

# HINDENBURG-ADANI CASE STUDY



On 24 January 2023, Hindenburg Research issued a research report on Adani Group stating that the Group has been involved in *stock manipulation and accounting frauds* since many years. It also highlighted that the company's stocks are overpriced and have a downside potential of 85%. Post publishing the report, Hindenburg had taken short position on Adani Group through US bonds and derivatives.

The report resulted to havoc in the share market. Not only did it impact Adani's listed companies' shares but also smashed overall index i.e. Sensex and Nifty. Bank shares also observed a decline as the investor's fear rose because of significant debt in Adani's book.

Citigroup Inc.'s wealth arm and Credit Suisse has stopped accepting bonds of Adani group as collateral for margin loans to its private bank clients as bank is inspecting into Group's finances. As a consequence, yields on bonds issued by Adani has soared in the overseas market.

The Group responded to the report testifying that the report has no significance and the company has always disclosed all the necessary information in the public domain. Sighting the volatility in the market, Founder, Gautam Adani announced to cancel its fully subscribed Follow-on Public Offering (FPO) and pre-pay USD 1.1bn loans maturing September 2024 to release its pledged shares.

The overall share market has seen stability in recent days including banking industry. While Adani shares has not fully recovered, but it is viewing an up trend subsequent to loan pre-payment announcement.

Adani Group has hired **Watchtell**, US-based law firm, known for taking complex corporate cases, to fight against claims made by Hindenburg Research.

Founded by **Gautam Adani**, Adani Group is an Indian multinational conglomerate headquartered in Ahmedabad, Gujarat. It was established in 1988 as a commodity trading business (mining and trading of coal and iron ore), with its flagship company Adani Enterprises Limited (AEL) incorporated in 1993. AEL act as an incubator to Group's new projects till the time they become self-sustainable.

The Group's investments were regionally concentrated, but over time, they have involved into other businesses such as port management, electric power generation and transmission, renewable energy, mining, airport operations, natural gas, food processing and infrastructure. Apart from Adani Wilmar which is a food processing business, all other Adani business revolve around infrastructure, logistics and energy.

The Adani conglomerate is India's biggest airport operator with 6 airports under it i.e. Ahmedabad, Lucknow, Mangalore, Jaipur, Guwahati and Thiruvananthapuram. It also controls nation's largest port named as Mundra Port that it developed in 1990 to provide a base for its trading operations.

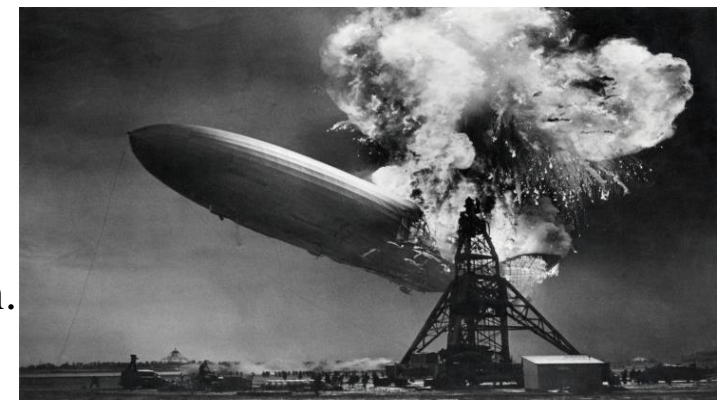
Adani group has **nine publicly traded companies** including ACC and Ambuja Cements that it acquired in May 2022. As of January 2023, Gautam Adani net worth was USD 120bn, with more than USD 100bn coming in the past 3 years, mainly through exponential appreciation in stock prices.

Hindenburg research is a “*forensic financial research*” firm founded by Nathan Anderson, a graduate of international business management from the University of Connecticut, in 2017. Anderson started his career with a consulting job in financial software company FactSet, and then at broker dealer firms in Washington and New York.

The firm specializes in identifying wrongdoings and frauds (so called, *man-made disasters*) of the companies across the globe such as accounting irregularities, bad actors in management/key service provider roles, undisclosed related-party transactions, illegal/unethical business or financial reporting practices, an undisclosed regulatory, product, or financial issues etc.

The firm takes market bet against such companies by investing its own capital and also publishes its findings in the public. For carrying out in depth research on the companies and for supporting its investment decisions, apart from employing fundamental analysis, it also uses unconventional sources to disclose hard to find information.

It was named based on the *Hindenburg disaster of 1937*, when a German passenger airship named Hindenburg flying into New Jersey caught fire and crashed, killing 35 passengers on board. The firm viewed this incident as man-made and totally avoidable as there were some 100 people on the airship filled with the most flammable material in the universe i.e. hydrogen.



According to the Hindenburg's website, the company has published reports on misconduct of more than 16 companies since 2017 such as Nikola, SC Worx, WINS Finance, Predictive Technology Group, SmileDirectClub, China Metal Resources Utilization, Yangtze River Port & Logistics and few others.

Among all, **Nikola** was Anderson's best bet so far. Nikola Corporation is an American energy solutions company that manufactures electric vehicles. In *September 2020*, the short seller stated that Nikola has duped its investors about its technological advancements. Nikola had released a video showing its electric truck cruising at high speed, while in reality the vehicle was moved down a hill. There were no such vehicle in existence as the one showcased in the video.

Nikola's founder and executive chairman Trevor Milton resigned immediately amid allegations that he lied to his investors and later he was announced guilty by US jury of fraud. The company accepted the charges and agreed to pay USD 125 mn to Securities and Exchange Commission (SEC). This entire incident resulted in steep fall of Nikola's valuation from USD 34bn to USD 1.34bn.

Hindenburg mentioned that **whistleblowers and former employees** of Nikola had helped them in the research.



On the basis of two years of investigation including review of thousands of documents, talks with former Adani senior executives and site visit to numerous countries, Hindenburg on January 24, 2023 published a report alleging that Adani Group has engaged in ***“a brazen stock manipulation and accounting fraud scheme”*** over the decade. Hindenburg has taken ***short positions in Adani companies*** through US-traded bonds and non-Indian-traded derivative instruments.

The highlights of the allegations made by Hindenburg research report are:

1. On a fundamental basis, seven key listed companies of Adani group have an **85% downside** merely due to sky-high valuations.
2. Key listed Adani companies have taken substantial debt against **pledging shares** of their inflated stocks. **Current ratio** of 5 out of 7 companies is **below 1** indicating liquidity crunch.
3. Adani Group has previously been the focus of four major **government investigations** relating to allegations of money laundering, theft of taxpayer funds and corruption, totaling an ~USD 17 bn.
4. Adani family members have created a large web of **offshore shell entities** in tax heaven countries like Mauritius, Cyprus, Singapore, Caribbean Islands and UAE. These entities are being used for money laundering and stock manipulation. In Mauritius, there are 38 shell entities controlled by Vinod Adani, Gautam Adani's elder brother, and his close associates.
5. Rajesh Adani, younger brother of Gautam Adani and Samir Vora, Gautam Adani's brother-in-law have been designated as Managing Director of Adani Group and Executive Director of the critical Adani Australia division respectively despite being accused by the Directorate of Revenue Intelligence (DRI) in diamond trading scam.
6. The **independent auditor** of AEL and Adani Total Gas is a **small firm** with only 4 partners and 11 employees having no website. The auditor seems incapable of complex audit work as AEL alone has 156 subsidiaries and many joint ventures and Adani's 7 key listed entities collectively have 578 subsidiaries.
7. Publicly traded companies are required to have at 25% of their shares be held by non-promoters and to pass this threshold, Adani Group has shown **foreign fund investments** which is **controlled by Adani family**.

Adani Group has denied all the accusations made by Hindenburg sighting that it's a “*malicious combination of selective misinformation and stale, baseless and discredited allegations that have been tested and rejected by India's highest courts*”. The Group has said that the report is a "calculated attack on India". Also, the timing of report signifies a wrong intention to harm the Group's reputation with the prime objective of damaging the upcoming Follow-on Public Offering (FPO) from AEL, the biggest FPO ever in India.

It also said that it had complied with all local laws and had made all necessary regulatory disclosures. It accused the Hindenburg, a short seller, of trying to create a false market in order to book huge gains at the cost of numerous investors. The Group is evaluating ways to take legal actions against Hindenburg in US and India.

Though the INR 20,000 crore FPO from AEL was fully subscribed after the support of high-net-worth individuals and institutional investors with poor response from retail investors and employees of the group, the company has withdrawn the share sale. This move has been taken to protect investors from any potential financial losses given such unprecedented situation and market volatility.

Gautam Adani has stated that the Group's balance sheet is very strong and cancelling FPO will have no impact in their present operations and future plans.

# Impact on Adani's Stocks and Bonds

Adani Group companies' shares experienced a steep fall due to Hindenburg's scorching allegations. Within two days of report released, the market value of Adani Group fell by 21.8% to INR 15 trillion (vs INR 19 trillion). The shares of all listed Adani companies (apart from Adani Power and Adani Wilmar which decreased by 9.8%) experienced a downfall of 20-25%,

Gautam Adani net worth has plunged from USD 120bn (24 Jan 2023) to USD 60bn (7 Feb 2023) slipping him down to 17<sup>th</sup> position on Forbes' list of world richest person from 3<sup>rd</sup> position.

Adani Group Companies	Mkt Cap (24 Jan)	Mkt Cap (6 Feb)	Change% (6th Feb vs 24th Jan)	Mkt Cap (7 Feb)	Change% (7th Feb vs 6th Feb)
Adani Transmission	307,447	140,708	-54.23	139,626	-0.77
ACC	43,869	36,983	-15.70	37,471	1.32
Ambuja Cements	98,994	75,345	-23.89	76,189	1.12
Adani Ports	164,354	117,954	-28.23	119,520	1.33
Adani Power	105,989	70,370	-33.61	66,860	-4.99
Adani Wilmar	74,491	49,440	-33.63	51,909	4.99
Adani Total Gas	427,326	169,888	-60.24	161,397	-5.00
Adani Green Energy	303,113	140,591	-53.62	133,566	-5.00
Adani Enterprises	392,474	179,288	-54.32	205,485	14.61
<b>Total</b>	<b>1,918,057</b>	<b>980,568</b>	<b>-48.88</b>	<b>992,025</b>	<b>1.17</b>

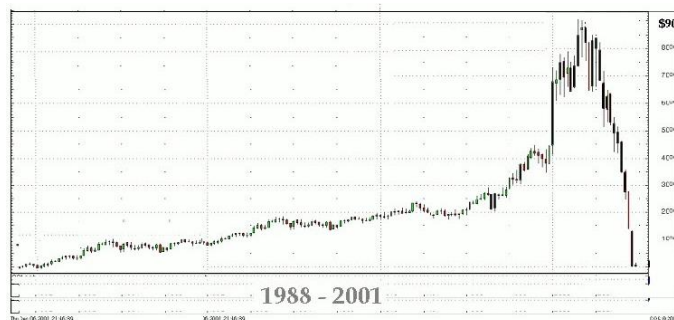
*Note:* Market cap is Rs Crore

Though Adani Group's value has waned drastically following the Hindenburg's report, it has seen an upside since 7 Feb. One of the major reason for the surge is the announcement by Adani Group promoters to *prepay USD 1.1bn of loans* for the release of pledged shares of its firms ahead of maturity in September 2024. The shares are of Adani Ports & Special Economic Z ones, Adani Green Energy and Adani Transmission. The step has been taken sighting the recent market volatility.

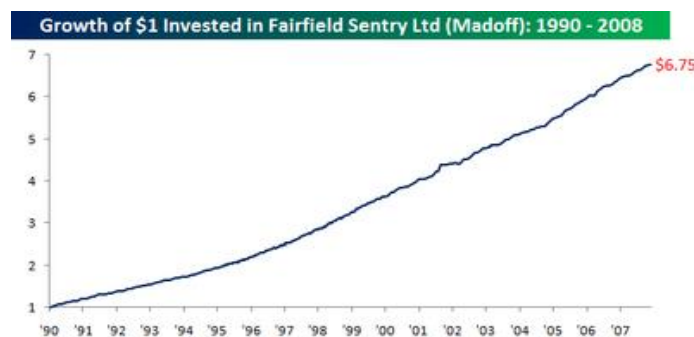
Adani bonds has entered distressed zone in US trading post the company pulled out its FPO, while trade has frozen in domestic market as prices offered by prospective buyers are way below what the holder are expecting to get.



## ➤ Meteoric appreciation in stock prices in short span of time



Enron



Bernie Madoff



Adani Enterprise

## ➤ Valuation metrics compared to industry and peers

Metrics such as Price to Earnings, Price to Sales, EV to EBITDA, EV to Sales among others can provide meaningful information about an enterprise if looked in conjunction with that of industry and its peers. It can help to assess whether an organization is overvalued or undervalued.

## ➤ Extensive use of leverage

Huge deployment of leverage can impact solvency of a firm. It can be identified using leverage ratios like Debt to Equity, Net debt to EBITDA, Debt to Capital (debt plus book equity), Debt to Capital (debt plus market capital), Interest Coverage etc. in comparison to the industry. Metrics such as Free Cash Flow, Current ratios can be valuable to figure out current situation of an enterprise. Situation where debt is raised pledging shares could be detrimental.

## ➤ **Shareholding structure**

Shares of the company concentrated in the hands of promoters may lead to liquidity risk in the market, increase probabilities of insider trading and market manipulation.

## ➤ **Auditors information**

A basic check should be made on the auditors responsible for auditing the financial reports of the company. Well know and credible audit firm provides confidence to the investors that the financial are being reviewed independently by a capable team. Details like number of employees in the audit firm, years of experience, number of clients, book size etc. can be significance on deciding whether to rely on auditors report or not.

## ➤ **Use of shell companies**

Large organizations establish shell companies in tax heaven countries to manipulate their stocks and financial statements. Companies purchase their own float shares through shell companies and try to control the market. Detailed information about companies' investors, their shareholding, headquarter, owner, website and employees of the investing firm, news articles etc. can be useful to identify potential shell companies.

## ➤ **Warning signaled by Questions on Corporate Governance**

Any concerning news about the company, or its promoters regarding the functionality of the company in any period of the past can be a red flag for the investors to note.