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Post Merger Financial Analysis- Air India & Indian Airlines

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ABSTRACT

Mergers and acquisitions have become highly strategic involving several considerations. When Air India and Indian Airline merged ,there were mixed reaction to it.The viability and its outcome were highly critical. **(1)V Thulasidas,the former CMD ,Air India considers it as a big mistake on HR failures.** This paper has focused on the financial performance of the two Companies within five years of merger.The main objective of this paper is to analyze whether the Companies have achieved financial performance efficiency during the post-merger & acquisition period specifically in the areas of profitability, leverage, liquidity, and capital market standards. The objective of this paper is to study, why organisations take the inorganic mode of expansion. However, the main focus is on studying the operating performance and shareholder value of acquiring companies and comparing their performance before and after the merger. A feasibility test that mergers improve operating performance of acquiring companies is done.. However on studying the cases, we conclude that as in previous studies, mergers do not improve financial performance at least in the immediate short term.

Key words:Strategic,financial efficiancies,profitability,Ooperating performance

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1.LITERATURE REVIEW

Anup Agrawal Jeffrey F. Jaffe (1999), in their article "The Post-merger Performance Puzzle", examines the literature on long-run abnormal returns following mergers. The paper also examines explanations for any findings of under- performance following mergers. We conclude that the evidence does not support the conjecture that under- performance is

specifically due to a slow adjustment to merger news. We convincingly reject the EPS myopia hypothesis, i.e. the hypothesis that the market initially overvalues acquirers if the acquisition increases EPS, ultimately leading to long-run under-performance.

Saple V. (2000) in his research thesis on “Diversification, Mergers and their Effect on Firm Performance: A Study of the Indian Corporate Sector”, finds that the target firms were better than industry averages while the acquiring firms had lower than industry average profitability. Overall, acquirers were high growth firms which had improved the performance over the years prior to the merger and had a higher liquidity

Ramaswamy and Waegelein (2003) in their article, “Firm Financial Performance Following Mergers,” studied the post-merger financial performance of 162 merging firms that occurred during 1975-1990 in the US. They used industry- adjusted operating cash flow returns on market value of assets as the measure of performance & used only firms that had not gone in for any merger during the study period as part of their control sample, since they felt that only that would make the data incorruptible and the results more robust. The study found a significant increase of 12.7 per cent in firm performance after the merger had taken place.

Dr. Salma Ahmed & Yasser Mahfooz (2009) in their case study paper, “Consolidation in the Sky - A Case Study on the Quest for Supremacy between Jetlite and Kingfisher Airlines”, did an attempt to descriptively analyse the rationale for consolidation in the Indian airline industry. The paper also evaluates major changes in the business environment affecting the airline industry.

Neena Sinha, K.P.Kaushik , Timcy Chaudhary (2010) in their research article on “Measuring Post Merger and Acquisition Performance: An Investigation of Select Financial Sector Organizations in India”, examines the impact of mergers and acquisitions on the financial efficiency of the selected financial institutions in India. The analysis consists of two stages.

Firstly, by using the ratio analysis approach, we calculate the change in the position of the companies during the period 2000-2008. Secondly, we examine changes in the efficiency of the companies during the pre and post-merger periods by using nonparametric Wilcoxon signed rank test. The result of the study indicate that M&A cases in India show a significant correlation between financial performance and the M&A deal, in the long run, and the acquiring firms were able to generate value.

N. M. Leepsa & Chandra Sekhar Mishra (2012) in their research paper on “Post Merger Financial Performance: A Study with Reference to Select Manufacturing Companies in India”, intends to study the trend in merger and acquisition (M&A) particularly with reference to manufacturing companies. The present study is an attempt to find out the difference in post-merger performance compared with pre-merger in terms of profitability, liquidity and solvency.

Pramod Mantravadi and Vidyadhar Reddy,(2007), “Relative size in Mergers and Operating

Performance" they explains that This research study aims to study the impact of m & A on the operating performance of acquiring corporate in different periods in India, by examining some pre and post merger financial ratios with chosen sample firms and mergers between 1991-2003. The result suggests that there are minor variations in terms of impact on operating performance following merger in different intervals of time in India.

Kumar (2009), "Post-Merger Corporate Performance: an Indian Perspective", examined the post-merger operating performance of a sample of 30 acquiring companies involved in merger activities during the period 1999-2002 in India. The study attempts to identify synergies, if any, resulting from mergers. The study uses accounting data to examine merger related gains to the acquiring firms. It was found that the post-merger profitability, assets turnover and solvency of the acquiring companies, on average, show no improvement when compared with pre- merger values.

Canagavally R.(2000); "An Analysis of Mergers and Acquisitions" they measures the performance in terms of size, growth, profitability and risk of the companies before and after merger. The dissertation also investigates the share prices of sample companies in response to the announcement of merger.

2.OBJECTIVES

1. Study post M&A influence on profitability standards of the Merged Companies.

2.Determine post M&A liquidity position of the surviving firm .

3.Ascertain post M&A improvement in capital market standards of the surviving company .

3.RESEARCH METHODOLOGY

3.1SCOPE OF THE STUDY

The Study is restricted to first few years post merger scenario. The paper is tested the influence of M&A on the financial performance of the surviving company by considering Pre and Post M&A financial analysis and ratios for the entire set of sample firm.

3.2 SAMPLING TECHNIQUE

Convenience sampling has been employed to select the sample companies for the study. Such a selection is undertaken as these units represent the sample in a better way and reflect better relationship with the other variable.

3.3 DATA ANALYSIS

Pre and post-merger performance ratios are computed for the entire set of sample companies, which have gone through M&A during the selected period. The pre and post M&A performance ratios are compared to see if there is any statistically significant change in performance of acquirer firm after M&A, using ratios and balance sheets.

4.INTRODUCTION:

India is currently the ninth largest aviation market in the world, according to a RNCOS report "Indian Aerospace Industry Analysis". The Government's open sky policy has attracted many foreign players to enter the market and the industry is growing in terms of both players and the number of aircrafts. Given the strong market fundamentals, it is expected that the civil aviation market will register a compound annual growth rate (CAGR) of more than 16 per cent during 2010-2013. India's domestic air traffic grew at a rate, which is the second highest after Brazil, according to global figures for June 2011, compiled by IATA. The country's domestic traffic grew by 14 per cent in the same period as against Brazil's 15.1 per cent.

Indian airlines reported a continuous growth trend and a strong domestic passenger growth rate of 22.3 per cent in July 2013. Passenger traffic has grown at 18 per cent year on year (y-o-y) basis and the year 2012 closed at 90 million passengers both domestic and international. India is the fastest growing aviation market and expected to be within 4-5 big aviation markets by 2020 and 3rd in terms of domestic market after US and China.

In July 2013, airlines in India handled 5 million domestic passengers, according to data released by the Directorate General Civil Aviation (DGCA) on September 12, 2013, marking the 11th consecutive month of double-digit growth. India's domestic market has witnessed passenger growth for 26 consecutive months now. In July 2013, India's airlines handled 1.3 million international passengers, an increase of 8.5 per cent y-o-y, according to DGCA.

Passengers carried by domestic airlines during Jan-Aug 2013 were 39.63 million as against 33.41 million during the corresponding period of previous year thereby registering a growth of 18.6 per cent, according to data released by DGCA.

Passengers carried by domestic airlines during Jan-Nov 2013 were 534.14 lakhs as against 550.33 lakhs during the corresponding period of previous year thereby registering a growth of – 2.94%. India is expected to cross the 450 million mark of domestic passengers by 2020. During the last two decades from a fleet of only about 100, the scheduled operators now have reached 435 aircrafts connecting the nation and the world.

Private carriers are anticipated to post a combined profit of US$ 350–US$ 400 million for the fiscal years 2012-13, as reported by Centre for Asia Pacific Aviation (CAPA) India, in its 2012- 13 - Aviation Industry outlook. Domestic capacity is also projected to grow by 13-14 per cent for the assessment period.

4.2 Air India and Indian Airlines

In February 2007, the Government of India approved plans to merge Indian Airlines with Air India. In May 2007, India's Ministry of Civil Aviation announced that Air India Limited (AI), India's national flag carrier and Indian Airlines Limited (IA), the government owned domestic airline, would merge with effect from July 15, 2007. The new airline formed by the merger was to be called "Air India", and would operate in both the domestic and international sectors.The company became registered on March 30, 2010.The key benefits to Indian

Airlines and Air India on account of this merger were as under:

• The merger had created a mega company with combined revenue of Rs. 15000 crores.

• The new entity had seen a number of changes in its operating model. It was much less restricted by government control and is therefore much more agile and could churn better returns than the two different entities. Since the two companies had come together, they had also been able to bring together their best practices and reduced the overall operational cost as well as administrative cost by a considerable margin.

• Air-India would have a combined fleet of 112 aircraft and would be among the top 10 airlines in Asia and among the leading 30 airlines globally.

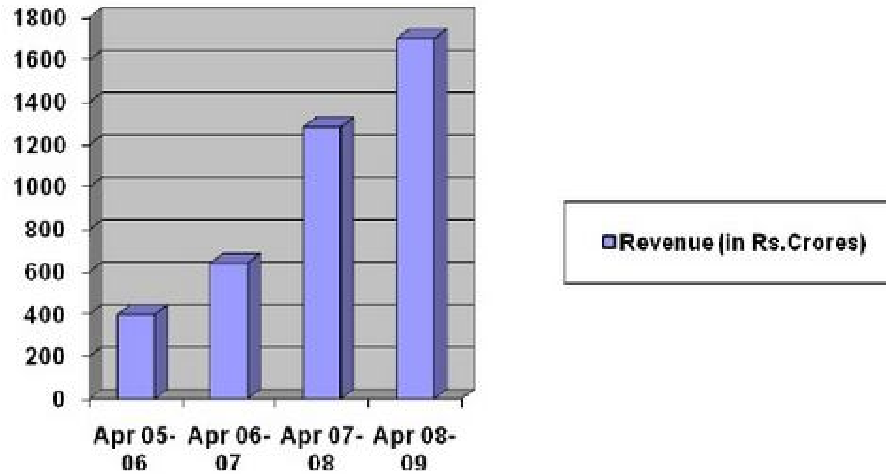
4.3Financial crisis

Around 2006-2007, the airlines began showing signs of financial distress. The combined losses for Air India and Indian Airlines in 2006-07 were Rs 770 crores. After the merger of the airlines, this went up to Rs 7,200 crores by March 2009. This was followed by restructuring plans which are still in progress.. In July 2009, SBI Capital Markets Ltd was appointed to prepare a road map for the recovery of the airline. The carrier sold three Airbus A300 and one Boeing 747-300M in March 2009 for $ 18.75 million to survive the financial crunch.

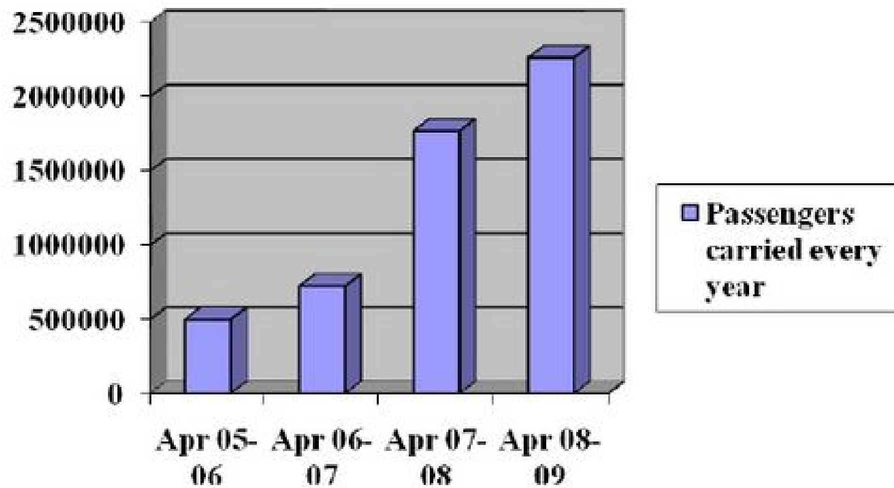
4.4 Post-Merger-

	Air India	Indian Airlines	Merged entity	Share in total industry
No of Aircraft	48	74	122	30.50
Flights (daily)	35	300	335	25.75
Revenue (Rs cr)	9,677	6,000	15,677	53.00
Profit (Rs cr)	16.50	49.50	66.00	-
Parking slots*	20	20	40	25.00
Engineering services	3	2	5	62.50
Passengers (in mn)	4.7	7	11.7	26.00
New aircraft order	68	43	111	31.71

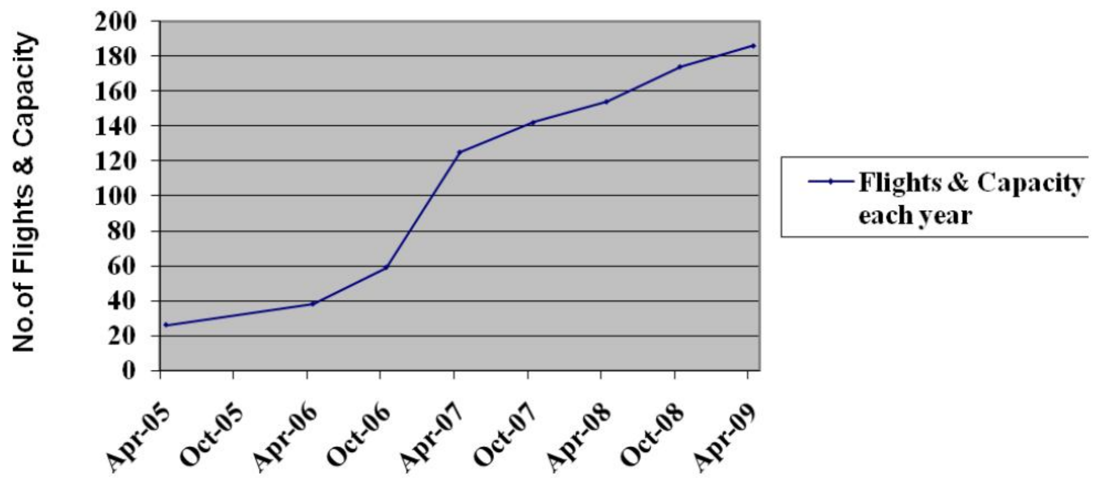
Source: DGCA



Source: DGCA



(Sources: Air India)



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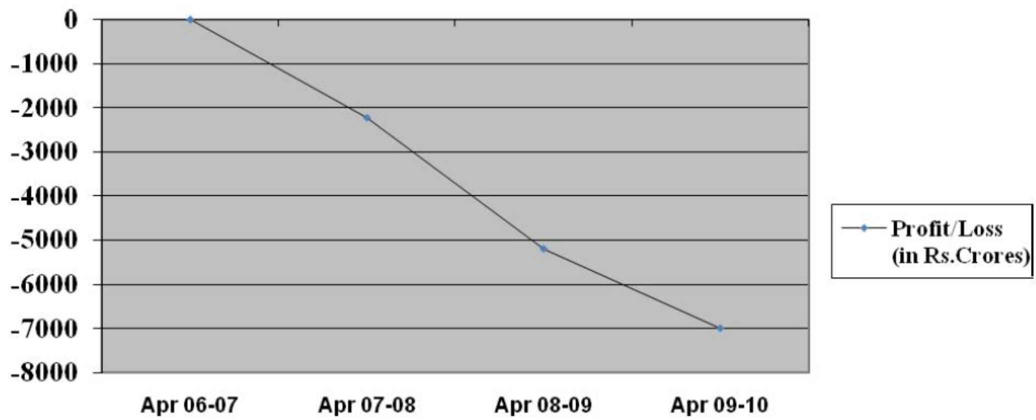

4.5 Financial Analysis

Air India	2004-05	2005-06	2006-07	2007-08	2008-09

Operating Profit Margin	14.23%	11.02%	-12.23%	-25.32%	-33.61%
Gross Operating Margin	8.62%	6.42%	-16.95%	-30.91%	-42.88%
Net Profit Margin	1.26%	0.16%	-4.85%	-14.59%	-41.16%
Return on Net Worth	29.65%	-4.39%	-	-38.29%	-2,662.95%
Debt Equity Ratio	3.88%	10.66%	-	3.17%	148.35%
EPS	6.26	0.97	-29.12	-153.53	-382.64

- From the ratio analysis, it is seen that the operating profit margin of Air India which was already declining before the merger, went to negative after the merger, which indicates negative cash inflows.
- Similarly, the gross profit margin post-merger, reduced further from-16.95% to -30.91%, which means the net loss for the company has increased.
- Return on Net worth was already negative and it reduced to a large extent after the merger of the airline.
- EPS was 0.97, it went into negative in the year of merger. EPS fell to -29.12 in the year 2007 and in years after that it further decreased.

4.6 Test for Profitability standards of Air India

Ratios	Mean		Std Deviation		Mean Difference
	Pre	Post	Pre	Post	
GPM	34.89	17.5	6.56	9.69	17.39
NPM	-1.57	-50.58	3.71	11.62	49.01
ROA/ ROI	-1.1	-19.52	4.74	7.69	18.42
ROE	-97.36	-662.27	176.83	157.19	564.92

ROCE	-1.56	-0.47	0.61	0.12	-1.1

- Profitability ratios reflect the AI’s ability to deliver air travel service at a high cost or a low price. All profitability ratios have declined post-merger, demonstrating negative impact of operating performance and lowering overall yield.
- Post-merger GPM has declined by 50% indicating inability of the management to control the COGS and unfavorable purchasing policies. Major contributing factor for lower gross profit is attributed to rising ATF prices and hike in airport fees.
- During past five years Indian airline industry had witnessed major downturn on account of global economic crisis, lower passenger count, rising fuel prices, fluctuations in foreign exchange rate, all these external environmental factors along with internal environmental factors like operational inefficiency, non- strategic management decisions, higher overheads & financial charges influenced NPM negatively & resulted in greater losses. Post-merger period AI had shown highest losses that were greater than the reported losses of all the private airline companies operating in India on domestic routes.
- Positive Mean difference value of ROA/ROI indicates destruction of shareholders’ funds by bad management policies and intense competition in airline industry. AI did not utilize its assets to the full extent to generate higher sales revenue in spite of increased fleet size post- merger period.
- Pre & post-merger ROE has been negative which reflects greater financial leverage practices. Higher debt component in capital structure resulted into greater financial charges, expropriating shareholders’ value.
- The analysis reveals the negative relationship between profits actually earned and capital actually employed. ROCE had shown negative return over the years due to non-strategic investment decisions. Management team has failed to provide minimum return on capital employed on account of unsound financial investment decisions. Top management did not take strict measures to control the budgetary system that lead to imperfect borrowing policies. Leading financial institutions downgraded AI’s creditworthiness due to lack of professional management practices & inefficiency to generate minimum required rate of return on the capital employed.

4.7 Test for Financial Leverage standards of Air India

Ratios	Mean		Std Deviation		Mean Difference
	Pre	Post	Pre	Post	
Debt to equity	29.41	58.62	26.51	47.71	-29.21

Capitalization	0.95	0.98	0.05	0.02	-0.03

- Post-merger D/E ratio has doubled indicating the higher leverage policy employed by AI instead of infusing more equity funds in its capital structure. AI cannot access the capital markets for fund raising purpose on account of being a PSU and all equity shares are held by president of India that are non-tradable or not issued to public at large. Every year GoI infuses additional capital into AI but this capital is devoted for long-term investment purposes and acquisition of capital assets. Thus, in order to fulfill working capital needs, AI had borrowed loan from leading Indian banks & financial institutions on short-term basis. Over the years the debt amount had increased on account of inefficient borrowing policies and at the same time low operating probability contributed limited funds to service the debt and amortization of the same. The analysis indicates that the claims of outsiders are more than the owner, lenders interests are not safe & they have to bear the probable future losses.
- Over the years total capitalization had shown increasing trend on account of more debt addition to the capital structure. The proportion of debt is high compared to equity funds reflecting use of over leveraging to fund the business operations. Post-merger AI had incurred losses & unable to create enough reserves for future investment purposes. To fulfill operating activities and strategic plans AI had dependent on debt financing as a result it is leading to debt trap wherein future earnings are not enough to meet the obligations and there is a likely possibility of default.

4.8 Test for Liquidity Standards of Air India Ltd

Ratios	Mean		Std Deviation		Mean Difference
	Pre	Post	Pre	Post	
Current Ratio	1.79	0.97	0.72	0.19	0.83
Acid-Test Ratio	0.8	0.59	0.18	0.16	0.21
Interest Coverage	-4.5	-2.18	14.76	1.25	-2.32

- Post-merger current ratio decreased by 56% indicating scarcity of resources to pay its debts over the short-term period and difficulty meeting current obligations. Over the year's relative increase in current liabilities is greater than the addition in current assets on account of rising financial charges, creditors payments etc.
- A falling acid-test ratio indicates worsening liquidity positions of AI and failure to meet immediate current liabilities. It is also observed that acid-test ratio is much lesser than the current ratio suggesting current assets are highly dependent on inventory &

sundry debtors.

- Over the years interest coverage had shown negative trend and AI's inability to honor its debt payments due to negative operating profit margin reported over past five years. Post-merger the interest coverage had lowered its negative trend on account of GoI bailout and negotiation with creditors.

4.9 Test for Capital Market standards of Air India

Ratios	Mean		Std Deviation		Mean Difference
	Pre	Post	Pre	Post	
EPS	-8.45	-297.47	20.58	337.59	298.02

- Post-merger EPS had indicated a negative trend due to continual losses incurred by the AI. Management team failed to provide bare minimum profit to equity holders. Fortunately, AI's equity is not traded in open market otherwise investors' would have lost their funds.
- Decline in EPS is attributed to higher operating expenses, increasing interest payments, proportionate decrease in sales revenue on account of inefficient management practices and intense competition.

5.CONCLUSION

The result of financial shows that there is insignificant improvement in return on equity, expenses to income, earning per share and dividend per share post-merger. The result from ratio analysis illustrated that there is no significance difference in the defined financial performance standards between pre-merger and post-merger. Hence there are no significant improvements in surviving company's performance post-merger and acquisition and reject the alternative situation which considers that there is significance improvement in surviving company's performance post-merger and acquisition activity for the sample under consideration.

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