

STUDY OF THE TRANSACTION STRUCTURE DESIGN OF BACKDOOR LISTING, TAKING COMPANY A AS AN EXAMPLE OF BACKDOORING COMPANY B

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With China's market economy developing more and more, companies with increasing demand will enter the securities market to seek financial assistance. Due to the cumbersome and time-consuming IPO process, many companies are in a critical period of development. In order not to miss development opportunities, some companies will choose to acquire listed companies and complete their listing through backdoor financing.

This article takes company A's successful shell listing of company B as the starting point to explore how home furnishing enterprises can raise funds through shell listing. Company A's backdoor listing is representative and advanced in the home furnishings industry. Company A overcame the equity dispute and landed in the A-share market with the approval of the CSRC within one year, indicating that company A has a bright spot in the transaction structure design.

“Transaction structure design” is when the two parties' main companies combine and change their financial, asset, and human resource resources in order to come up with a better and more acceptable solution for a market transaction. This can help both parties finish the delivery quickly during the transaction process.

Keywords: backdoor listing; home furnishing enterprises; transaction structure design

Introduction

With the continuous deepening of reform and opening up, the income of the Chinese people began to rise year by year. In 1978, China's per capita GDP was 156 US dollars. From 1978 to 2000, China's per capita GDP growth rate was not very fast—only 959 US dollars. But in the millennium After China joined the WTO later this year, the economy began to accelerate.

In 2010, China's per capita GDP rose to US\$5,618, and in 2023 it reached US\$12,000. The economy's rapid development means that consumers' consumption habits have begun to



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shift toward high-end. Consumers' requirements for home furnishings are no longer simple styles. More and more styles appear on the market for consumers to choose from, which has led to the rise of home furnishings. Manufacturers need to add new production lines and showrooms for consumers to choose from.

As the home furnishing market continues to grow, production requirements have also increased. From the previous single wood style to more novel types such as leather or fabric, manufacturers are required to add corresponding production lines to meet production needs. At the sales terminal, it is also necessary to add more stores to display samples for consumers to choose from. This motivates manufacturers to invest more money in stores.

However, manufacturers have limited funds and cannot complete the two-line layout on their own. With the simultaneous advancement of the industry, manufacturers urgently need the support of external capital flows to complete their industrial layout, so companies with strength and ambition will choose to go public to seek funds. An IPO is the normal listing process.

The review process for an IPO is relatively complicated. It takes a long time to submit information to a listing, and the entry threshold for enterprises is also high. It is not suitable for businesses that urgently require listing and financing opportunities. It was not a good choice. Choosing a backdoor listing is a faster method. Backdoor listing is preferred by rapidly emerging companies because it allows them to gain market access quickly.

Backdoor listing encompasses not only the equity distribution and asset reorganization of two companies, but also the transaction plan and transaction process, which are very complicated. There are hidden risks that are not easy to discover, which will lead to the transaction's failure. Backdoor listing is even more restricted by the China Securities Regulatory Commission.

Under strict scrutiny, Company A successfully got rid of the equity dispute and made rapid progress in promoting the acquisition of Company B. On October 17, 2019, Company A successfully acquired A-shares through the acquisition of Company B, resulting in a backdoor listing of a home furnishing company and a move into the securities market. a model of transformation.

This article selects Company A as the backdoor company of Company B as the research object, analyzes the transaction structure design of Company A's acquisition of Company B, finds the advantages of this transaction design, summarizes the successful experience, and provides some novel references for subsequent listings of home furnishing companies in selecting transaction structures.

Objectives

As China's market economy develops more fully, companies with increasing needs will enter the securities market to seek financial assistance. Since the IPO process is quite cumbersome and time-consuming, many companies are in a critical period of development. In order to not miss development opportunities, some companies will choose to acquire listed companies and complete listings through backdoor transactions.

Six major links typically divide the backdoor listing process: selecting the acquisition target, screening shell resources, conducting detailed research on the shell's background, designing the transaction structure, negotiating with all parties, and delivering property rights.

The transaction structure is one of the six major links. The design plan is a critical step in the complete backdoor listing. Companies across various industries will select distinct transaction structures due to the impact these structures will have on their primary business post-merger.

Therefore, they cannot utilize a universal transaction structure and must tailor their structure to the specific circumstances at hand. Refer to The best solution is to design based on excellent examples from other companies in the same industry and combine them with your own situation.

Company A, a leading company in the home furnishing industry that went public via backdoor listing, successfully went public after overcoming various difficulties. There are many bright points worth discussing and referencing in the asset reorganization plan's design.

This article examines the transaction structure of Company A's backdoor listing, specifically focusing on the successful acquisition of Company B's backdoor listing by Company A. This article combines existing theories on transaction structure to analyze the motivations of both parties, the principles for selecting target shells, and the choice of transaction methods. It also aims to identify innovation points in this transaction structure, assist other companies in finding new perspectives when facing similar problems, and provide guidance to managers of home furnishing companies. Think differently.

Literature review

Related research on the IPO

By studying the impact of corporate dividend signals on the capital market under the approval system and the registration system, Li (2022) found that most listed companies under the approval system are larger companies with complete internal systems, guaranteed operating conditions, and an approval system. The release of dividend information under the registration system will elicit a positive response from the market.

However, under the registration system, market participants themselves must evaluate the effectiveness of corporate information. Under the premise that the market cannot be completely sure that the information is true or false, the signals released may not necessarily be able to affect stock value.

After studying specific cases, we believe that the approval system is more conducive to companies with sound systems and larger sizes of financing in the capital market because passing the strict review of the approval system means that the company's overall strength is greater and the information disclosure is closer to the truth. Investors believe that the information gap is small and that they can obtain greater profit returns by investing in this stock.

According to Xiang (2022), the approval system's disadvantages are that the process is too long, and the review requirements are relatively strict. It is not very friendly to companies with a short market period. However, once the approval system passes, the company can quickly gain market favor. Passing the approval system means that the company has a good foundation and long-term operation capabilities, which is a better investment choice for medium- and long-term investors?

Li (2024) analyzed multiple registration-based listing cases and believed that the registration system lowers the entry threshold for companies to enter the capital market,

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allows companies to go public quickly to harvest external funds, and is not easy to miss during the critical period of corporate development.

However, the capital market is still a certain amount of distrust in registered companies because the authenticity of information after disclosure requires investors to judge for themselves. For cautious market investors, untrue information means no investment opportunity.

Through empirical analysis, Li (2022) believes that companies with good operating conditions and great development potential can quickly obtain funds for investment in their main business by choosing a registration-based listing, which can prevent the company's strategic layout from falling behind due to insufficient funds. It is also conducive for enterprises to convert the trend dividend into actual profits for the enterprise.

In general, being able to go public through the approval system is the best choice for companies to enter the capital market, because passing the strict review of the approval system means that they have obtained a certain amount of CSRC endorsement in a short period of time, and market investors are more inclined to invest in this.

Types of stocks and obtaining a large amount of external funds are two of the main purposes of enterprises entering the capital market. Passing the approval process means that when they go public, they can get financial support.

The introduction of the registration system also gives certain opportunities to small and medium-sized enterprises to circulate capital in the restricted capital market.

However, there is a big gap between the amount of funds and the approval system, but there is no difference between the two methods. Strongly, every enterprise should judge which method to choose based on its own current situation. Listing and financing have the ultimate goal of providing financial support for the enterprise's development and expansion.

Related research on backdoor listing

In a case study of mergers and acquisitions, Singh (2010) found that companies that choose backdoor listings usually have the characteristics of low market capitalization and poor operating conditions.

Therefore, they are unable to fully invest and hope to achieve their listing goals through reverse takeovers to increase financing. In their study on the size of listed companies, Thomas (2007) discovered that backdoor listing is no longer exclusive to small and medium-sized enterprises. Some state-owned enterprises also use backdoor listings to achieve their listing goals. Additionally, public companies tend to be capital-intensive.

Brown & Ferguson (2010) studied some cases of Australian backdoor-listed companies and concluded that not all companies that choose backdoor listings are small companies. In fact, many of them have more total assets and market size than those at the same stage. The companies listed in the IPO are much larger.

Carpentier et al. (2012) concluded through a survey of listed companies that they believe that backdoor listing is a passive choice of the company rather than a subjective choice. These companies, unable to meet the criteria for a direct listing, resort to using shell companies to fulfill their listing objectives.

Lei (2010) analyzed the specific cases of backdoor listing and believed that the essence of backdoor listing lies in how to design the transaction structure. The transaction structure directly affects the operation of the enterprise after a backdoor listing.

Backdoor listing should pay attention to the design of the transaction structure rather than simply pursuing listing to obtain funds. support.

When Wang (2017) studied SF Holding, he pointed out that the advantage of backdoor listing is that it can shorten the process by which enterprises enter the capital market and avoid the constraints of some review rules. However, backdoor listing also has certain disadvantages, namely that it will cause some companies to separate from the real industry. Some companies resort to trading shell resources, becoming disinterested in the advancement of genuine industries.

Park (2018) studied the 360 backdoor listing case and pointed out that 360 decisively chose to go public when the company was at the forefront of the market. Rather than opting for the traditional IPO route, 360 opted for the backdoor listing method, successfully entering the capital market through the acquisition of Jiangnan Jiajie. It went public during a period when network security was at its peak and received significant financial support.

Luo (2021) research mainly focuses on risk prediction during backdoor listing. It is crucial to predict the risk of shell resources because backdoor listing revolves around the shell from beginning to end, so the choice of shell resources is crucial. When choosing a shell, try to use financial means to judge the quality of the shell resources.

Some scholars also put forward their own opinions on the use of backdoor listings by state-owned enterprises to deepen reforms. Policies actively encourage state-owned enterprises to accelerate the process of marketization, which will inevitably require access to the capital market for market pricing and market financing.

The corporate framework and equity composition of state-owned enterprises are relatively complex, so listing under the approval system requires many changes and restrictions, and backdoor listing has emerged as a new option. Backdoor listing can skip some framework restrictions and directly place the entire subsidiary's assets to achieve the listing purpose (Di Congzhi et al., 2022; Cheng et al., 2022).

One of the purposes of backdoor listing companies in the spotlight is to shorten the listing process, which requires the design of the transaction structure to be prudent. The transaction structure design must prioritize a seamless backdoor listing. To ensure their safety, we should carefully select the shell and asset injection method. We only want the convenience of asset injection, but we must also consider its safety. If issues arise during the asset injection stage, the backdoor progress will stagnate.

Therefore, the design of the transaction structure needs to be stable, and progressing step by step without problems is the fastest way.

After sorting out the existing research on backdoor listings, we can see that many scholars believe that backdoor listings have the advantages of a shorter listing process, moderate review rigor, and high market recognition.

However, backdoor listings, such as shell listings, have certain risks and uncertainties. The quality of resources can determine the success of backdoor transactions. Every researcher is deeply concerned about transaction structure, as it guides all actions before, during, and after backdoor transactions. However, each case's implementation is unique, necessitating adjustments to the transaction structure design based on the actual situation.

Therefore, the transaction structure design is the main source of backdoor listing risks.

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Related research on backdoor listing transaction structure design

Backdoor companies relate transaction structure design to a series of financing channels, fund-raising channels, and debt release choices following successful backdoor transactions. When studying the behavior of backdoor listed companies, we found that some companies go public not only to save time and speed up the review process but also to use the influence of backdoor listing to raise more funds in the capital market, thereby reducing the company's liabilities.

Strongroom (2008) started with the motivation of enterprise "demand" and concluded that the biggest reason for enterprises to choose "backdoor" is the need to broaden financing channels to obtain more capital.

Lei (2010) asserts that backdoor listings aim to fulfill the listing purpose by obtaining control rights from other listed companies and incorporating assets into the listed company. The key to backdooring is how to gain control and trade the company's assets. In actual operation, the transaction structure is subject to many conditions, and issues such as shareholders, employees, and debts need to be considered. The transaction structure's design should still follow the principle of comprehensive benefits and take all aspects into account. We cannot limit the overall situation to the interests of one aspect alone.

Cao & Su (2014) takes accounting as the starting point and believes that the transaction structure design of a backdoor listing should pay attention to accounting risks. When determining the quotation, the buyer should on-site verify the authenticity of the acquisition target and pay attention to the fair value. The design plan must account for the fluctuation in fair value.

When shell resources have no historical issues and still own certain assets, the highlight of real shell transactions is the equity swap. If the resources of the shell company overlap with those of the buyer, it can save the asset disposal step and directly obtain control through an equity swap, then place the assets and then integrate the resources. The cost of the backdoor transaction is not only to purchase the listing qualification but also to expand its own production chain (Dai, 2015).

There is also a reverse takeover in the transaction structure of a backdoor listing. The classic case is the Giant Network. Giant Network sold 100% of its shares to the listed company, Century Cruises, in a non-public way. When Giant Network became a wholly-owned subsidiary of Century Cruises, the actual controller of Giant Network also became the actual controller of Century Cruises through an equity swap. The operation of reverse acquisition is faster than forward acquisition, and non-performing assets can also be disposed of through asset swaps and additional stock issuance (Ding, 2017).

The disposal of non-performing assets is a key part of the transaction structure design. Enterprises listed on the backdoor market all want to find a clean shell, but in reality, clean shell resources are extremely rare. Therefore, the disposal of non-performing assets to create a clean shell is what the transaction structure design needs to solve. The problem. Once the shell company packages and places the non-performing assets into a wholly-owned subsidiary, it sells the subsidiary to obtain equity or cash proceeds. The shell resource becomes a real one after the sale of the non-performing assets (Park, 2018).

The transaction structure design of a backdoor listing needs to consider the financing methods and financial pressure of the company. If the transaction structure is designed to use too much cash to sell out non-performing assets or acquire equity in cash, it may cause the company to face greater cash flow pressure.

Conducting transactions through equity swaps is the most ideal way to alleviate financial pressure for the buyer, while also assisting the acquired party's actual controller in obtaining cash flow through the capital market after the company's listing (Zhao, 2022).

Methodology

Document analysis method

The author of this article reviewed journal articles and dissertations in CNKI, the thesis database, and the school library thesis database, sorted out and guided the relevant concepts of backdoor listing, and sorted out the current concepts and processes of backdoor listing, thus constructing this article's backdoor listing theoretical system.

Obtain the content of backdoor listing transaction structure design by consulting Tonghuashun, the official website of the China Securities Regulatory Commission, financial websites, etc., and understand the laws and regulations, access criteria, strength of state support, policies of the China Securities Regulatory Commission, and related case analysis that need to be designed for transaction structure design. By thinking about and analyzing Company A's successful cases, you can learn from existing design ideas.

Case analysis method

This article selects Company A's successful backdoor takeover of Company B as a research case, combines the historical background of the acquisition, analyzes the transaction structure design process and transaction plan, conducts an in-depth analysis of Company A's transaction structure, and explores the differences between the transaction structure and other plans., which serves as a reference for subsequent home furnishing companies.

Results

As the Chinese government's financial market reform deepens, it will become more and more common for companies to enter the capital market to obtain development funds. Company A's backdoor listing has improved its overall strength. This article discusses Company A's backdoor listing of Company B. A summary of the structural design is as follows:

For offline stores

One of the main development directions for home furnishing companies is to open more offline stores to increase the exposure of their corporate brand. The stores then need to be located in areas with significant and stable foot traffic. The flow of people in supermarkets is large and relatively stable. On weekends, the flow of people in supermarkets will continue to increase. Supermarkets are the primary choice for home furnishing companies to open their stores.

If home furnishing companies do not choose shell resources with fixed assets from offline stores, they will need to obtain a large amount of financing to purchase the equity in shell resources. After obtaining control of Shell Resources, home furnishing companies still need to deal with the assets and liabilities of Shell Resources because the assets of Shell Resources are not compatible with those of home furnishing companies.

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To make a better impression in the capital market in the future, they must deal with Shell Resources' assets and liabilities. "Real shell resources" have evolved into "net shell resources." Once the assets are in place, the primary business and name undergo changes. The process is cumbersome, and the financing risks are high.

When choosing shell resources, home furnishing companies can try to choose shell resources with fixed assets and offline store properties. When shell resources incorporate fixed assets from supermarkets, they can retain this portion of the fixed assets instead of selling them off. Among shell resources, this design has the advantage of reducing steps and risks, as well as integrating resources for rapid layout. Choosing shell resources with offline stores can reduce the steps of backdoor listing, shorten the time of backdoor listing, and also reduce financial pressure and financing risks.

The backdoor listing transaction structure design of home furnishing companies

If a non-listed company wants to gain control of a listed company, the normal way is to make the assets and liabilities of the parent company part of its own company, then merge the business and assets of the original company, separate the debt issues, and finally complete the listing process.

In the transaction plan design, there are different operating procedures for "net shell" and "real shell." Operational asset replacement includes asset disposal, i.e., the divestiture of the original listed company's assets, liabilities, and business.

When the asset divestiture aligns with the "net shell," the backdoor listed company sells its resources to its shareholders, while the backdoor company purchases the "real shell" resources. The goal of asset placement is to integrate the backdoor company's assets and operations, primarily through share exchange, cash purchase, asset replacement, and private placement.

In the design of the backdoor listing transaction structure of a home furnishing company, the assets and debts of the home furnishing company can be fully packaged, and the shell resources can reversely acquire the home furnishing company and use equity as the payment method. This has many benefits.

The first is to use equity as the payment method. The acquisition of home furnishing companies through payment methods does not involve financing, which can reduce the financial pressure on home furnishing companies and shell resources and avoid financing risks.

The second is that home furnishing companies reversely place assets into shell resources, which can save time in dealing with shell resources and further reduce the risk of backdoor listing.

The third benefit is that the home furnishing company's controller can securely take control of the shell resources. Once the home furnishing company has deployed its original assets, it can swiftly integrate the existing resources and initiate production.

Use equity swaps to control shell resources

Home furnishing companies are characterized by a high proportion of fixed assets and a low proportion of available liquid assets. When a home furnishing company acquires shell resources, it must pay the corresponding costs.

There is pressure on working capital, and according to corporate management requirements, the working capital available to the company is not enough to acquire a

complete shell resource, which requires home furnishing companies to seek financing from outside. A large amount of funding will increase financial pressure on backdoor companies and reduce liquidity. A shortage also risks breaking the capital chain.

After a company obtains funds through external financing to acquire shell resources, the external financing will appear in the company's annual report after the merger and acquisition. When investors in the capital market select investment targets, they will read the company's annual report in detail. If they find that the company has high risks, A large number of investors regard this company as an investment target, which is contrary to the original intention of home furnishing companies to seek strategic development funds through backdoor listing.

Home furnishing companies can use stock-for-share exchanges to obtain control of shell resources. The advantage of a stock-for-share exchange is that home furnishing companies can avoid the risks caused by external financing, and it expresses their willingness to operate well. Enterprises can make the owners of shell resources and small shareholders feel trust in furniture enterprises and promote the completion of transactions.

Recommendation

First, the analysis of this transaction structure is solely based on the annual reports of listed companies, public announcements of asset restructuring, and public information found on relevant financial community websites. Due to my location outside the country, I was unable to conduct the analysis on-site at the enterprise.

Second, at that time, the selected cases were only available in the capital market through initial public offerings and mergers and acquisitions. However, in subsequent financial market reforms, the emergence of the Science and Technology Innovation Board significantly reduced the difficulty and time cost of listing. Some of the literature referenced in this article is not accurate. It does not reflect the existence of the Science and Technology Innovation Board, and interested readers will have some doubts when reading the article.

In future studies, we will maintain a humble and studious attitude, continue to learn new knowledge and concepts, and enrich my insights on how to go public.

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