Analysis of Financial Statements of M&A Enterprises from the Perspective of Investor

—Case Study based on Wanda Film Acquiring Muwei Fashion

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Abstract: Since the film industrialization reform, the growing spiritual and cultural needs of people, the cultural media industry has undergone rapid growth. China's film market has also shown a booming trend, both in terms of market size, the number of people watching movies, and the number of cinemas and silver screens. According to case study based on Wanda Film acquiring Muwei Fashion, this paper proposes some possible suggestions for the mergers and acquisitions in the cultural media industry from the perspective of investors on the basis of analyzing the financial indicators and shareholder wealth effects before and after the merger.

1. Introduction

Since the film industrialization reform, China's film market has shown a booming trend, both in terms of market size, the number of people watching movies, and the number of cinemas and silver screens. China's movie box office has maintained a rapid growth in recent years with the number of audiences increasing from 440 million in 2012 to 1.716 billion in 2018, reaching an average compound annual growth rate of 25.5%. The domestic movie box office increased from 17.07 billion yuan in 2012 to 60.976 billion yuan in 2018, marking an average compound annual growth rate of 23.6%. Against the backdrop of new economic development, the Chinese film industry has achieved rapid growth. At the same time, since 2013, listed companies in the cultural media industry have ushered in a wave of mergers and acquisitions, among which film and television companies have the largest total amount of mergers and acquisitions. For instance, Wanda Film acquired Muwei Fashion (Beijing) for RMB 1.2 billion for its market value exceeding the total market value of the top three theatre chains in North America, which marked the largest horizontal M&A transaction in the domestic film and television industry and aroused the attention of all parties. Therefore, taking this case as an example and analyzing the financial indicators and shareholder wealth effects before and after the merger, this paper proposes some possible suggestions for the mergers and acquisitions in the cultural media industry from the perspective of investors.

2. Analysis of Wanda Film Financial Statements

On December 17, 2015, Wanda Film successfully acquired 100.00% equity of Muwei Fashion (Beijing) for RMB 1.20 billion. On the one hand, as a leader in the industry, Wanda Film was completing the transition from chain movie projection terminals to technology-based, platform-based and eco-type companies; and it has laid out the entire industry chain and created the world class film life ecosystem. On the other hand, based on the film real-time big data decision system (FilmBI), Muwei Fashion can improve the efficiency and effectiveness of the company's management and operation from film selection, differentiated pricing, and information management; so the acquisition of Muwei Fashion was beneficial to the company in terms of the operation with Hollywood, the increase of advertiser resources, and customer resources. This paper attempts to study whether the acquisition has defended the market share of Wanda Film and opened new sources of profit, and promoted its upgrade by analyzing the financial status and profitability of Wanda Film before and after the acquisition of Muwei Fashion.

Wanda Film went public in 2015 and acquired Muwei Fashion in December 2015. Therefore, this paper selects its financial statements from 2012 to 2017 to analyze the financial indicators before and after going public, and before and after the merger. The indicators related to the cultural media industry at the same time period were selected as reference for comparative analysis.

2.1 Profitability Analysis

Profitability refers to the ability of an enterprise to obtain profits, also known as the capital or capital appreciation ability of a company, which usually shows the amount of the company's income and its level in a certain period of time. For enterprises, profitability is an essential part of the company's four financial capabilities. Especially, for a listed company, profitability reflects its real operating conditions and operating profit, showing the company itself and its investors the company's financial capabilities. Moreover, the core objective of listed companies is to obtain profit, so profitability can best reflect the core value of listed companies and business development prospects. This paper mainly analyzes four indicators of profitability, namely, return on total assets, and return on equity, net profit margin on sales and earnings per share.

Table 1. Comparison of Wanda Film's profitability before and after its M&A with the average level of the cultural media industry

Financial indicators / Year	Return on total assets (%)		Return on equity (%)		Net profit margin on sales (%)		Earnings per share (%)	
	Wanda Film	Cultural media industry	Wanda Film	Cultural media industry	Wanda Film	Cultural media industry	Wanda Film	Cultural media industry
2012	15.02	25.49	24.35	12.22	12.87	17.23	0.78	0.64
2013	17.52	28.4	27.42	11.78	15.03	18.61	1.21	0.54
2014	17.55	28.28	26.72	11.55	15.03	17.25	1.6	0.56
2015	13.83	28.13	13.02	10.09	14.85	16.45	1.07	0.56
2016	14.06	26.9	13.16	7.41	12.2	14.4	1.16	0.45
2017	14.15	27.27	12.99	7.05	11.46	15.4	1.29	0.45
2018	15.03	20.28	10.29	-2.87	9.17	-23.3	0.74	-0.01

It can be seen from Table 1 and Figure 1 that, in terms of return on total assets, Wanda Film's was lower than the industry average from 2012 to 2018, indicating that Wanda Film was less efficient in asset utilization. However, after 2015, while the industry's average return on total assets declined, Wanda Film's increased, indicating that Wanda Film improved its profitability and management to a certain extent after going public and the merger. In terms of ROE, Wanda Film's was much higher than the cultural media industry from 2012 to 2018, and its utilization of shareholders' funds was efficient. As the return on equity of the industry dropped, Wanda Film's was also in the decline. However, in 2015, return on equity of Wanda Film began to rise, meaning that its shareholders' funds increased the profit after it went public. The merger also contributed to Wanda's ability to enhance its continued profitability. As for net profit margin on sales, Wanda Film's had been slightly lower from 2012 to 2018 than the industry level, indicating that it needed to increase profits while increasing sales revenue. However, its net profit margin on sales declined after 2015. This was because Wanda Film incurred more costs while expanding sales, indicating that the company underwent negative growth in terms of net profit, which prompted Wanda Film to pay attention to management and management to increase profit. As for earnings per share, Wanda Film's was significantly higher than the industry average between 2012 and 2018, indicating that the company's profitability is relatively high. After 2015, its earnings per share increased slowly. Considering its net profit margin on sales, this growth in profit may be caused by Wanda Film's acquisition of Muwei fashion.

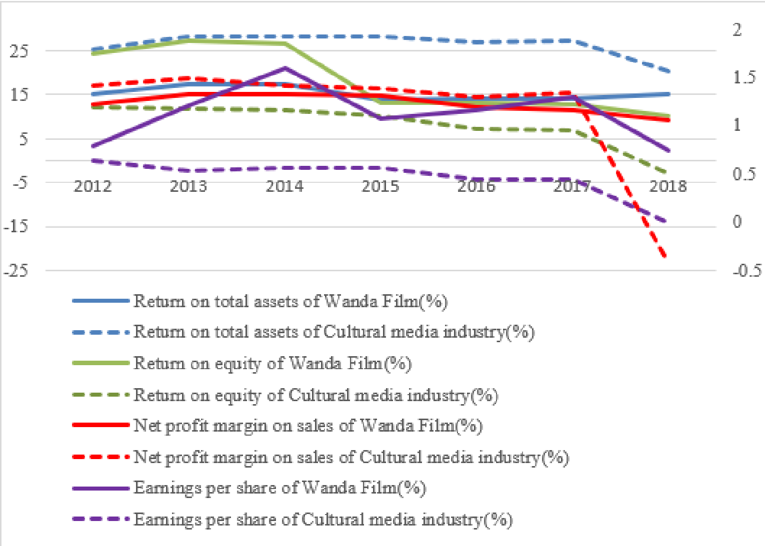

Figure 1. Comparison of the average profitability between Wanda Film before and after M&A and cultural media industry

2.2 Solvency Analysis

Solvency refers to the ability of an enterprise to repay long-term and short-term debts with its assets. Whether an enterprise has the ability to pay in cash and to pay back debts is the key to whether it can survive and maintain healthy development. Corporate solvency is an important indicator of a company's financial status and operational capabilities. Through the analysis of solvency, we can examine a company's ability to keep sustainable business and the risks it may face, which helps predict the future earnings of the company. Corporate solvency includes both short-term solvency and long-term solvency. This paper analyzes the solvency of Wanda Film based on four indicators: current ratio, quick ratio, cash ratio and asset-liability ratio.

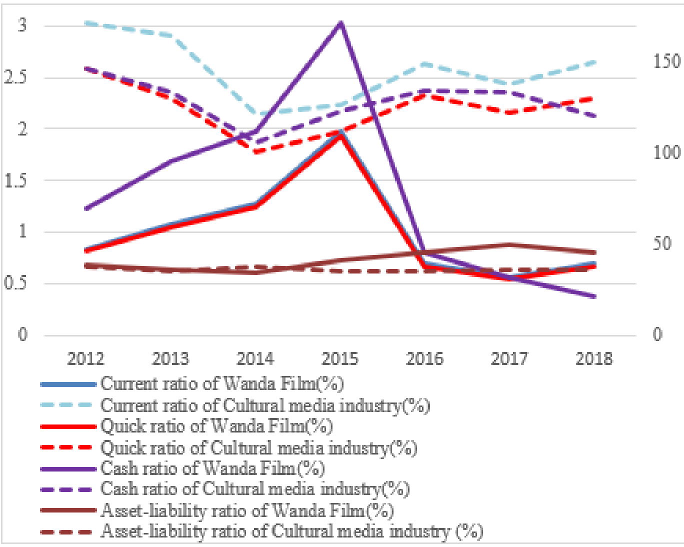

Figure 2. Comparison of Wanda Film's solvency before and after its M&A with the average level of the cultural media industry

Table 2. Comparison of Wanda Film's solvency before and after its M&A with the average level of the cultural media industry

Financial indicators / Year	Current ratio		Quick ratio		Cash ratio (%)		Asset-liability ratio (%)	
	Wanda Film	Cultural media industry	Wanda Film	Cultural media industry	Wanda Film	Cultural media industry	Wanda Film	Cultural media industry
2012	0.83	3.03	0.81	2.59	69.7	145.94	38.41	37.86
2013	1.08	2.9	1.05	2.29	94.79	133	36.19	34.78
2014	1.273	2.14	1.24	1.78	111.84	105.71	34.34	37.75
2015	1.97	2.24	1.93	1.98	170.78	122.54	41.03	34.74
2016	0.7	2.63	0.67	2.32	45.17	133.55	45.57	34.85
2017	0.55	2.43	0.54	2.16	31.47	132.54	49.4	36.06
2018	0.7	2.65	0.67	2.29	20.75	120.05	45.44	35.56

It can be seen from Table 2 and Figure 2 that, as for current ratio, Wanda Film's was significantly lower than the industry average between 2012 and 2018. Especially, its current ratio had dropped drastically since 2015, indicating that the company had some difficulty repaying short-term debt and required more funds. In terms of quick ratio, Wanda Film's was basically floating at around 100%, thus being safer than competitors of the same industry. From 2012 to 2015, Wanda Film's quick ratio was on the rise. Although the company had the ability to repay debt, its inability to make cash and increase accounts receivable led to an increase in opportunity costs. After 2015, Wanda Film had seen decreased quick ratio and increased debt risks. Combining the analysis of the current ratio and quick ratio, we can see that Wanda Film failed to improve its solvency after going public and acquiring Muwei Fashion. In terms of cash ratio, Wanda Film fluctuated greatly between 2012 and 2018, and enjoyed significant growth in the first four years, indicating that the company's short-term solvency had increased. However, there had been a sharp decline since 2015, and its own current ratio and quick ratio also declined, meaning that Wanda Film had weaker ability to repay debt and resist risks. This indicated that Wanda Film was at a disadvantage compared with other companies in the same industry. As for asset-liability ratio, Wanda Film's had been below 50% between 2012 and 2018, indicating that this company had better solvency and debt management capabilities. However, vertically the asset-liability ratio had increased since 2015 and horizontally these enterprises was significantly higher than competitors in the same industry, indicating that Wanda Film's total liabilities and operating costs increased after the merger.

2.3 Operating Capacity Analysis

Operating capacity refers to the ability of an enterprise to operate business, that is, the ability to use various assets to earn profits. The research on the operating capacity of an enterprise is actually the study of its efficiency in terms of asset management. This ability is first manifested in the contribution of the turnover rate and volume of various assets. And this contribution has a fundamental impact on the realization of value-added goals. In this sense, operating capacity determines a company's solvency and profitability, thus being at the heart of the overall financial analysis. Therefore, the analysis of operating capacity can help companies find business gaps and the root causes of gaps, strengthen the management of various assets, and improve economic benefit.

This paper mainly analyzes the operating capacity of Wanda Film from three aspects: turnover rate of accounts receivable, turnover rate of total assets, and turnover rate of current assets.

Table 3. Comparison of Wanda Film's operating capacity before and after its M&A with the average level of the cultural media industry

Financial indicators / Year	Turnover rate of accounts receivable (frequency)		Turnover rate of total assets (frequency)		Turnover rate of current assets (frequency)	
	Wanda Film	Cultural media industry	Wanda Film	Cultural media industry	Wanda Film	Cultural media industry
2012	85.37	26.16	1.16	0.54	4.5	1.52
2013	145.93	29.3	1.33	0.52	3.72	1.51
2014	94.77	21.1	1.33	0.52	3.22	1.38
2015	34.07	14.07	0.8	0.46	2.31	1.23
2016	20.88	11.6	0.65	0.42	2.55	1.11
2017	20.88	13.62	0.63	0.39	2.99	1.05
2018	9.8	12.19	0.61	0.35	2.95	0.92

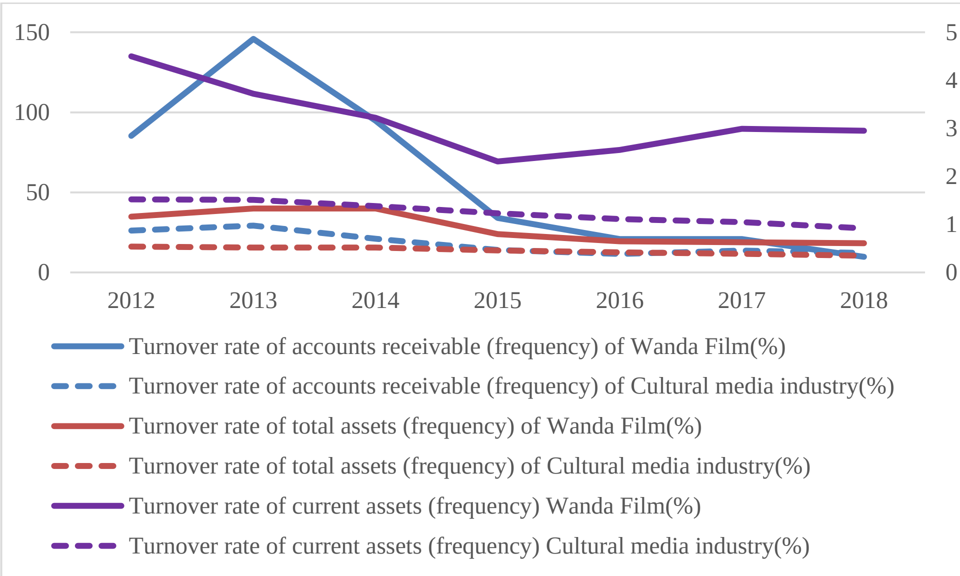

Figure 3. Comparison of Wanda Film's operating capacity before and after its M&A with the average level of the cultural media industry

It can be seen from Table 3 and Figure 3 that, in terms of the turnover rate of accounts receivable, Wanda Film's had been higher than the industry average over the six-year period, indicating that the company's collection of accounts receivable was fast. Besides, it maintained more efficient management than competitors of the same industry, which was conducive to collecting loans and reducing bad debts. However, Wanda Film's accounts receivable turnover rate had been declining since 2015, and the frequency of turnovers had decreased. The decrease in Wanda Film's turnover rate of accounts receivable slowed down after 2015, which also indicated a decline of its liquidity of corporate assets and the ability to repay short-term debts. As for total asset turnover rate, Wanda Film's was higher than the average level of the industry (see figure 3), and it was the one with strong sales ability and high asset utilization efficiency. However, from the vertical comparison in Table 3, the total asset turnover rate had decreased since 2014. While net sales revenues had decreased, the turnover rate of assets had slowed down, indicating decreased operational efficiency. As for liquidity turnover, Wanda Film had been taking the lead in the industry between 2012 and 2018. And with a faster turnover rate, the use of current assets would be relatively economical. While the company experienced decline in current assets turnover rate from 2013 to 2015, it started to enjoy increase since 2016, indicating that the growth rate of the main business income was higher than that of current assets, which enhanced the profitability of the company.

2.4 Development Capability Analysis

Development capacity refers to the potential ability of an enterprise to expand scale and enhance strength, which includes the expansion of the scale of an enterprise, and the increase of its profits and owners' equity. An enterprise's development capacity demonstrated its asset scale, profitability, the ability to maintain the growth of market share and prospects with the changes of the market environment. The analysis of a company's ability to expand business is used to examine its ability to expand scale by increasing annual revenues or other financing channels. This paper analyzes Wanda Film's development capacity and prospects from the growth rate of its main business income, growth rate of net profit and growth rate of total assets.

Table 4. Comparison of Wanda Film's development capacity before and after its M&A with the average level of the cultural media industry

Financial indicators / Year	Growth rate of main business income (%)		Growth rate of net profit (%)		Total assets of growth rate (%)	
	Wanda Film	Cultural media industry	Wanda Film	Cultural media industry	Wanda Film	Cultural media industry
2012	37.24	30.28	26.9	34.59	35.88	51.21
2013	32.71	14.5	55.02	24.23	32.9	14.62
2014	32.73	30.98	32.7	29.93	32.48	55.62
2015	49.85	33.13	48.02	34.23	237.98	49.36
2016	40.1	12.92	15.14	-30.57	23.5	16.03
2017	18.02	8.59	10.79	-8.84	21.21	12.78
2018	6.49	-5.8	-14.72	-239.68	-0.15	-0.82

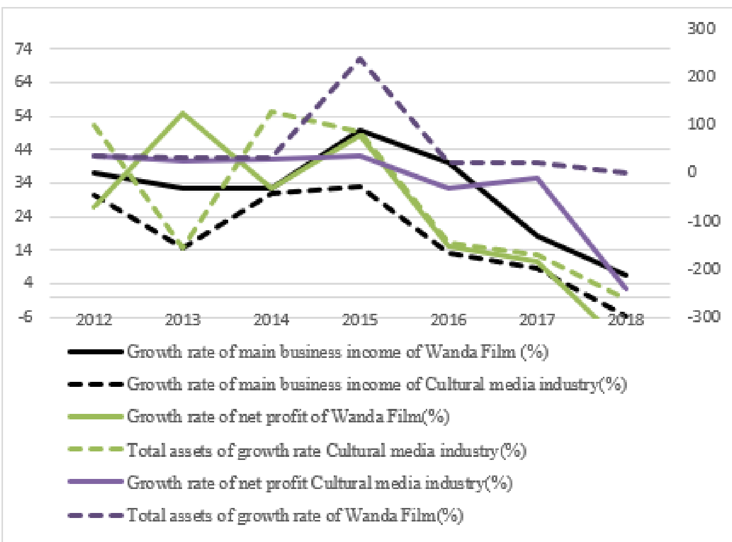

Figure 4. Comparison of Wanda Film's development capacity before and after its M&A with the average level of the cultural media industry

It can be seen from Table 4 and Figure 4 that, in terms of the growth rate of the main business, Wanda Film had maintained a growth rate of more than 30% between 2012 and 2016, indicating that market demand for its product was large and its capability to expand business was strong. Although its growth rate of the main business started to decline in 2017, it maintained a higher level than the industry average, indicating that Wanda Film had good growth and development prospects. In terms of net profit growth rate, Wanda Film had always been higher than competitors of the same industry since 2012, meaning that the company had outstanding operating performance and strong market competitiveness. Although its growth rate of net profit had declined since 2015, the overall industry had experienced negative growth. And Wanda Film had a relatively high growth rate of net profit. As for the growth rate of total assets, Wanda Film's was gradually declining except for 2015, indicating that the company's expansion of the asset operation and management slowed down. However, compared with competitors of the same industry, Wanda Film took the lead in terms of expansion and capital growth. And the highest growth rate of total assets in 2015 had a lot to do with the listing and merger.

3. The Wealth Effect of Shareholders before and after M&A

The wealth effect is a new concept put forward in the process of modern social development, which means that a certain stock accumulation will inevitably exert a conduction effect or a control effect on the relevant field. Mergers and acquisitions play an extremely important role in realizing the concentration of corporate capital, expanding the scale of business, and optimizing the industrial structure of enterprises. In particular, in the past two decades, mergers and acquisitions have provided enterprises with extremely convenient and effective channels to achieve cross-border expansion, and a large number of multinational companies have chosen to achieve their own global operations through mergers and acquisitions. Therefore, the impact of the merger can be identified through the study of wealth effect of shareholders before and after M&A.

3.1 Short-term Wealth Effect of Shareholders after M&A

Analysis of the wealth effect of Wanda Film after M&A is mainly to examine the additional benefits brought to shareholders by the fluctuation of company's share price after acquiring Muwei Fashion. This article selects the data of 15 days before and 15 days after the announcement of Wanda Film acquiring Muwei Fashion released by the Shenzhen Stock Exchange (including the announcement day).

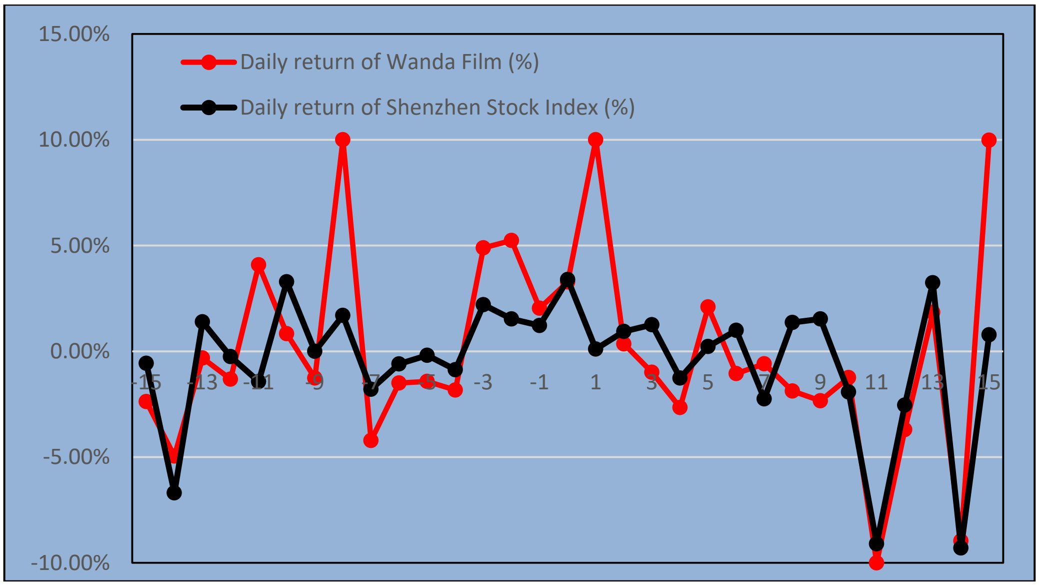

Figure 5. Changes in the daily returns of Wanda Film and Shenzhen Stock Index

Table 5. Daily returns of Wanda Film and Shenzhen Stock Index

Day	Daily return of Wanda Film (%)	Daily return of Shenzhen Stock Index (%)	Day	Daily return of Wanda Film (%)	Daily return of Shenzhen Stock Index (%)
-15	-2.38%	-0.57%	1	10.00%	0.11%
-14	-4.95%	-6.69%	2	0.35%	0.94%
-13	-0.32%	1.39%	3	-0.99%	1.26%
-12	-1.32%	-0.25%	4	-2.66%	-1.26%
-11	4.09%	-1.43%	5	2.10%	0.23%
-10	0.83%	3.29%	6	-1.05%	0.99%
-9	-1.26%	0.00%	7	-0.59%	-2.25%
-8	10.00%	1.70%	8	-1.88%	1.36%
-7	-4.22%	-1.79%	9	-2.34%	1.53%
-6	-1.50%	-0.60%	10	-1.24%	-1.92%
-5	-1.42%	-0.19%	11	-10.00%	-9.10%
-4	-1.83%	-0.87%	12	-3.70%	-2.54%
-3	4.89%	2.20%	13	1.85%	3.24%
-2	5.24%	1.53%	14	-8.96%	-9.30%
-1	2.04%	1.22%	15	9.98%	0.78%
0	3.28%	3.39%			

It can be seen from Table 5 and Figure 5 that, before and after the merger, the number of days in which the daily return of the Wanda Film was lower than that of the Shenzhen Stock Index was the same. Before the merger, difference between the daily returns of Wanda Film and Shenzhen Stock Index was small except for one day when the daily return of Wanda Film was 8.30% higher than that of Shenzhen Stock Index. After the merger, there were two days when the difference between the daily returns of Wanda Film and Shenzhen Stock Index was up to 9.89% and 9.2%. In other trading days, the fluctuations did not change much compared with those before the merger. This indicates that investors were disputed over the merger, some investors not having too high short-term expectations but still holding positive attitudes towards the merger.

3.2 Long-term Wealth Effect of Shareholders after M&A

This paper analyzes the long-term wealth effect after the merger by comparing the monthly returns of Wanda Film and Shenzhen Stock Index from December 12, 2015 to September 2017. During this period, Wanda Film was suspended from trading from March to May in 2016 and from August to September in 2017, so the monthly returns during the suspension period were not calculated.

Table 6. Monthly returns of Wanda Film and Shenzhen Stock Index

Month	Monthly return of Wanda Film (%)	Monthly return of Shenzhen Stock Index (%)	Month	Monthly return of Wanda Film (%)	Monthly return of Shenzhen Stock Index (%)
Dec., 2015	20.85%	7.97%	Dec., 2017	-18.79%	-5.43%
Jan., 2016	-35.46%	-29.01%	Jan., 2017	7.23%	-3.05%
Feb., 2016	3.68%	-2.51%	Feb., 2017	-4.19%	5.75%
Jun., 2016	-0.25%	8.64%	Mar., 2017	1.75%	-1.47%
Jul., 2016	-10.70%	-1.41%	Apr., 2017	-6.72%	-5.95%
Aug., 2016	0.91%	6.20%	May, 2017	5.08%	-7.34%
Sept., 2016	-6.56%	-0.18%	Jun., 2017	-7.64%	3.81%
Oct., 2016	-1.19%	4.92%	Jul., 2017	2.10%	-2.09%
Nov., 2016	0.15%	3.58%			

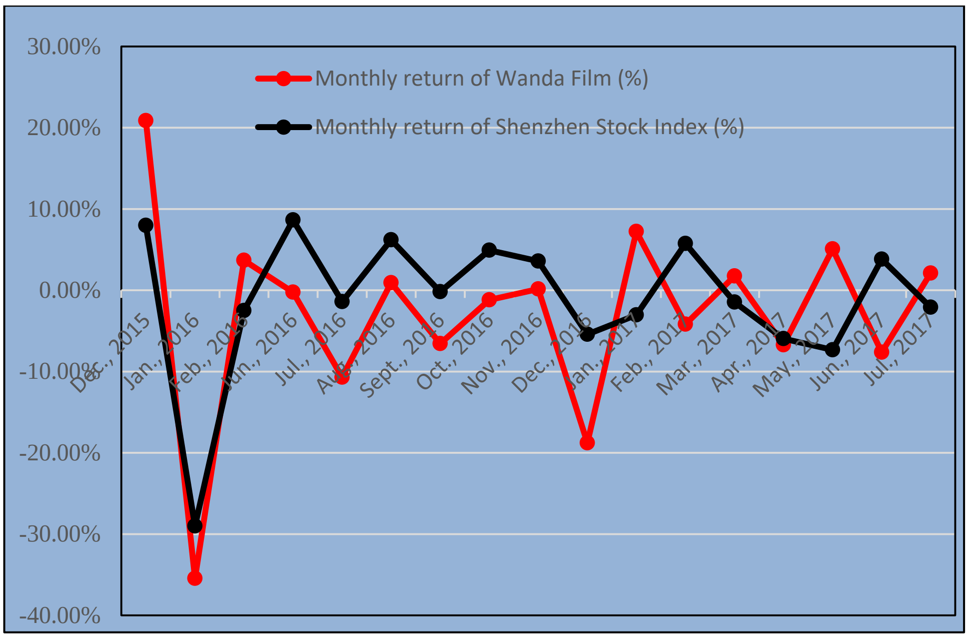

Figure 6. Monthly returns of Wanda Film and Shenzhen Stock Index

It can be seen from Table 6 and Figure 6 that, after Wanda Film completed the acquisition of Muwei Fashion in December 2015, its return of the month was as high as 20.85%. However, except for the months of suspension, there were 11 out of 16 months in which the monthly return of Wanda Film was lower than that of the Shenzhen Stock Index. And the company had a negative monthly return for 9 months. This indicates that the market was not optimistic about Wanda Film's development after the merger, and investors needed to be more cautious to examine the market prospects and investment value of the company.

4. Suggestions for Investment based on the Financial Status of Wanda Film

With the growing spiritual and cultural needs of people, the cultural media industry has also undergone rapid growth. Besides, people are increasingly willing to spend time and money on watching movies. All this has kept driving the development of the industry. As a film and television company in the booming cultural media industry, Wanda Film still possesses a mature and stable business model and maintains sustainable main business. Despite the increase of market competition, Wanda has continued to expand its scale and seek innovation, thus having good development prospects in the future. Suggestions for investment proposed in this paper are mainly based on the theoretical framework of value investing. Meanwhile, operational risks that the enterprise may encounter are hedged by trading stocks below the tangible book value.

To begin with, it can be seen from the above comprehensive analysis of the four financial statements of Wanda Film (2012-2018) that its current ratio and cash ratio had been lower than the industry average, and that its turnover rate of accounts receivable also kept declining, both of which would affect the overall financial strength of the company. However, through the horizontal comparison with the industry and vertical comparison within the company, it is found that its current ratio had the highest value in 2015 during this six-year period, and that the cash ratio in the same year also rose remarkably, both of which were related to the increased assets and improved liquidity brought by the merger. In 2018, the current ratio rebounded again, indicating that the company's solvency was still relatively safe. In contrast, the decline in the turnover rate of accounts receivable indicates that the company's liquidity was weak, which is not conducive to business development. In addition, the company failed to shop this decline after the merger, meaning that it is necessary for investors to carefully consider whether the company's bad debts are excessive. Nevertheless, other financial indicators basically demonstrated a positive trend after the merger, so the acquisition of Muwei Fashion has played a positive role in improving the financial status of Wanda Film.

Second, the acquisition of Muwei Fashion helped Wanda Film gain a positive wealth effect, a lot of liquidity, and good market valuation, thus providing good resources for the company to further develop, expand the scale, improve profitability, and increase its competitiveness. The company's business idea of "chain operation capability, innovative marketing capability, and service branding capability" demonstrates competitiveness, strengthens shareholders' confidence of long-term investment, ensures the short-term and long-term wealth effects of shareholders, and safeguards the interests of investors.

Third, it is also necessary for investors to pay attention to the intrinsic value of the invested company, which specifically includes brand effect, word of mouth marketing, management team and other non-financial indicators. Muwei Fashion is committed to film investment, publicity and promotion. Besides, it maintains close cooperation with many famous Hollywood film companies, thus having accumulated rich industry resources, commercial channels and quality customers. Furthermore, its brand "Shadow Fashion" enjoys a high reputation in the film industry. All this was taken into account by Wanda Film when acquiring Muwei Fashion. Therefore, compared with the “hard power” demonstrated by the financial statements, the “soft power” that an enterprise exhibits in the market is also crucial.

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