

The Effect of Takeovers on the Performance of Acquirers in Australia Based on The Economic Value Added Method

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ABSTRACT

In theory, the acquisition is a fast way to expand a business or enter a new market, so the bidder company should perform better after the takeover. Research has been conducted on whether the performance of the bidder company can be improved after the acquisition, but the empirical results do not fully support the theory. Moreover, the studies on takeover activities in Australia are relatively rare. This paper examines bidding companies' performance in public acquisitions in Australia in 2017 based on EVA accounting methodology. We collect the data from 2013 to 2021 of the acquirer companies that bought the target companies in 2017 and calculate the acquirer companies' performance by EVA. We then compare their EVA before and after the acquisition and analyze the effect of the acquisition, demonstrating the average EVA experienced a slight rise in the three years after the acquisition. Two companies had a positive EVA after the acquisition, while the EVA of all the companies were negative before.

Keywords: Takeover, Australia, EVA.

1. INTRODUCTION

1.1. Benefits and Risks of Acquisition

The acquisition has several benefits and is an essential part of a company's investment decisions. It helps integrate resources, enhance supply chains and strengthen capital efficiency. Some acquirer companies could achieve economies of scale, increase the market share or even enter a new market. Professional employees could also be obtained through acquisition to avoid training expenses.

Due to the volatility of the market and the uncertainty of the target company's value, the risks of acquisition are also significant. The risk can be affected by due diligence. It is essential in the acquisition life cycle, including fact-checking and validating information about the company and its assets, particularly before taking ownership. Over-payment is another risk in acquisition. 60% of financial professionals believed deal valuation is the largest M&A risk factor (Allocca, 2016) [1].

1.2. Research Framework

This paper focuses on the performance of the bidder

companies that acquired the target companies in 2017. Section 2 reviews the previous research methods and conclusions about the effect of the acquisition in terms of the bidder companies' performance and divides them into two categories according to the performance measure. Then the formula of the EVA method and the standardization method are introduced in Section 3. The result is analyzed to conclude in Section 4. And the conclusion, the research implication and the research gap are presented at the end.

1.3. Study Area

Australia has strict acquisition laws. For example, it is restricted that a person acquires more than 20% interest in a company unless it makes a takeover bid to all shareholders, or another exception applies based on Australian takeover law. These legal provisions encourage bidding companies to consider their options and complete efficient acquisitions carefully. The Australian market is mainly dominated by private and subsidiary acquisitions, which means a rare study has been conducted on the public takeover activities. Australia saw a \$120 billion trade in the merger and acquisition market driven by global consolidation in

2017, the highest since 2011 [2]. And the bidder companies are mostly from the foreign market.

2. LITERATURE REVIEW

Acquisitions are typically based on the promise of increasing shareholder wealth. However, in practice, the rise of the acquirer companies' performance cannot be ensured. Several studies have investigated the acquisition impact on the acquirer company. The research can be divided into share price performance and accounting performance depending on the performance measure.

Sudarsanam and Mahate used different types of acquirers to study the acquisition from 1983 to 1995 in the UK and concluded that acquirers experienced BHARs in the region of -15% over a three-year post-acquisition period (Sudarsanam & Mahate, 2003) [3]. Alan Gregory and Steve McCorriston investigated the foreign acquisitions by UK companies on US and EU targets over the period 1985–1994. While some firms showed insignificant returns following acquisitions in the EU, those acquired by US companies underperformed (Gregory & McCorriston, 2005) [4]. Using the three-factor model and capital asset pricing model, a study of public acquiring firms from 1991 to 1998 in the UK concluded that the abnormal return of acquirer company is around -1% [5].

The research in this field uses accounting performance measures as well. Guest, Bild, and Runsten investigated the UK acquisitions completed during 1985–96 and found that the acquisition impact on fundamental value is slightly negative (Guest, Bild, & Runsten, 2011) [6]. They also tested the operating improvements of Malaysian acquisitions from 1988 to 1992. They compared the operating performance of the bidder companies before and after the acquisition and indicated that the operating cash flow performance for combined firms improved significantly after acquisitions (Rahman & Limmack, 2004) [7]. Vu investigated failed takeover efforts in search of new evidence about whether mergers add or subtract value for acquirers and targets two months before and after the bid (Vu & Cole, 2007) [8]. Evaluation of acquisitions occurring from 1989 to 1993 reveals that the raw EVA of the acquirer company declined significantly after acquisitions, caused by the industry factors (Yook, 2004) [9].

3. MATERIALS AND METHODS

3.1. EVA

Economic value added (EVA) measures company performance representing a company generated from the investment. It was proposed by the American academic Stewart and implemented by an American consulting firm, Stern Stewart & Co (Brewer, Chandra & Hock, 1999) [10]. EVA is the remaining profit after deducting

the opportunity cost of all capital used to generate those profits from after-tax operating earnings.

EVA is an accounting research method. The traditional accounting research method may lead to data being distorted. For example, profits and earnings per share can be easily manipulated. But the EVA model considers both profit and the cost of capital to evaluate a company's performance. The EVA method also reflects the company's capital performance objectively. Adjusting certain items, including goodwill, interest expense, and deferred tax, reduces accounting policies' impact.

The formula of EVA is:

$$\text{EVA} = \text{NOPAT} - (\text{Invested Capital} \times \text{WACC}) \quad (1)$$

$$\text{Invested capital} = \text{Debt} + \text{capital leases} + \text{shareholders' equity} \quad (2)$$

$$\text{NOPAT} = \text{Operating Income} \times (1 - \text{Tax Rate}) \quad (3)$$

$$\text{Operating Income} = \text{Gross profits less operating expenses} \quad (4)$$

3.2. Standardization

To avoid one of the indicators being overly or underweighted, we use a standardization method to deal with the results:

For positive indicators:

$$X_{ij}' = \frac{X_{ij} - \min(X_{ij})}{\max(X_{ij}) - \min(X_{ij})} \quad (5)$$

For negative indicators:

$$X_{ij}' = \frac{\max(X_{ij}) - X_{ij}}{\max(X_{ij}) - \min(X_{ij})} \quad (6)$$

4. ANALYSIS

Seventeen public acquisitions were completed in Australia in 2017, including seven that had both the acquiring and target company listed on the Australian stock market. The seven acquirer companies are NWH Australia Asset Co Pty Ltd, Cimic Group Limited, Washington H Soul Pattinson & Company Limited, Downer EDI Limited, Zeta Resources, Geopacific Resource Ltd., and Lithium Australia NL. Their financial data are collected from Morningstar and Gurufocus. The EVA from 2013 to 2021 is calculated using EXCEL to process the data, and the result is shown in table 1.

In the four years prior to the acquisition, these companies experienced significant declines in EVA and are all below 0. Four companies experienced a slight increase in EVA the first year after the acquisition. However, there was no smooth upward trend, and all companies experienced a turbulent EVA after the acquisition.

The results are standardised to ensure that none of the companies is overly or underweighted, and each company's EVA is averaged in Figure 1. However, the average eva of the seven companies experienced a relatively significant increase post-acquisition, with a standardised average eva of 0.339 in 2016, 0.439 in the year of acquisition and 0.445 one year post-acquisition. The average EVA experienced a slight rise after the acquisition from 2017 to 2020 and began to decline in 2021, mostly caused by covid-19.

Their average EVA from 2013 to 2016 and from 2018 to 2021 is calculated. Before the acquisition, all the companies had negative EVA, indicating poor performance of the acquirer company. After the acquisitions of 2017, most companies experienced an increase in eva, with two of them growing to positive eva. Washington H Soul Pattinson & Company Limited and Zeta Resources- had a positive EVA after, as shown in table 2.

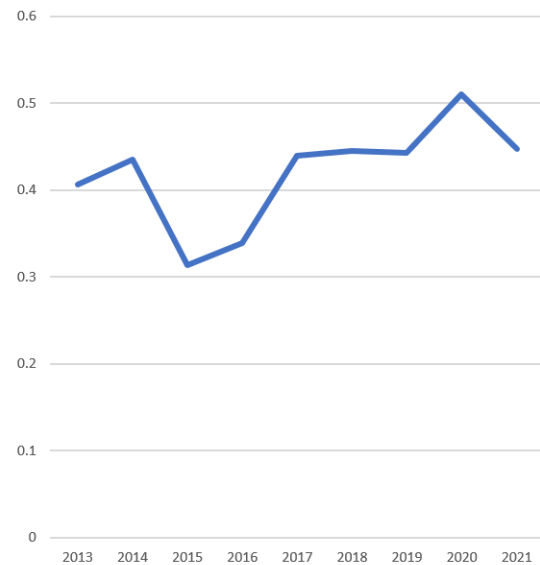


Figure 1 Average EVA.

Table 1. EVA of Acquirer Companies

	2013	2014	2015	2016	2017	2018	2019	2020	2021
NWH Australia AssetCo Pty Ltd	11.11	-21.48	-244.21	13.76	-1.09	-17.97	-99.25	-86.92	-84.04
Cimic Group Limited	-1002.94	-1586.95	-468.04	-140.54	297.79	404.15	-1749.95	-1626.72	77.55
Washington H Soul Pattinson & Company Limited	-127.48	-73.74	-140.37	-29.13	152.98	17.54	122.11	551.79	-43.59
Downer EDI Limited	-332.92	-240.15	-263.09	-184.08	-361.40	-436.54	-4.09	-827.93	-537.72
Zeta Resources	-3.99	22.03	-70.62	-13.47	10.49	29.04	-70.92	-36.33	127.41
Geopacific Resource Ltd.	-5.23	-6.33	-8.92	-13.70	-13.75	-57.18	-22.00	-15.08	-57.38
Lithium Australia NL	-1.48	-2.67	-1.51	-5.20	-7.76	-13.65	-11.06	-10.14	-21.80

Table 2. Average EVA from 2013 to 2016, 2017, and from 2018 to 2021

	Average from 2013 to 2016	2017	Average from 2018 to 2021
NWH Australia AssetCo Pty Ltd(aud)	-60.20	-1.09	-72.04

Cimic Group Limited (CIM)	-799.62	297.79	-723.74
Washington H Soul Pattinson & Company Limited	-92.68	152.98	161.97
Downer EDI Limited	-255.06	-361.40	-451.57
Zeta Resources	-16.51	10.49	12.30
Geopacific Resource Ltd.	-8.55	-13.75	-37.91
Lithium Australia NL	-2.71	-7.76	-14.16

4. CONCLUSION

The result indicates that the average EVA experienced a slight rise in the three years after the acquisition, but post-acquisition EVA did not rise smoothly. The performance of the post-acquisition company is slightly better than that before the acquisition. And the average EVA of these bidder companies rise and that of two companies changes from negative to positive, demonstrating that the performance of acquirer companies is improved after acquisition. It shows that the acquisition has a positive impact on the performance of the acquirer companies while these companies still need some adjustment after the acquisition.

This paper focuses on the public takeover activities in Australia in 2017. And the result demonstrates that the changes of the performance of Australian acquirer companies in 2017 are consistent with theory, providing support for takeover theory. There are few scholars have previously examined the impact of acquisitions on the performance of Australian public companies, and this paper fills this gap. Further research could investigate the performance of private companies and cross-border acquisitions, and the performance differences between companies. It is also worth looking into whether the differences in some acquisitions influencing the company's performance

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