

Research on the Motivation and Path of China Concept Shares Returning to China Capital Market: A Case Study of Focus Media

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Abstract. Since 2010, the China concept shares have set off a wave of delisting from overseas capital market through privatization. This paper takes Focus Media, the first Chinese concept share relist on A share market, as an example, and studies the motivation, risk, ways and process of privatization and relist on China capital market for China concept shares, and provides suggestions and reference for the delisting of the China concept share and the improvement of the Chinese capital market.

Introduction

In 1992, Brilliance Auto listed on the New York Stock Exchange, which set up a new way for Chinese companies to raise funds in overseas capital market. In the following 20 years, due to the lag of in Chinese capital market development, strict requirements for listing approval, and long waiting time, a large number of high-quality Chinese enterprises such as Baidu and Alibaba have listed in overseas capital markets. Such companies that the income is mainly in China, but list on the overseas stock market are referred to as China Concept Shares (CCS). After the global financial crisis in 2008, the United States introduced the Sarbanes-Oxley Act to strengthen the supervision of listed companies. In addition, since 2010, CCS in US have experienced a collective short-selling crisis which set off a wave of delisting of the CCS through privatization. Taking 2015 as an example, 29 CCS planned to privatize and delist (see Table 1).

Table 1 List of enterprises planned to delist by privatization in 2015

| Company Name | Proposed Date | Premium | Company Name | Proposed Date | Premium |
|--------------------|---------------|---------|------------------------------|---------------|---------|
| Century Jiayuan | Mar 17 | 15.73% | iDreamSky | Jun 13 | 39.8% |
| Shanda Games | Apr 3 | 46.5% | Qihoo 360 | Jun 17 | 16.58% |
| Jiubang Digital | Apr 13 | 8.89% | Airmedia | Jun 19 | 70.45% |
| Xueda Education | Apr 21 | 5.62% | China Information Technology | Jun 22 | 31.07% |
| China Cord Blood | Apr 27 | 11.36% | Vimicro | Jun 22 | 11.57% |
| WuXi Pharma | Apr 29 | 16.46% | Momo | Jun 23 | 20.46% |
| China Mobile Games | May 18 | 5.50% | KongZhong | Jun 29 | 21.76% |
| Taomee | Jun 1 | 19.73% | Nepstar | Jul 6 | 18.18% |
| Mindray | Jun 4 | 9.21% | YY INC | Jul 09 | 17.40% |
| JA Solar | Jun 5 | 19.93% | Dang | Jul 09 | 19.97% |
| E-House China | Jun 9 | 24.45% | MecoxLane | Jul 21 | 12.30% |
| Renren Inc | Jun 10 | 2.19% | Long | Aug 10 | 26.58% |
| 21vianet | Jun 10 | 15.52% | iKang | Sep 2 | 10.77% |
| Home Inns | Jun 12 | 21.65% | Tina Solar | Dec 12 | 21.5% |
| Bona Films | Jun 12 | 6.53% | | | |

Focus Media Holdings Limited (Focus Media), established in 2003 and headquartered in

Shanghai, is a leading company for out-of-home media advertisement, and its market share in the media advertising market is over 90%. On July 12, 2005, Focus Media successfully listed on NASDAQ, and delisted on May 23, 2013; On November 17, 2015, by back-door Qixi Holdings, Focus Media returned to the China capital market and listed on the Shenzhen Stock Exchange. Focus Media has also become the first company that returned to A-shares after the delisting from NASDAQ, which is of great significance to other CCS. This article takes Focus Media as an example to discuss the motivation and path for CCS to return to Chinese capital markets.

The Motivation of the CCS Returning to the Chinese Capital Market

With the continuous improvement of China's capital market, stricter supervision in oversea capital market, and seriously shorted and undervalued by foreign investors, more and more SCC propose to return to Chinese capital market.

The Greater Attraction of the China Capital Market. Compared with the offshore market, companies listed on domestic exchanges can obtain higher premium through lower communication costs. At the beginning of 2015, the Chinese regulatory authorities accelerated the reform of the New Third Board and the Growth Enterprise Market. The participation of investment institutions has also played an important role in promoting the privatization of CCS. In July 2012, the largest policy bank in China, the China Development Bank confirmed that it would provide nearly \$1 billion to help CCS to delist, and that their interest rates are much lower than normal commercial loans. The tendency of these policies is obviously to promote the return of CCS to China capital market. Many companies have begun to privatize to return to A-shares. Institutions and investors are familiar with Focus Media's business model and also recognize its industry status. Focus Media has a better growth environment in China's securities market.

Low Valuation in Oversea Capital Market. On the one hand, the value of CCS is seriously underestimated, and even the market value was significantly lower than the company's cash reserves. As of December 31, 2015, not only the price of newly listed CCS was below the issue price, Baidu also fell by 13.87%, Alibaba fell by 21.16%, and even more striking is that the Star Source Fuel fell by 98%, ZOOM fell 99%. On the other hand, the trading volume of CCS is generally lower, and the turnover rate was less than one-fifth of that of A-share market. As can be seen from Figure 1 the Focus Media's monthly K-line chart, the issue price of Focus Media's was \$17. In financial crisis of 2008, and the price went all the way down. In 2009, there was a slight rebound, but from 2010 to the delisting in 2013, the price has remained between \$12 and \$38. Although in 2012, Focus Media's net profit reached \$238.1 million, the stock price did not increased significantly.



Fig. 1 The Focus Media's monthly K-line chart

Rigorous Supervision and High Listing Cost. After the Enron incident, the United States enacted the Sarbanes-Oxley Act, which is the most stringent bill for corporate governance and corporate finance. In order to maintain listing eligibility, CCS must undergo strict supervision, pay high audit fees, consulting fees, and various legal fees, etc.

Short Selling by Overseas Investment Institutions. Foreign short-sellers used the misunderstanding caused by unfamiliar with US legal environment, initiated a series of litigation activities to short CCS. Meanwhile, because the CCS generally adopt the VIE structure, SEC can only get the financial information of the listed entities, and can not get the financial information of Chinese domestic entities, which will give short-sellers opportunities. In addition, some companies are undervalued because of the fact that local investors do not understand business models of CCS or the Chinese market. Since November 2011, Muddy Waters had launched several attacks on Focus Media, and believed that Focus Media has problems in terms of screen quantity, impairment provision, M&A, related party transactions, etc. As can be seen from Figure 1, the issuance of these questioning reports has had a huge impact on the stock price, and the price got to the lowest point, which seriously affected the investment enthusiasm of minority shareholders.

The Risk in the Return of CCS

Based on the above motivations, many CCS began to seek to delist from the overseas capital market and re-listed in A share market. However, there are also many risks in the process.

Risk of Privatization in Overseas Capital Markets. High cost of privatization. The most common way to privatize is tender offer, which generally has a high acquisition premium. It can be seen from Table 1 that among the planned privatization enterprises in 2015, most premium is more than 10%, and AirMedia has even reached 70%. Moreover, SEC requires that the repurchase of tradable shares must be paid in cash. Take Focus Media as an example, in the final tender offer agreement, the premium was 17.62%, and approximately \$3.5 billion was paid. In the privatization process, Focus Media also paid the financial consult fee, legal consult fee, as well as the transaction expenses, etc.

Litigation risk. In the United States, almost all privatization of listed companies is accompanied by litigation. If the repurchase price that the company is willing to pay is much lower than the expectations of minority shareholders, the major shareholders of the privatized company will be investigated by relevant institutions, and the company will also fall into legal disputes. In the process of privatization, the company's stocks still maintain normal transactions. The company also accepts the US District Court and the SEC's review of privatization. If it finds violations, privatization will be terminated.

Uncertainty of re-listing in A Share Market. Difficulty in restructuring of the equity structure. In order to list in oversea markets, CCS generally built a VIE structure. However, CSRC still does not allow foreign companies to list on A share market. Therefore, it is necessary to demolish the VIE structure and introduce domestic shareholders to replace the overseas shareholders. Whether the equity structure of the proposed listing entity is clear, whether the actual controller has changed, whether the performance of the proposed listed entity can be continuously calculated, will generate a series of legal, financial and tax risks.

Uncertainty in listing approval in A Share market. Recently, some CCS disrupted the market order through various concept speculations. At the beginning of 2016, the shares such as Momo and Qihoo 360 delisted from the US stock market, the CSRC worried about the valuation of CCS, and strictly regulated the "backdoor listing" process in order to protect the interests of the minority shareholders. In addition, In 2015, there were 670 companies waiting for approval to list in the A-share market. Take Focus Media as an example, returning to A shares by backdoor listing, took 830 days.

The Return Path of CCS

The process of delist of Focus Media. As can be seen from Figure 1, in November of 2011, there was a long lower shadow line on the monthly K-line, and the trading volume was also extremely huge, because in the month, Muddy Waters launched a short-selling attack on Focus Media. On November 22, 2011, Muddy Waters released a report saying that Focus Media falsely reported the number of advertisement screens and fraudulent activities in the acquisition activities, which led to 39.49% decline of the share price. In the following months, Muddy Waters stepped hard and repeatedly issued a report questioning the quality of the information disclosed by Focus Media, which became the fuse of delisting. On August 13, 2012, less than a year after the short-selling attack by Muddy Waters, Focus Media issued a notice saying that it received a privatization offer and officially began the privatization.

Focus Media's privatization way was tender offer plus simple merger. On August 13, 2012, the Board of Focus Media announced that it had received a privatization offer from the acquisition team. The acquisition team consisted by the Chairman of Jiang Nanchun, and five investment institutions: Fountain Vest Partners, The Carlyle Group, CITIC Capital Partners, CDH Investments, China Everbright Limited. In the offer, the preliminary price was \$27 per CDS, approximately \$5.4 per common share, that was 10% premium to the average of the previous 30 trading days closing price. Subsequently, the BOD established a special committee to hire independent financial advisers and legal advisers to guide the tender offer. On December 19, 2012, Focus Media announced that the final repurchase price increased to \$27.5 US per CDS, about \$5.5 per common share, and agreed the simple merger model:

In the first step, Giovanni Group Holdings Limited, Giovanna Parent Limited and Giovanna Acquisition Limited were established in sequence in the Cayman Islands by the same proportion of Carlyle, Fountain Vest and CITIC(see Figure 2). The Giovanna parent limited was mainly used to issue equity, and the Giovanna Acquisition was mainly used for debt financing and obtaining loans from banks.

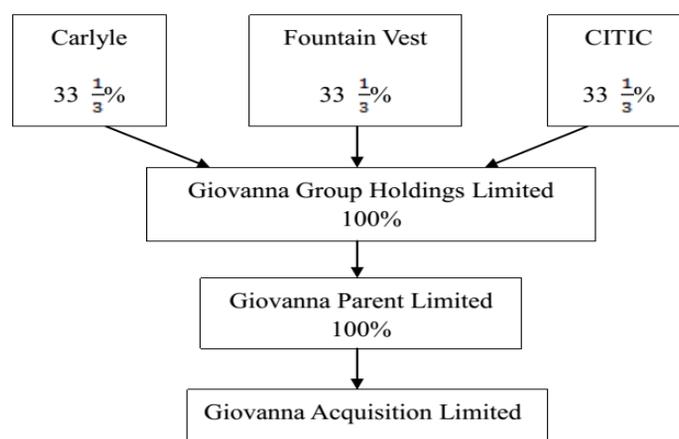


Fig. 2 The equity structure of acquisition entity before privatization^①

In the second step, Focus Media's original largest shareholder Jiang Nanchun, and the second largest shareholder Fosun International, replaced the shares of Giovanni Group with a certain number of Focus Media shares. Other investors may replace the shares of Giovanni Group with the Focus Media shares or the amount of investment. At the same time, the Giovanna subsidiary merged with Focus Media, and the debt generated by the Giovanna subsidiary in the merger was continued to be repaid by Focus Media, and the Giovanna subsidiary entity no longer existed. The new shareholding ratio of the Giovanni Group is shown below (see Figure 3).

^① CDH Investments withdrew from the acquisition team because the repurchase price did not reach an agreement.

The financing of privatization included two parts, one was equity financing; the other was debt financing. Four institutions, such as Carlyle and Fountain Vest, provided about \$1.18 billion in equity financing; Bank of America, CDB and other five banks provided \$1.525 billion in loans, totaling about \$2.7 billion. On May 24, 2013, after 283 days, Focus Media was privatized through a tender offer and a simple merger, officially delisted from NASDAQ.

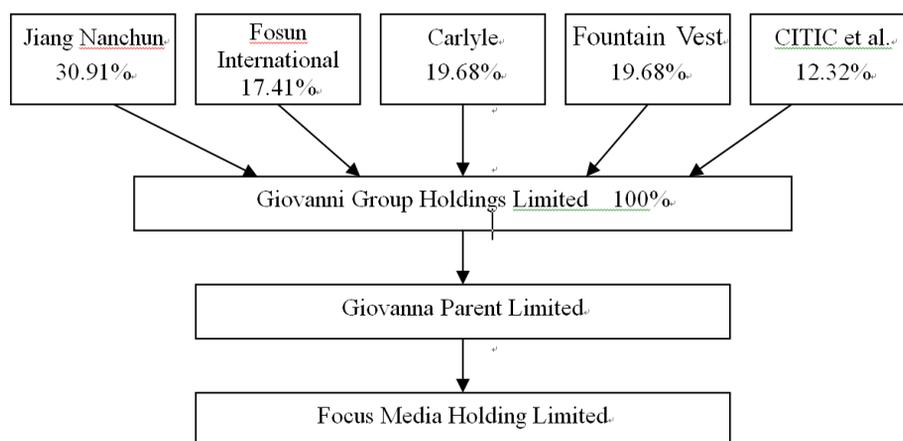


Fig. 3 The equity structure of acquisition entity after privatization

Focus Media's Backdoor Listing. Although as a leader in the out-of-home media advertising industry, its return path to A-shares is not smooth. Focus Media initially planned to return to the A-share market by means of a backdoor listing. The backdoor listing can be launched in the shortest possible time with a greater chance of success. The first shell Focus Media chose was Hongda-chemical (002211). On May 20, 2015, the Hongda-chemical announced that it intended to purchase 100% share of Media Technology (Shanghai) Co., Ltd. through asset swap, shares issue and cash payment. In the following month, Hongda-chemical issued dozens of announcements to disclose the progress of this major restructuring event in details, including changes in equity, company structure, etc. For Focus Media, the backdoor listing is close at hand, just waiting for the approval of the CSRC. However, what everyone did not expect was that on June 18, 2015, Hongda-chemical and the actual controller Zhu Dehong were investigated by the CSRC and there was a risk of delisting. Although Hongda-chemical was not ordered to be delisted after a series of urgent treatments, the backdoor listing was forced to stop.

Subsequently, Focus Media launched a new round of backdoor listing activities with the HEDY Holdings (002027). On September 1, 2015, HEDY Holdings issued 29 announcements, including reverse merger drafts, financial advisory opinions, and law firm submissions. In the reverse takeover draft, the parties in the transaction agreed to set aside the property price of 8 000 million CNY and the proposed asset price was ¥457 million CNY. The difference was purchased by HEDY Holdings from all shareholders of Focus Media in the form of issuing shares and paying cash. In the following two months, after a series of statutory procedures, on November 11, 2015, the HEDY Holdings received the consent form Ministry of Commerce, on November 17, 2015, received the approval of the CSRC. At this point, Focus Media returned to A share market successfully.

Conclusions and Recommendations

Suggestions for the Companies. Going to the US for listing with deliberation. Compared with the auditing system of the Chinese securities market, the US registration system can make the listing of enterprises faster, reducing the long waiting time and cumbersome procedures. However, we can see that the status of CCS is not ideal. In a strict regulatory environment, the minority shareholders can go to the SEC to question the information disclosed by the CCS. The CCS had to pay a large

amount of money each year to maintain its relationship with investors. In the case of a significantly undervalued market, most of the CCS did not achieve good financing results.

Delisting with twice thinking. As a profit-oriented company, we must consider the costs and benefits of delisting. Although Focus Media's current market value has reached about 150 billion CNY, we have to see the hard work of Focus Media on this road. In this wave of privatization, other CCS should think twice before, absorb the experience and lessons of Focus Media, weigh the pros and cons, and make their own choices.

Suggestions to the Improve China's Securities Market. Launch the corresponding board. In this wave of privatization, the return of these companies to the A-share securities market is already a trend. Correspondingly, for China's securities market, the corresponding policies and systems should also be adjusted accordingly. The corresponding sectors, such as the international board, strategic emerging board, will be introduced to guide the return of high-quality CCS, making the Chinese securities market more market-oriented.

Improve the capital market system. As far as delisting is concerned, a over-the-counter market should be established and corresponding laws and regulations should be introduced to regulate. After the listed company is delisted, there is a well-run trading platform that can transfer shares, which can protect minority shareholders as well as the equity of delisting companies. Therefore, it is especially necessary to establish a multi-level capital market system with clear hierarchy and smooth trading function.

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