2.91	54.57	13.24
2019.12	5.80	4.05	44.23	13.32
2020.6	-36.79	-27.63	53.10	-101.54
2020.12	-26.00	-18.85	49.66	-52.78
2021.6	13.76	9.86	52.69	24.89
2021.12	11.44	8.28	53.06	21.26

Table 5. Ireader Technology Profitability Financial Indicators, 2016-2021

	Return on net assets (%)	Net margin on total assets (%)	Gross Profit Margin on Sales (%)	Net sales margin (%)
2016.6	3.09	-	4.22	34.99
2016.12	11.16	8.73	6.45	32.95
2017.6	9.01	6.53	8.62	30.75
2017.12	14.98	10.65	7.43	29.76
2018.6	7.64	5.43	8.32	29.26
2018.12	13.25	9.25	7.15	29.46
2019.6	5.81	3.39	6.14	34.63
2019.12	13.74	8.38	7.80	37.58
2020.6	8.60	5.62	11.11	45.24
2020.12	19.77	12.05	12.27	45.94
2021.6	6.10	4.77	12.38	47.82
2021.12	6.45	5.31	7.36	52.50

Through the analysis of China Literature Limited's profitability from the first two years to the last three years of the M&A, it can be found that China Literature Limited has acquired the downstream company of the IP industry chain, intending to further explore the value of IP through film and television production. However, the integration of the enterprise after the acquisition is of poor performance, the return on net assets and total return on assets have slightly declined during the two years after the acquisition, the acquisition did not effectively improve the profitability of the enterprise. Although in 2021 China Literature Limited and New Classics Media both turned a profit in terms of net profit but compared with the parent company of China Literature Limited's net profit of 1.84-billion-yuan, New Classics Media only realized a net profit of 530 million yuan, the merger and acquisition did not play the original expected effect. In contrast, Ireader Technology, which did not carry out IP industry chain mergers and acquisitions, has realized stable growth in profitability because it focuses on the main business of online reading. This analysis shows that enterprises in the IP industry chain may have certain difficulties in integration after mergers and acquisitions, and it is difficult to realize the synergistic effect of mergers and acquisitions.

3.2.2 Analysis of Operating Capacity

The operating capacity of China Literature Limited from 2016-2021 is shown in Table 6.

Table 6. China Literature Limited’s Financial Indicators of Operating Capacity, 2016-2021

	Total assets turnover	Current assets turnover	Inventory turnover
2016.6			
2016.12	0.38	1.47	10.51
2017.6	0.25	0.80	6.33
2017.12	0.37	0.71	11.21
2018.6	0.15	0.23	3.87
2018.12	0.23	0.42	14.09
2019.6	0.11	0.22	2.69
2019.12	0.31	0.63	12.66
2020.6	0.14	0.27	2.64
2020.12	0.36	0.72	7.29
2021.6	0.20	0.36	3.56
2021.12	0.39	0.72	6.64

Table 7. Ireader Technology's Financial Indicators of Operational Capacity, 2016-2021

	Total assets turnover	Current assets turnover	Inventory turnover
2016.6	0.61	0.64	
2016.12	1.35	1.44	170.26
2017.6	0.76	0.82	84.66
2017.12	1.43	1.55	90.83
2018.6	0.65	0.73	23.97
2018.12	1.29	1.45	39.22
2019.6	0.55	0.66	
2019.12	1.07	1.29	
2020.6	0.51	0.64	
2020.12	0.98	1.26	1,745.61
2021.6	0.39	0.48	722.96
2021.12	0.72	0.93	1,383.93

Compared with China Literature Limited's expansion in the IP industry chain, Ireader Technology is also expanding with the advantage of IP copyrights, but the difference is that Ireader Technology does not seek its dominant position in the IP industry chain, but taps into its own IP advantages through cooperation, for example, cooperating with ByteDance to jointly realize the development of IP resources, and launching the copyright authorization business for the website of bilibili, etc. These new business expansions are also based on core resources, in 2020 Ireader Technology was not obviously negatively affected by the COVID-19, but instead realized both growth in revenue and profit.

China Literature Limited and Ireader Technology have both promoted the expansion of IP copyright in the industry chain. China Literature Limited, which uses M&A to expand the industry chain, has a more diversified business and a more complex organizational structure after M&A, and the difficulty of the enterprise's operation and management has also risen significantly, and the rise in the number of days of turnover of the enterprise's total assets and the number of days of turnover of accounts receivable is extremely obvious after the M&A. Ireader Technology, which adopts the cooperation mode to promote the expansion of the IP industry chain, has seen a relatively slow rise in the number of turnover days.

3.2.3 Analysis of Liquidity

The liquidity of China Literature Limited from 2016-2021 is shown in Table 8.

Table 8. China Literature Limited's Financial Indicators of Liquidity, 2016-2021

	Gearing(%)	Current ratio
2016.6		
2016.12	26.97	1.28
2017.6	26.94	1.74
2017.12	16.35	5.35
2018.6	14.97	4.92
2018.12	33.84	2.16
2019.6	28.37	1.96
2019.12	26.05	2.06
2020.6	23.43	2.92
2020.12	29.17	2.73
2021.6	27.54	2.76
2021.12	26.23	2.82

Table 9. Ireader Technology's Financial Indicators of Liquidity, 2016-2021

	Gearing(%)	Current ratio
2016.6		
2016.12	24.97	3.78
2017.6	28.51	3.28
2017.12	26.91	3.45
2018.6	30.37	2.85
2018.12	29.78	2.89
2019.6	31.37	2.58
2019.12	34.37	2.35
2020.6	33.78	2.28
2020.12	36.62	2.12
2021.6	25.17	3.41
2021.12	26.04	3.35

As an emerging industry in China, the IP industry is highly recognized by the capital market, and enterprises can obtain sufficient funds for mergers and acquisitions through equity financing methods such as private placement, which also makes enterprises in the IP industry chain maintain a better level of debt. Comparing the China Literature Limited and Ireader Technology, it can be concluded that the mergers and acquisitions of enterprises in the IP industry chain will not have a great impact on the solvency of the company.

3.2.4 Analysis of Growth Capacity

The Growth Capacity of China Literature Limited from 2016-2021 is shown in Table 10.

Table 10. China Literature Limited's Financial Indicators of Growth Capacity, 2016-2021

	Growth of operating income (%)	Net Profit Growth (%)	Growth of shareholders' equity (%)
2016.6			
2016.12	59.14	110.55	16.83
2017.6	92.50	200,118.87	
2017.12	60.16	1,416.04	143.13
2018.6	18.64	138.57	116.43
2018.12	23.03	63.75	45.43
2019.6	30.14	-22.36	41.51
2019.12	65.69	20.35	5.41
2020.6	9.74	-939.24	-12.55
2020.12	2.13	-509.13	-22.22
2021.6	33.19	132.85	-0.31
2021.12	1.67	141.18	13.83

Table 11. Ireader Technology's Financial Indicators of Growth Capacity, 2016-2021

	Growth of operating income (%)	Net Profit Growth (%)	Growth of shareholders' equity (%)
2016.6			
2016.12	87.23	161.14	11.79
2017.6	63.08	231.56	9.33
2017.12	39.19	60.22	35.20
2018.6	18.20	15.33	6.65
2018.12	14.17	12.62	12.71
2019.6	-4.00	-18.51	1.92
2019.12	-1.09	15.57	11.46
2020.6	8.96	72.82	3.95
2020.12	9.47	64.07	15.96
2021.6	11.64	21.10	75.90
2021.12	0.49	-42.99	76.31

China Literature Limited increased operating income through mergers and acquisitions in IP industry chain, however, the quality of this revenue growth is relatively low, and did not lead to an increase in shareholders' equity. Because of unfavorable corporate integration, external environmental factors, etc., the corporate profits are highly volatile, and the enterprise's operation are unstable. Ireader Technology, which does not carry out mergers and acquisitions within the IP industry chain, but rather through win-win cooperation, has shown good growth, with relatively stable growth in operating income, net profit and shareholders' equity, and has not experienced a significant decline in five years, and has a better resistance to external adverse factors. The use of financial indicators to analyze the case of China Literature Limited mergers and acquisitions of New Classics Media found that China Literature Limited's financial position after the merger is relatively poor. Indicators of profitability, operating capacity and growth capacity have fluctuated considerably after the merger and acquisition, and all of them have declined significantly. The expected economies of scale and synergies through M&A integration did not materialize, and the financial performance was instead significantly weaker than Ireader Technology, which did not experience M&A activity.

3.3. Evaluation of China Literature Limited's Non-Financial Performance Indicators

3.3.1 Market share analysis

The following table reflects the market share of the leading enterprises in the domestic online reading market, China Literature Limited was the leading enterprise in the online reading market in 2017, accounting for 48.4% of the total market, and it can be considered that China Literature Limited had an absolute advantage in the market at that time.

Table 12. Online Reading Market Competition 2017-2019

2017		2018		2019	
Companies	Market Share	Companies	Market Share	Companies	Market Share
China Literature Limited	48.4%	Ireader Technology	30.1%	China Literature Limited	25.2%
Ireader Technology	25.0%	China Literature Limited	28.5%	Ireader Technology	20.6%
Alibaba ShuQi	2.3%	Alibaba ShuQi	15.9%	Alibaba ShuQi	20.5%
COL Group Co.,Ltd	2.0%	Migu Digital Media	10.8%	Midu Reader	9.6%

The online reading market is still in the stage of rapid development, other enterprises still have more space for development. 2018 when Ireader Technology launched the free reading platform, the market share reached 30.1%, becoming the leading enterprise in the online reading market, and China Literature Limited's market share plummeted to 28.5%, which made Ireader Technology the biggest competitor of China Literature Limited.

Based on the consideration of improving market share, in 2018, China Literature Limited implemented the acquisition of New Classics Media, which adapted the IP of China Literature Limited, " Joy of Life " and " Battle Through the Heavens" into TV dramas, which strongly enhanced the market influence of China Literature Limited's IP, and at the same time drove the development of the main business of online reading. In 2019, China Literature Limited's market share was 25.2%, which returned to the No. 1 position in the market. The emergence of this phenomenon is not difficult to understand, itself China Literature Limited has a large number of literary works to support, and after the merger and acquisition of New Classics Media, the IP industry linkage development, the market share is an inevitable result. However, the gap between China Literature Limited and other competitors is also decreasing.

3.3.2 Analysis of User Activity

User activity mainly describes the number of users who log in to the client with high frequency, and this indicator can reflect the attractiveness of the enterprise's online reading business to users and is used to measure the vitality and development ability of online reading. Table 8.14 shows the user data of China Literature Limited from 2017 to 2022.

Table 13. Users of the China Literature Limited, 2017-2022

	2017	2018	2019	2020	2021	2022
Monthly Active User (million)	191.5	213.5	219.7	228.9	248.6	243.9
Monthly Paying User (million)	11.1	10.8	9.8	10.2	8.7	7.9
Average Monthly Payment Per User (CNY)	20.5	24.1	25.3	34.7	39.7	37.8

The number of monthly active users of China Literature Limited from 2017 to 2021 is growing slowly, and in 2022, the monthly active users have declined, and the online reading market size has increased by 113.4% from 2017 to 2022, while the growth rate of the number of monthly active users of China Literature Limited is only 27.36%, which reflects that the growth of the monthly active users of China Literature Limited has fallen into a bottleneck.

According to the analysis of the motives for the merger and acquisition of China Literature Limited in the previous article, the initial intention of China Literature Limited 's merger and acquisition of New Classics Media is to use China Literature Limited 's famous IP for film and television adaptation, which to a certain extent enhances China Literature Limited 's market power, and theoretically expands the market influence of China Literature Limited 's IP, thus attracting more monthly active user numbers. However, in practice, only the number of monthly active users grew faster during the period from 2017 to 2018 and from 2020 to 2021, indicating that the growth of market power after mergers and acquisitions of IP industry chain enterprises is relatively weak.

4. Merger and acquisition risks

4.1. Goodwill impairment risk

At of the end of 2018, China Literature Limited had accrued goodwill of CNY 6.933 billion in relation to this M&A of New Classics Media. The impairment risk may come from two aspects, namely, the overvaluation of the underlying assets and the failure to fulfill the performance commitments.

First, the valuation of the underlying assets is too high. In this case, China Literature Limited 's valuation of 100% of New Classics Media is not more than 15.5 billion yuan, a significant premium.

New Classics Media 's net profit after tax in 2016 and 2017 was 161 million yuan and 377 million yuan respectively, and as of December 31, 2017, the total value and net value of New Classics Media 's assets were 4.118 billion yuan and 1.299 billion yuan respectively. Valued in accordance with the merger and acquisition cost method, the merger and acquisition premium were 11 times compared with the net assets of New Classics Media at the end of 2017.

The valuation of New Classics Media was assessed using the market method, vertically comparing the valuation of New Classics Media in other equity transaction events in the same year, and horizontally comparing the market value of A-share listed companies of similar size in the same industry during the same period. In mid-March 2018, Tencent purchased all 27.642% of the equity interests in New Classics Media held by Tencent from Light Media, with the transaction price of 3.3 billion yuan, according to the calculation of this price, the market valuation of New Classics Media was measured at 11.9 billion yuan. Five months later, read the valuation of the new Li but 15.5 billion yuan, the valuation rose about 30.25%. 15.5 billion yuan of high valuation has reached or even exceeded many A-share listed TV drama production company.

Secondly, the performance commitment is not up to standard.

New Classics Media completed the merger and acquisition was on October 31, 2018, in the share purchase agreement, New Classics Media made a performance commitment for the next three years, 2018 commitment to net profit of 500-million-yuan, 2019 commitment to net profit of 700-million-yuan, 2020 commitment to net profit of 900 million yuan, a total commitment of 2.1 billion yuan. However, from a macroeconomic point of view, in 2018, the film and television industry is generally in a downturn, most of the film and television companies operating results are dismal, the development of the company's development is even more difficult for the main income of the movie box office, these performance commitments may not be able to be completed.

As expected, due to the betting agreement: In the betting period 2018, 2019 and 2020 three years, the profit of New Classics Media shall not be less than 500 million, 700 million and 900 million, but its performance within the first two years have not met the expectations. The potential economic benefits available to the acquiring unit declined and failed to meet the expected results of the acquiring unit, resulting in the impairment of goodwill. In 2020, New Classics Media recorded a $4 billion goodwill impairment resulting in a loss of 4.5 billion yuan for China Literature Limited.

4.2. IP industry chain synergy effect risk

After the acquisition of New Classics Media, China Literature Limited intended to imitate the successful business model of Disney's adaptation of Marvel's works and put forward a plan to carry out IP film and television adaptation in bulk.

An examination of New Classics Media’s film and television products over the past five years shows that the company is adept at focusing on realistic themes and is able to draw on scenarios that are close to the real life of the audience to trigger their thinking and identification. Several popular movie and television products all reflect the hot issues of the times. On the other hand, many of the hot IPs under the platform of China Literature Limited are wuxia and metaphysical themes, which are hollowed out in the theme of social life, with varying quality, and most of the audience of online literature on the platform is under 30 years old, so they prefer non-realistic themes, or even non-mainstream core values. Therefore, the intensification of the industry's regulation not only creates difficulties in the creation of IPs of China Literature Limited, but also has a profound impact on the broadcast ratings later. The impact on the broadcast ratings will be profound.

In fact, the integration of China Literature Limited and New Classics Media has been difficult and far from satisfactory, with Cheng Wu, president of China Literature Limited, describing it as "the integration with New Classics Media has failed to generate sufficient synergies".

5. Summary

One of the most important reasons for the failure of M&A of China Literature Limited is that it has too high expectation on the prospect of IP industry, which makes China Literature Limited take a very aggressive way to carry out operation and investment activities, and greatly increases the operation risk and financial risk of the enterprise. There are many ways for enterprises to participate in the IP industry chain, either through mergers and acquisitions to expand the power of enterprises in the industry chain, as in the case of China Literature Limited, to bear the risks and profits of the company's operation alone, or like IReader Technology to strengthen cooperation with upstream and downstream enterprises, to reduce the enterprise's operating risks and profits through the way of "risk-sharing and benefit-sharing". But in reality, the domestic IP industry is still in a state of flux. However, in reality, the domestic IP industry is not as prosperous as the European and American markets or the Japanese market. A large number of fantasy IPs have encountered policy restrictions because their cultural connotations are inconsistent with the mainstream values in China, and domestic film and television production companies generally lack the ability to produce science fiction films, making it difficult to produce IP-adapted movies with the same quality as the Marvel movies, which has led to a decline in the word-of-mouth of IP-adapted movies.

Overall, there is a big gap between the policy environment and economic environment faced by the domestic IP industry and the macro environment of the IP industry in Europe and the United States, and it is unreasonable to judge the prospects of the domestic IP industry with reference to the IP industry situation in Europe and the United States, and enterprises adopting aggressive operation and investment methods within the IP industry chain are likely to encounter the constraints of the bottleneck of the industry's development and fall into difficulties.

After the merger and acquisition of New Classics Media by China Literature Limited, in order to maximize the profitability of both parties, the layout of the profit structure and the allocation of internal resources should be adjusted in a timely manner. In fact, the timing of this merger is better, because due to the impact of the general environment, the previous main business of the China Literature Limited online paid reading model has been impacted, the industry is gradually to the free reading transition, so the focus of the revenue structure will not continue to rely on paid reading, and need to transition to the use of the sale of IP copyrights to obtain income, the merger and acquisition of New Classics Media can promote the realization of the IP. 2021, by the New Classics Media to produce the in 2021, " Doula Continent ", an IP adapted drama by China Literature Limited, was released in theaters, and anime and online game of the same name were launched at the same time, establishing a benign quadrilateral interaction among literature, movies, animation, and online games. This also fully proves that the China Literature Limited and New Classics Media will integrate and configure the content resources to generate a more efficient profit-generating model, which reacts to the whole industry chain to produce more high-quality IP. when other enterprises in the pan-entertainment mode of mergers and acquisitions, must be the re-integration of internal resources as one of the first tasks, in order to maximize the synergistic effect of mergers and acquisitions of the two sides. In addition, the merging and acquiring parties should make scientific and reasonable arrangements for internal resources, including discussing sound and standardized management requirements, rationally arranging the division of labor among personnel, and reasonably planning the proportionate relationship between the main business and other business revenues.

References

[1] Kar Rabi Narayan, Bhasin Niti, Soni Amit. Role of mergers and acquisitions on corporate performance: emerging perspectives from Indian IT sector [J]. Transnational Corporations Review,2021,13(3).

[2] Nara Jeong. Diversity management and post mergers and acquisitions performance [J]. Management Decision,2021,59(10):2369-2384.

[3] Shayani Sengupta. Integration in Mergers and Acquisitions: Bringing Together Type of Diversification, Synergy Potential and Cultural Distance [J]. NHRD Network Journal, 2020, 13(2): 152-159.

[4] Teti Emanuele, Dell'Acqua Alberto, Bonsi Paolo. Detangling the role of environmental, social, and governance factors on M&A performance [J]. Corporate Social Responsibility and Environmental Management,2022,29(5).

[5] Sumit K. Majumdar, Rabih Moussawi, Ulku Yaylacicegi. Merger Waves and Firm Growth: Contemporary Historical Evidence [J]. Annals of Public and Cooperative Economics, 2013, (8):41-45.