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PRE-MERGER AND POST-MERGER ANALYSIS OF FINANCIAL PERFORMANCE OF TARGET COMPANY - A CASE STUDY

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ABSTRACT

This study has been undertaken for Pre-merger and Post-merger analysis of financial performance of target company. This paper is an attempt to understand the impact of merger of MEL with SAIL on the financial performance of MEL/CFP. For the purpose of this study, eight ratios representing the categories of ratios such as liquidity ratios, solvency ratios, activity ratios and profitability ratios of the target company i.e. MEL/CFP are calculated for analyzing the pre-merger and post-merger analysis of financial performance. The four years before the merger and four years after the merger is taken for this study and impact of merger is studied using the t-test. In the study it is concluded that post-merger, there is no significant impact on current ratio and operating cycle ratio whereas there is significant impact on quick ratios and asset turnover ratio. It is also concluded that there is no significant change in both the solvency ratios i.e. debt to asset ratio and interest coverage ratio of the MEL/CFP. Further, no positive change in profitability of the MEL after merger is found.

KEYWORDS
ferro alloys, financial ratios, merger.

INTRODUCTION

Post LPG i.e. (Liberalisation, Privatisation and Globalisation), the business environment in India has changed a lot. The Indian companies strive hard and also succeeded to maintain their position in the market in spite of having steep competition from the international players operating in different sectors. One of the key strategies to stay in the competition that were adopted in last two-three decade by the corporates is merger and acquisition. The objective of Merger and acquisition is different in different cases and it depends upon the various factors such as position of the company in the sector where it is operating, dynamics of the sector, strength and weakness of the company, economic conditions etc. Most of the merger and acquisition takes place for the reasons mentioned as under:

- For consolidation of business
- To achieve economiesof scale,
- For diversification,
- For procuring raw material
- To strengthen distribution channel
- To expand geographic reach

One of the important sectors responsible for the growth of infrastructure of any country is the steel sector and the industry which is closely associated with this industry is Ferro ally industry. In the year 2011, Maharashtra Elektrosmelt Limited (MEL) representing the Ferro alloy industry merged with Steel Authority of India (SAIL) representing steel industry. MEL now called as Chandrapur Ferro ally Plant (CFP). In this paper an attempt has been made to understand the impact of this merger on the financial performance of MEL/CFP. The four year before the merger and four years after the merger is taken for this study and eight ratios representing the categories of ratios such as liquidity ratios, solvency ratios, activity ratios and profitability ratios are calculated for analyzing the pre-merger and post-merger analysis of financial performance of the target company i.e. MEL in this case.

REVIEW OF LITERATURE

In order to study the impact of the merger, the Author 'Govind M. Dhinaiya' carried out a research titled *"Impact of mergers & acquisitions on the performance of companies"*. The objective of this study was to analyze operating performance of companies involved in mergers & acquisitions using various ratios. The analysis was done using the data of two years before & after mergers & acquisitions with help of paired sample t-test. The results suggest that there were minor variations in the performance after M&A but it was not statistically significant. Further, the result has proved that companies failed to perform well after mergers and acquisitions in all parameters under study. The analysis shows that performance was different from different industry. Hence performance of company depends on the type of industry in which mergers and acquisitions take place.

Author 'Komal Gupta' conducted a research on *"Mergers and acquisitions in the Indian banking sector: A study of selected banks"*. In this study the effects of merger and acquisitions on the financial performance of the selected banks in India has been evaluated. Pre and post merger comparison is conducted on selected variables to analyse the effectiveness of mergers and acquisitions on the banks. The results of the study indicate that there is a positive impact of mergers and acquisitions on the financial performance of the selected banks.

Researcher 'Mahesh R. & Daddikar Prasad' conducted a research on *"Post merger and acquisition financial performance analysis: a case study of select Indian airline companies"* with the objective to analyze whether the Indian Airline Companies have achieved financial performance efficiency during the post merger & acquisition period specifically in the areas of profitability, leverage, liquidity, and capital market standards. They used sample t-test to determine the differences in financial performance standards two year before and two year after the merger activity. The result of this study shows that there is no improvement in surviving Company's return on equity, net profit margin, interest coverage, earning per share and dividend per share post-merger & acquisition.

A research on the topic "*Comparative Study of Pre and Post Corporate Integration through Mergers and acquisition"* was conducted by researchers 'Manoj Kumara. N.V, Satyanarayana'

to explore the potentialities and capabilities of the firm by looking pre and post merger and acquisition performance. This study examined the comparative difference between pre and post merger and acquisition in terms of financial performance. The samples of ten major companies were taken from a list of merger and acquisition in India-2010.The results indicated a significant positive value creation to the acquired firms.

Researcher 'Long Hoang Pham' carried out study titled "*An analysis of pre and post-acquisition financial performance of target czech banks: a comparative analysis"*. The objective of the study is to analyze and compare the pre and post-acquisitions financial performance of four identified banks, through ratio analysis., with greater emphasis on ROA, RONW, EPS, DE and NPM as financial efficiency parameters. Secondary sources such as published annual report and accounts of the selected banks were used to collect the data and subsequently analyzed using Wilcoxon signed rank test. The data was being collected for three years before and after the acquisition. The study concluded that M&A of the selected firms have resulted in no significant change in the financial performance of these firms.

'Dr. Yusuf Ali Khalaf Al-Hroot' conducted research on the topic "P*re and Post-Merger Impact on Financial Performance: A Case Study of Jordan Ahli bank".* The results of this study show that 5 Out of 12 ratios (41.67%) significantly improved after the merger to Jordan Ahli bank, while 3 ratios (25%) improved but insignificantly, in the other hand 3 ratios (25%) significantly deteriorated after merger, while 1 ratio (8.33%) insignificantly deteriorated after merger. This shows that merger has improved performance of Jordan Ahli bank with a total percentage (66.67%). On the basis of findings, we concluded that financial performance of merger Jordan Ahli bank insignificantly improved in the post-merger period.

A study on "*Impact of Mergers & Acquisitions on Firms'Long Term Performance: A Pre & Post Analysis of the Indian Telecom Industry"* was conducted by researcher 'Neha Verma and Dr. Rahul Sharma' with the aim to study the impact of mergers and acquisitions on the performance of Indian Telecom industry, by examining some pre and post-merger financial and operating variables. For the purpose of the study, companies which have been merged or acquired during the period 2001-02 to 2007-08 have been selected. This study concluded that it becomes important to generate elevated profits after the mergers and acquisitions in order to rationalize the decision of M&A, undertaken by the management to the shareholders.

In the paper *"Indian Ferro Alloy Industry– Present Status and Future Outlook"* the authors *C.N. Harman and N.S.S. RamaRao,* discussed in detail about the evolution of the Indian Ferro alloy industry in a phased manner.

In the paper 'The Indian Ferroalloy Industry at Cross Roads'- the paper for Metals & Minerals Review – Ferroalloy Special – January 2013 issue the author *Prabhash Gokarn*, discussed in detail the various aspects regarding the past performance of the industry and the expected growth of it.

OBJECTIVES

The core objective of this study is to find out the impact of the merger on the financial performance of the target firm.

1. To study the change in the liquidity ratios of MEL/CFP after merger.
2. To analyse the impact on the solvency ratios of MEL/CFP after merger.
3. To find out the impact on profitability ratios of MEL/CFP after merger.
4. To access the improvement in efficiency ratios of MEL/CFP after merger.

RESEARCH METHODOLOGY

Nature and source of the Data: The data which is being used for the purpose of this study is collected from secondary sources. Annual reports of MEL and SAIL, websites of SAIL, various stock broking firms and research agencies are used for collecting the data. Further the year books of Indian Bureau of Mines (IBM) are also used for conceptual framework

Sample size and period: The data for a period of eight years i.e. from 2008 to 2015of MEL/CFP is taken for this study.

Tools and Techniques: The ratio analysis and t test are used for the purpose of this study. The variables used in the study are quantitative variables. Hypothesis testing has also been carried out.

Formulation of Hypothesis: The hypotheses are formulated taking into account the objective of the study. The hypotheses for this study are as follows:-

(a) H1- Post merger, there is significant impact on the liquidity ratio of the MEL.

(b) H1- Post merger, there is significant change in the solvency position of the MEL.

(c)H1- There is change in profitability of the MEL after merger.

(d)H1- There is impact on activity ratios of the MEL before and after merger.

DATA ANALYSIS AND HYPOTHESIS TESTING

In order to evaluate the impact of the merger on the performance of MEL a comparative study for the same period i.e. four year before the merger and four year after the merger (including the year of merger) has been carried out. For the purpose of this study two ratios from each category of ratios are identified and exhibited accordingly.

1. LIQUIDITY RATIOS

Current ratios and quick ratios are the two ratios which have been considered from the category of liquidity ratios. These ratios are tabulated in the table-1.

TABLE 1: PRE AND POST MERGER LIQUIDITY RATIOS

	Liquidity Ratio	
	Current Ratio	**Quick Ratio**
	Pre-Merger	**Pre-Merger**
2007-08	1.64	1.24
2008-09	1.93	1.32
2009-10	2.55	1.88
2010-11	3.26	2.18
	Post-Merger	**Post-Merger**
2011-12	2.44	0.40
2012-13	1.01	0.08
2013-14	3.28	0.17
2014-15	3.10	0.07

Source: Ratios are calculated using data collected from financial statements of company.

Descriptive analysis for liquidity ratios				
	Mean		Variance	
	Pre-Merger	Post-Merger	Pre-Merger	Post-Merger
Current Ratio	2.34	2.46	0.52	1.06
Quick Ratio	1.66	0.18	0.20	0.02

Observations

There is not much difference in the mean value of pre and post current ratio of MEL, however, the variance of current ratio of MEL before the merger and after merger has difference. Further, in case of quick ratio there is wide gap in mean as well as variance of pre and post-merger.

2. SOLVENCY RATIOS

The Solvency ratios are also known as leverage ratios. These ratios measure the burden of the debt on the company and compare it with assets or equity. The solvency ratios considered for the pre and post-merger study are debt to asset ratio and interest coverage ratios. The other important solvency ratios such as debt to equity, equity multipliers etc are not considered due to limitations of data on account of merger of MEL.

For the purpose of this study, the two identified ratios are exhibited in the table 2.

TABLE 2: PRE AND POST MERGER SOLVENCY RATIOS

	Solvency Ratio	
	Debt to Asset Ratio	Interest Coverage Ratio
	Pre-Merger	Pre-Merger
2007-08	0.00176	497.66
2008-09	0.00406	241.99
2009-10	0.00080	434.66
2010-11	0.00070	144.29
	Post-Merger	Post-Merger
2011-12	0.00069	26.92
2012-13	0.00007	-1936.00
2013-14	0.00000	-3881.50
2014-15	-0.00002	-2260.00

Source: Ratios are calculated using data collected from financial statements of company.

Descriptive analysis for solvency ratios				
	Mean		Variance	
	Pre-Merger	Post-Merger	Pre-Merger	Post-Merger
Debt to Asset Ratio	0.0018	0.00018	0.00000244	0.000000114
Interest Coverage ratio	329.65	-2012.645	27098.49503	2573166.314

Observations

There is difference in the mean value of pre and post, Debt to Equity as well interest coverage ratios. Variance of both the ratios also indicates the same. The study of Change/impact/relationship of these variables has been done in the next section called hypothesis testing.

3. PROFITABILITY RATIOS

These are the ratios which are used to find out an ability of the firm to generate earnings against expenses and related costs. Profitability ratio measures earning ability of the firm relative to the sales made by the firm or assets held by the firm or the shareholder's funds etc. Taking into account the limitations of the data on shareholder's equity, net worth etc., following two ratios have been identified for pre and post-merger analysis.

TABLE 3: PROFITABILITY RATIOS

	Return on Asset(ROE)	Net Profit Margin (NPM)
	Pre-Merger	Pre-Merger
2007-08	0.165351173	0.114759708
2008-09	0.164349719	0.126151871
2009-10	0.172348683	0.144583568
2010-11	0.087289494	0.085077397
	Post-Merger	Post-Merger
2011-12	0.014378889	0.018864584
2012-13	-0.036050623	-0.052668788
2013-14	-0.068643918	-0.117471748
2014-15	-0.042935407	-0.085694252

Source: Ratios are calculated using data collected from financial statements of company.

Descriptive analysis for profitability ratios				
	Mean		Variance	
	Pre-Merger	Post-Merger	Pre-Merger	Post-Merger
ROE	0.147	-0.033	0.0016	0.0012
NPM	0.117	-0.059	0.0006	0.003

Observations

The mean value of ROE and NPS are different and with variance for these two ratios. This indicates the change the profitability of the company after its merger.

4. ACTIVITY RATIOS

The ratios which gives information about how efficiently the company is using its assets. These ratios involve the comparison of sales revenue or cost of goods sold with inventories, debtors, fixed assets etc., To examine the activity ratios pre and post-merger, the asset turnover ratio and operating cycle (days) are considered. They are exhibited as under:

TABLE 4: ACTIVITY RATIOS

	ASSET TURNOVER RATIO	OPERATING CYCLE
	PRE-MERGER	PRE-MERGER
2007-08	1.440846936	90.49858633
2008-09	1.302792557	99.79904377
2009-10	1.192035067	100.6343641
2010-11	1.026000998	77.43114637
	POST-MERGER	POST-MERGER
2011-12	0.762216058	95.88275749
2012-13	0.684477945	46.07976026
2013-14	0.584344059	84.89646354
2014-15	0.501030184	212.8248061

Source: Ratios are calculated using data collected from financial statements of company.

Descriptive analysis for Activity ratios				
	Mean		Variance	
	Pre-Merger	Post-Merger	Pre-Merger	Post-Merger
ATO	1.24	0.633	0.030	0.013
OC	92.09	109.92	116.61	5162.73

Observations

The pre-merger mean value of ATO is much different than post-merger whereas in percentage terms the pre-merger mean value for OC has not changes considerably as compared to OC. This indicates that different activity ratios perform differently.

The study of impact/relationship of these variables has been done in the next section called hypothesis testing.

HYPOTHESIS TESTING

On applying t-test on the above tables we get following results:

TABLE 5: t-TEST RESULT FOR VARIOUS RATIOS

T-TEST RESULT FOR	CR	QR	DAR	ICR	ROAR	NPMR	OCR	ATR
OBSERVATIONS	4	4	4	4	4	4	4	4
DF	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
T STAT	-0.28	5.33	2.09	2.98	7.25	5.21	-0.43	19.22
T CRITICAL TWO-TAIL	3.18	3.18	3.18	3.18	3.18	3.18	3.18	3.18

{CR- Current Ratio; QR- Quick Ratio; DAR – Debt to Asset Ratio; ICR – Interest Coverage Ratio; ROA – Return on Asset Ratio; NPMR-Net Profit Margin Ratio; ATR-Asset Turnover Ratio; OCR-Operating Cycle Ratio**}**

(a) First Hypothesis:

HO- Post merger, there is no significant impact on the liquidity ratio of the MEL.

H1 - Post merger, there is significant impact on the liquidity ratio of the MEL.

From the table 5 above, t- tabular at 3 degrees of freedom at 5 % level of significance

for current ratio, is higher than the t-calculated whereas for quick ratio t-tabular is less than the t-calculated. This implies that in case of current ratio null hypothesis is accepted and in case of quick ratio alternate hypothesis is accepted.

(b) Second Hypothesis:

H0- Post merger, there is no significant change in the solvency position of the MEL.

H1- Post merger, there is significant change in the solvency position of the MEL.

From the table 5 above, t- tabular values at 3 degrees of freedom at 5 % level of significance for both solvency ratios i.e. debt to asset ratio and interest coverage ratio are higher than the t-calculated and hence null hypothesis is accepted.

(c) Third Hypothesis:

H0- There is no change in profitability of the MEL after merger.

H1- There is change in profitability of the MEL after merger.

From the table 5 above, t- tabular at 3 degrees of freedom at 5 % level of significance

for both profitability ratios i.e.net profit margin ratio and return on asset ratio are lesser than the t-calculated and hence null hypothesis is rejected.

(d) Fourth Hypothesis:

H0- There is no impact on activity ratios of the MEL before and after merger.

H1- There is impact on activity ratios of the MEL before and after merger.

From the table 5 above, t- tabular at 3 degrees of freedom at 5 % level of significance

for operating cycle, is higher than the t-calculated whereas for asset turnover ratio t-tabular is less than the t-calculated. This implies that in case of operating cycle ratio null hypothesis is accepted and in case of asset turnover ratio alternate hypothesis is accepted.

CONCLUSIONS

Thus from the above data analysis and discussion, following conclusions are drawn:

1) Under the liquidity ratio category, post-merger there is no significant impact on current ratio whereas there is significant impact on quick ratios. Post-merger, the current ratio didn't change much but quick ratio had decreased significantly.
2) Post-merger, there is no significant change in both the solvency ratios i.e. debt to asset ratio and interest coverage ratio of the MEL/CFP. In case of interest coverage ratios, the changesare observed after merger but it is not statistically significant.
3) Neither return on asset ratio nor net profit margin ratios had shown increase during this period and hypothesis testing also suggest the same. Hence, it is concluded that there is no positive change in profitability of the MEL after merger.
4) In case of activity ratios, it is concluded that there is significant impact on asset turnover ratio whereas there is no significant impact on operating cycle ratio after thje merger of MEL with SAIL.

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