

# The Goodwill Impairment of Qtone Education Group Through M&A

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**Abstract:** With the concept of education stocks, Qtone Education Group has gained unprecedented attention from the investment community. At the same time, it has expanded its business through continuous mergers and acquisitions. Its stock price has risen sharply in just over a year, and it has won the title of “Share King.” The share price of Qtone Education Group once surpassed that of Kweichow Moutai, and the increase in its share price set a historical record for the stock market. The goodwill accumulated by the continuous mergers and acquisitions brought a temporary surge in its share price, and it has become one of the most concerned companies in the internet education industry. However, due to the goodwill impairment in the later period, it suffered losses year after year, facing the risk of delisting. Therefore, this paper analyzes the reasons for the impairment of goodwill by studying the case of Beijing Jijiao acquired by Qtone Education Group in hope to provide relevant reference for related enterprises.

**Keywords:** Mergers and acquisitions; Goodwill; Goodwill impairment

*Online publication:* March 10, 2022

## 1. Introduction of both parties in mergers and acquisitions

### 1.1. Acquirer

Qtone Education Group (stock code: 300359) was established in 2005. Its main business covers the use of mobile communications and the internet to adopt the development model of cooperation with basic operators. Its purpose is to provide efficient, convenient, and practical educational services to educational institutions, including primary and secondary schools as well as kindergartens. The company’s main products are Power Plus Smart Campus, All Courses, and Growth Helpers. As one of the “Top 10 Chinese Online Education” companies, Qtone Education Group focuses on the K12 education sector, innovates the education service industry through artificial intelligence, focuses on information and service operations, as well as continues to innovate for the users. It provides a high-quality education informatization platform, establishes long-term application service relationships with nearly 55,000 primary and secondary schools as well as kindergartens, and have multi-level education services for educational authorities, schools, and other unit users and individual users, such as teachers, students, and parents, covering PPP and BOT projects, campus Internet of Things, campus payments, mobile campus portals, dual-teacher classrooms, home-school co-education, international education, and other business areas. It multi-dimensionally meets the individual needs of users in batches, serving nearly 5,000 people in more than 200 cities across the country. It is the largest smart education service organization in China’s basic education.

## 1.2. Acquiree

Beijing Jijiao was established on August 2, 2004, with a registered capital of 10 million yuan. The company has four holding subsidiaries, among which it holds shares in Shenzhen Shangning Haiwen International Education Consulting Co., Ltd., Beijing Jijiao Network Education Technology Company, and Xinjijiao Network (Beijing) Information Technology Company. Jiaowang Cloud Technology Co., Ltd. holds shares in Fuzhou Good Teacher Distance Education Service Co., Ltd.

The main products or services offered by Beijing Jijiao include continuing education and training services for teachers. After more than 10 years of hard work, the company relies on its high-quality educational resources, perfect business system, training projects, and strong market competitiveness. It has become one of the largest K12 basic education online training platforms in China, with huge customer stock and good market performance.

## 2. M&A process and results

### 2.1. Payment method

In 2015, Qtone Education Group acquired 100% equity of Beijing Jijiao from four shareholders, including Zhu Min, Zhang Xuetao, Chen Jiangwu, and Shunye Hengtong, at a cash consideration of 525 million yuan and a share price of 525 million yuan. The merger formed a goodwill of 956 million yuan.

At the same time, Beijing Jijiao also made a performance commitment for mergers and acquisitions. This performance commitment is mainly from the perspective of annual net profit. In 2015, the committed net profit exceeded 68 million; in 2016, the net profit exceeded 85 million, while in 2017, the annual net profit exceeded 106 million yuan. On the basis of this commitment, if the company's net profit does not reach the promised performance during the annual operating process, then the original shareholders would have to make profit compensations to Qtone Education Group. Generally speaking, in the annual accounting treatment, it is necessary to carry out the impairment of assets according to the goodwill at the time of acquisition.

### 2.2. Asset valuation and pricing

The transaction price of the underlying assets was evaluated by Beijing Tianjian Xingye Assets Appraisal Company, hired by Qtone Education Group. The result under the income method is taken as the conclusion of this valuation. According to "Jijiao Technology Supplementary Assets Valuation Report," issued by Tianjian Xingye, the appraisal value and appreciation of the underlying assets on the valuation date of March 31, 2015, are shown in **Table 1**.

**Table 1.** Appraisal value and appreciation of the underlying assets under the income method as of March 31, 2015

Underlying asset	Audited net assets (parent company) as of March 31, 2015	Appraisal value (ten thousand yuan)	Value-added rate
100% equity of Beijing Jijiao	4,901.20	112,980	2,205.15%

Using the income method to evaluate, the total equity value of Beijing Jijiao's shareholders on the valuation date of March 31, 2015, was 1,129.8 million yuan, and the valuation value was 1,080.788 million yuan, which was 22.05 times the value.

### 2.3. The goodwill formed through M&A

China's new accounting standards for business enterprises have explained the merger of goodwill. Under

the business merger, the difference between the merger cost and the fair value of the identifiable net assets should be recognized as goodwill on the purchase date. Qtone Education Group purchased 100% equity of Beijing Jijiao at a price of 1.05 billion yuan; 50% of the transaction consideration was paid in cash, totaling 525 million yuan, whereas the other 50% was paid by issuing shares, totaling 525 million yuan. As shown in **Table 2**, the acquisition of Beijing Jijiao formed a goodwill of RMB 956.95 million.

**Table 2.** Goodwill formed by the acquisition of Beijing Jijiao

Consolidation cost (10,000 yuan)	Beijing Jijiao
Cash consideration	52,500
Consideration paid for the issuance of shares	52,500
Total consolidated costs	105,000
Less: share of fair value of identifiable net assets acquired	9,304.68
Goodwill	95,695.32

## 2.4. M&A motivation

### 2.4.1. Expand market share and enhance market competitiveness

Beijing Jijiao has been deeply engaged in primary and secondary schools and teachers for many years. It has a complete business training system. The training courses developed cover various disciplines and various stages of education. The company is supported by a strong team of experts and has won a large customer base with high-quality services over the years. The acquisition of Beijing Jijiao will enable All Access Education to extend its business to continuing education and training, rapidly increase its market shares in the field of school admissions services, and achieve rapid development in its core business; at the same time, through this transaction, Qtone Education Group's subsidiary, Quanke, will obtain numerous high-quality educational resources, deepen the company's understanding of basic subject courses, and provide better educational services; upon the completion of this transaction, Qtone Education Group will be able to heighten its experience in platform operation, and with the help of Jijiao's popularity, the core competitiveness of the online education business will be enhanced <sup>[1]</sup>.

### 2.4.2. Promote synergistic effect

Beijing Jijiao has rich business experience in the training industry, and the company has undergone more than ten years of development. It fully understands the needs and expectations of users in the training market in China. It can be said that the company has many advantages in terms of customers, markets, resources, and content. The acquisition of Beijing Jijiao will stimulate the company's development in online business, generate strong synergies, and enrich the business types of all-pass education. At the same time, with the help of Qtone Education Group's powerful data technology, diversified on-campus service channels, and O2O operation service model, it will also contribute to the continuous growth of Beijing Jijiao's core business in the next three years.

### 2.4.3. Improve profitability

Beijing Jijiao has rich business operation experience in the continuing education industry. It has advantages in terms of customers, markets, resources, and content. It can help Qtone Education Group to develop its continuing education business, give full play to existing teacher resources, and accelerate the rapid development of the company's main online education business <sup>[2]</sup>.

The acquisition of Beijing Jijiao is a strategic choice for Qtone Education Group to follow the changes in the industry, further extend the industrial chain, and enhance its competitiveness. After the successful

completion of this M&A transaction, Beijing Jijiao will gain the status of a wholly-owned subsidiary of the company and be included in the scope of consolidated statements. According to the profit commitment made by the counterparty to the company, Qtone Education Group believes that after the completion of the merger, the operating income and net profit of the listed company will increase significantly, which will improve the asset quality and profitability of Qtone Education Group.

## 2.5. M&A results

During the merger and acquisition of Beijing Jijiao, Qtone Education Group signed a performance commitment agreement with the company's original shareholders. According to the agreement, from 2015 to 2017, Beijing Jijiao's net profit needs to reach at least 68 million, 85 million, and 106 million, respectively. However, the company has not fulfilled its performance commitment and has made a large amount of goodwill impairment provisions in 2018 and 2019, as shown in **Table 3**.

**Table 3.** Beijing Jijiao's goodwill impairment statement

Time	Target company	Beginning balance of goodwill (ten thousand yuan)	Goodwill impairment provision (ten thousand yuan)
2018	Beijing Jijiao Network	95,700	60,900
2019	Beijing Jijiao Network	34,800	33,100

## 3. Analyzing the reasons for the large amount of goodwill impairment of Qtone Education Group

### 3.1. Unreasonable premium mergers and acquisitions

#### 3.1.1. Unreasonable valuation of underlying assets

The valuation date for this transaction is March 31, 2015. Under the income method, the appraisal value is 49.7741 million yuan, higher than the asset-based method. Beijing Tianjian Xingye Assets Appraisal Co., Ltd. believes that since the purpose of this merger is to value the future profitability of Beijing Jijiao, the result from the income method is assumed as the pricing. In 2015, there was a lack of similar reference targets in the market, so there were many subjective factors in evaluating the assumptions of Beijing Jijiao, and there was an overestimation of indicators, such as operating income and gross profit margin. The two parties negotiated with reference to the valuation value of the income method, and the final merger consideration was affected, resulting in an inflated valuation, and ultimately an inflated goodwill.

#### 3.1.2. Improper assessment of off-balance sheet intangible assets

The target company is engaged in and focuses on K12 teachers' internet continuing education and training business as well as home-school education information service business. It has the characteristics of "light assets and high income." The company's physical assets are relatively small, and it relies more on resources such as intangible assets. This brings a lot of challenges to its enterprise value assessment. Looking at the valuation report of All Access Education on Beijing Jijiao, it is found that the company has more off-balance sheet intangible assets, and the valuation agency did not make a proper valuation of these intangible assets during the valuation process, but rather, depended on the growth of this part of intangible assets. Performance and profitability are used as the basis for valuation, which makes the valuation value and goodwill inflated.

#### 3.1.3. Performance compensation agreement raises the price

In the case of the acquisition of Beijing Jijiao, Shunye Hengtong and other controlling shareholders signed a performance compensation agreement with Alltong Education. The agreement stipulates that if the

performance commitment is not fulfilled, the compensation obligations and responsibilities will be performed in accordance with this agreement. The signing of the performance compensation agreement enables the purchaser to accept a higher M&A valuation and raise the transaction price; at the same time, the performance compensation agreement enables the acquirer to obtain certain risk compensation, which can facilitate the completion of the transaction <sup>[3]</sup>.

### **3.2. The target company did not achieve the expected performance**

Beijing Jijiao did not realize the promised profits of RMB 68 million in 2015, RMB 85 million in 2016, and RMB 106.25 million in 2017. The actual net profits from 2015 to 2017 were RMB 66.41 million, RMB 85.47 million, and RMB 104.69 million, respectively. Although the net profit during the performance commitment period increased steadily, it did not meet the expectations in 2015 and 2017; the company only achieved the expected performance in 2016. In 2018, both the operating income and gross profit margin of Beijing Jijiao declined, and the performance suffered losses, in which the losses continued to expand in 2019.

Beijing Jijiao's two-year performance did not meet the expectations, the performance was not satisfactory, and it failed to bring continuous growth to the company, resulting in a huge amount of goodwill impairment for All Access Education. The company disclosed that the target company did not achieve the expected performance for two main reasons: (1) the new national training policy since 2018 has led to changes in the business structure of Beijing Jijiao; (2) the revenue and cost structure has undergone significant changes, and gross profit margins have fallen sharply.

## **4. Conclusion**

By analyzing the case of Qtone Education Group's merger with Beijing Jijiao, it is found that factors such as unreasonably high premium mergers and acquisitions as well as unfulfilled performance commitments during the M&A process have led to the company's provision of a large amount of goodwill impairment, which eventually resulted in the failure of mergers and acquisitions. This case provides relevant reference for related enterprises.

## **Disclosure statement**

The author declares no conflict of interest.

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