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Motivation and Performance of the Spin-off Listing of Shengyi Technology

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Abstract: China Securities Regulatory Commission issued “Several Provisions on the Pilot Project of domestic listing of the spin-off subsidiaries of listed companies” in December, 2019, which was an important milestone for capital market in China. Before this provision was released, domestic listed companies who planned to conduct equity carve-out had to go list on Foreign Exchange. Since Shengyi Technology was the first listed parent company conducting equity carve-out after the announcement, citing the spin-off listing of Shengyi Technology as an example may enrich the research on the equity carve-out in China and provide suggestions for companies with similar plans. This paper adopts case study method, briefly summarizing the results of the current liteture and then analyzing the motivation and financial performance of Shengyi Technology. Then, this study draws a conclusion, finding policy support, coping with copetition, raising money and focusing on core business were the key motivations, and that equity carve-out had a positive impact on the performance of Shengyi Technology in the short term.

Keywords: Spin-off listing, equity carve-out, motivation, performance

1. Introduction

China Securities Regulatory Commission issued “Opinions on the implementation of establishing a Science and Technology Innovation Board in the Shanghai Stock Exchange and the pilot Registration System” on January 30, 2019 and “The general implementation plan for the GEM reform and pilot registration system” on April 27, 2020. Developing China’s capital market, such series of policies enable enterprises to get more access to go to public and investment environment to become better for investors. Under such circumstances, the release of “Several Provisions on the Pilot Project of domestic listing of the spin-off subsidiaries of listed companies” make enterprises pay more attention to the spin-off listing. Since the reform hasn’t been taken for so long, it is still worthing analyzing the impact of the spin-off listing on enterprises. This thesis cites the spin-off listing of Shengyi Technology as an example. Shengyi Technology declared that its subsidiary, Shengyi Electronics, would go to public on February 24, 2021. This is the first case that parent company in the A-share market spins off its subsidiary in the A-share market since the landing of the provisions for equity carve-out. It may be useful for potential parent companies who plans to spins off its subsidiary to analyze the motivation, performance, and existing problems of Shengyi Technology. Based on the summary of the current literature, this paper examines the motivation of Shengyi Technology. Then using the financial data threes years before its spin-off and two years after it, this paper analyzes its performance and existing problems, and recommendations are made at the end.

2. Literature Review

Katherine and Abbie believe equity carve-outs means a part of a wholly-owned subsidiary's ordinary shares is for sale to the public [1]. Anand believes equity carveout means parent company sells part or all of the equity of its wholly-owned subsidiary to the public in order to raise money [2]. Unlike the aforementioned authors, Eric doesn't stress that the subsidiary has to be wholly-owned. He argues that equity carve-out means parent company sells a part of its ownership in a subsidiary via an IPO, showing characteristics of both restructuring and financing transactions [3]. In"Several Provisions on the Pilot Project of domestic listing of the spin-off subsidiaries of listed companies", CSRC defines equity carveout as a part of listed companies' asstes being controlled via an IPO or restructure and go public in domestic stock market [4]. Li argues that equity carveout is a process of parent companies making parts of its assets go public because of corporate strategy and other factors [5]. Vikram points out that is a good sign for investors, showing the value of the existing equity in the parent corporation is underestimated [6]. Robert and Gregg suggest that the increase in focus of the core business is consistent with shareholder wealth maximization [7]. Jeffrey and John believe equity carve-outs only happens when the firm is capital-constrained because managers value control over assets and therefore are reluctant to choose spin-off listing [8]. Biljana finds out that equity carve-outs that did not grant equity incentive underperform both relative to the overall market and relative to the sample of equity carve-outs that granted equity incentive [9]. Xie believes that equity carve-out is beneficial for corporate governance because the management of both parent company and its subsidiary would be encouraged in order to avoid hostile takeover [10]. Through empirical analysis, Otsubo argues that equity carve-out can lower the leverage of the parent company especially when the parent company is highly leveraged, and the trend continues after equity carve-out [11].

3. Company Overview

Shengyi Technology, the parent company, is specialized in manufacturing and selling electronic materials, including copper clad laminate. While Shengyi Electronics, the subsidiary, is specialized in printed circuit board. Printed circuit board, also known as PCB, can be extensively applied in many fields. Because copper clad laminate is the key raw material of PCB, the parent company is the upstream company of the subsidiary. They have different businesses but close trade relations. Shengyi Electronics submitted its application for an initial public offering through Shanghai Stock Exchange on May 27, 2020, and cooperated with the SEC inquiry on June 24. Shanghai Stock Exchange approved the listing on October 16. Then, Shengyi Electronics submitted its registration for IPO on the Science and Technology Innovation Board on December 9 and got approved on January 15, 2021. It successfully went to public on the sci-tech board on February 25, 2021, becoming the first spin-off listed company. The whole process lasted about 9 months. Before the equity carve-out, Shengyi Technology holds a 79% share of Shengyi Electronics, being the majority shareholder. After Shengyi Electronics successfully listed, the parent company holds a 63% share of it, still taking a controlling share and consolidating its financial statements.

4. Motivation and Performance Analysis

4.1. Motivation Analysis

With the landing of the registration-based IPO system on the Science and Technology Innovation Board and the second board, more and more companies choose to go to public on these two boards, because not only does this reform lower the threshold for listing and reduce time to market, but it makes enterprises have higher valuation. Under these circumstances, provisions on equity carve-out attract many companies to spin off their subsidiaries on the two boards, including Shengyi Technology. Therefore, policy support is the precondition for Shengyi Technology to conduct equity carve-out. As mentioned before, PCB can be extensively applied in many fields, including domestic appliance, telecommunication electronics, artificial intelligence etc. One of the characteristics of its downstream industries is that they are changing rapidly. Technological innovation requires PCB to be highly-integrated, multi-functional and ultrathin. Therefore, it is challenging for Shengyi Technology and Shengyi Electronics to keep pace with the development of the society. Although they already have competitive advantages in scale of production and technology after several decades of development, rivals in Japan and America are quite competitive. If Shengyi Technology and Shengyi Electronics cannot get their technology improved, they cannot survive in the market. Thus, spin-off listing is an inevitable choice to raise money for developing technology.

Broadening financing channels is one of the most important motivations for spin-off listing. Because of the limited internal financing and high external financing cost due to asymmetric information, equity carve-out is a better way for Shengyi Technology to raise money without losing the control of Shengyi Electronics. Besides, Shengyi Electronics can raise money later when it is lack of fund after the spin-off listing. The main development orientation of Shengyi Technology is to be a competitive global supplier of copper clad laminate while Shengyi Electronics focuses on research and development, production and sale of PCB. By conducting equity carve-out, they can focus on their own core business, thus increasing their efficiency and enhancing their core competitive strength.

4.2. Performance Analysis

Fig. 1 shows three short-term solvency ratios and one long-term solvency ratio of the parent company. With regard to the column, there was a decreasing trend in three short-term solvency ratios from 2018 to 2020, which means the liquidity of Shengyi Technology was declining before it conducted equity carve-out. Then an opposite trend could be seen from 2020 to 2021. All three ratios increased during this period and kept stable till 2022. This indicates that spinning off the subsidiary improved the liquidity of Shengyi Technology. As for its long-term solvency ratio, the debt ratio fluctuated before the equity carve-out, then declined in the year of 2021 and remained steady at about 40% afterwards, showing that its ability to pay long-term debt got strengthened after the spin-off listing.

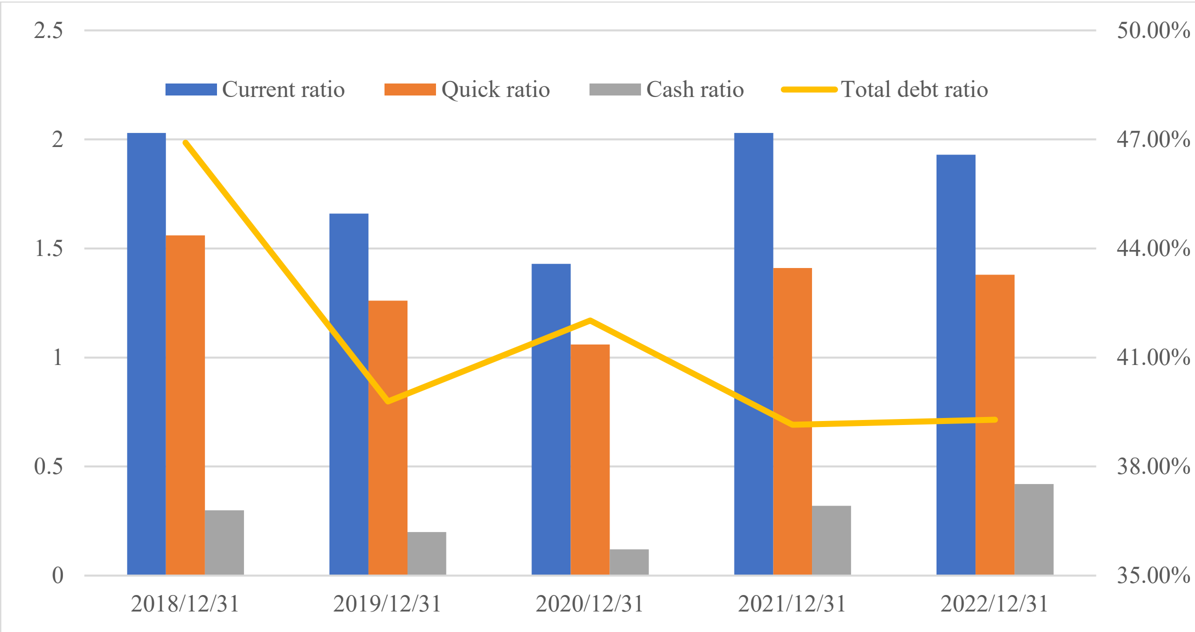

Figure 1: solvency ratios of Shengyi Technology from 2018 to 2022

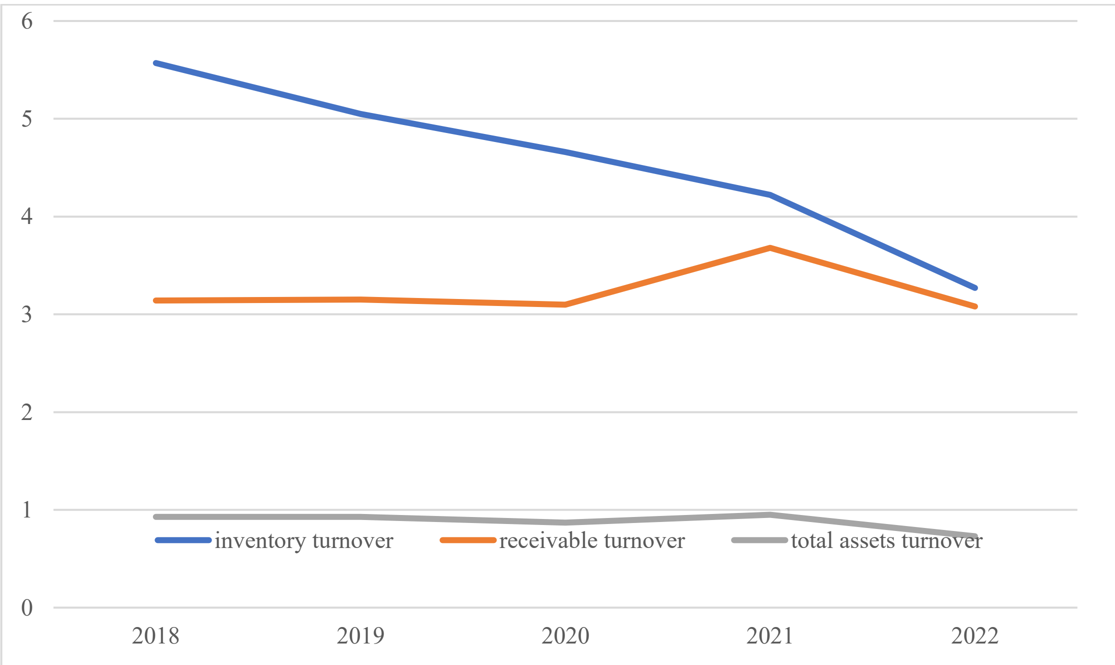

Figure 2: Operation ability indicators of Shengyi Technology from 2018 to 2022

Fig. 2 shows three turnover ratios over the given period. A similar trend could be seen in receivable turnover and total assets turnover, remaining stable at about 3.1 and 0.9 respectively with a slight increase from 2020 to 2021 when Shengyi Electronics went to public. Overall, these two turnover ratios show that the recovery of accounts receivable and the turnover of total assets in Shengyi Technology were stable. Differentiating from receivable turnover and total assets turnover mentioned above, inventory turnover dropped from 5.57 to 3.27. Two main reasons could contribute to this phenomenon. Firstly, Shengyi Technology are seeking to expand in recent years, therefore the inventory keeps growing. Secondly, the prices of the raw materials, such as copper and resin, are increasing over the years, which also makes Shengyi Technology choose stock up.

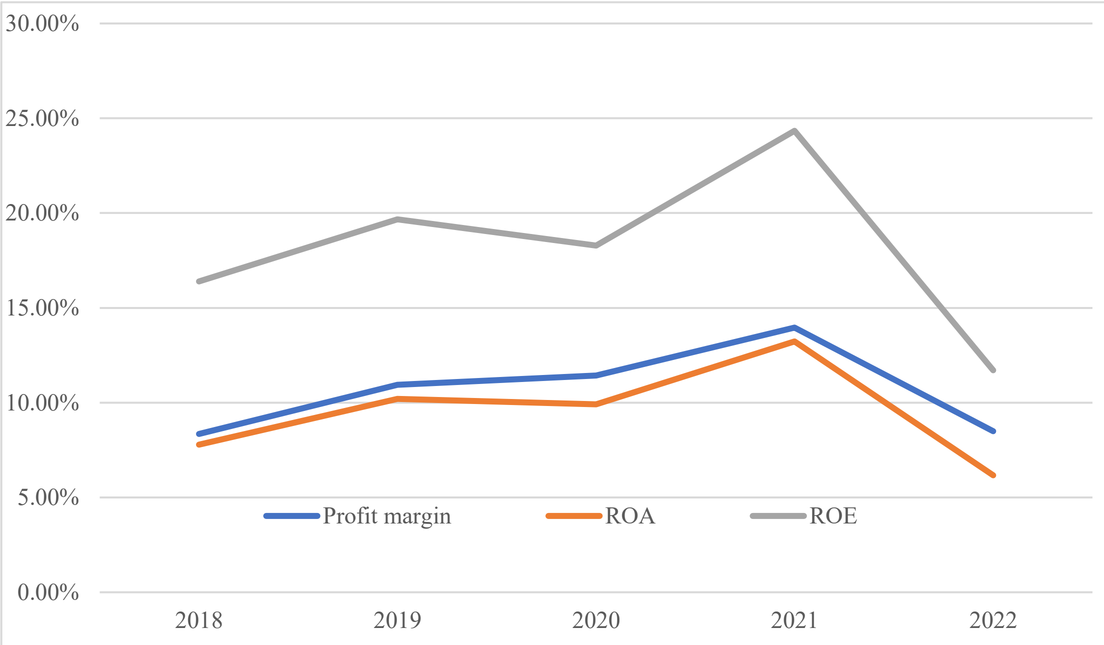

Figure 3: Profitability indicators of Shengyi Technology from 2018 to 2022

Fig. 3 shows three profitability indicators of Shengyi Technology from 2018 to 2022. A similar trend could be seen in them over the given period. Before the subsidiary was listed in 2021, these three indicators were quite stable with slight fluctuations. Then it is noticeable that three indicators all soared in the year of 2021, reaching the highest point at 24.34%, 13.96% and 13.23% respectively, which showed that the equity carve-out had a positive impact on the profitability of Shengyi Technology. However, all three indicators slunged next year. This was due to constant outbreaks of epidemic in China that year. Facing an economy slowdown, Shengyi Technology was affected by declining demand of electronic materials and falling prices of copper clad laminate. Therefore, the gross profit of Shengyi Technology sharply decreased.

5. Conclusion

To sum up, by analysing the motivation and financial performance of Shengyi Technology, this paper finds following conclusions. Policy support is the precondition for Shengyi Technology to spin off its subsidiary. By conducting equity carve-out, both parent company and subsidiary can raise money to expand and develop the technology, focus on their own core business and cope with the challenges from the competitors. Shengyi Technology has produced positive performance right after the equity carve-out. For example, solvency ability and profitability were strengthened in the year of 2021. However, long-term performance is not optimistic due to constant outbreaks of epidemic and economic recession. Although provisions on equity carve-out in China encourage a lot of enterprises to spin off its subsidiary, it is not a suitable way for all listed parent companies. Companies who aim to conduct equity carve-out should check whether this is coherent with its corporate strategy, and the subsidiary it spins off should have high-quality business. After the subsidiary go listed, further attention should be paid to secure sustainable growth of both parent company and subsidiary.

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