Adani and the Hindenburg Saga

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Abstract: *This assignment examines the impact of the Hindenburg report on the Adani Group and its corporate governance practices. It highlights the importance of transparency and accountability in corporate governance, especially in multinational corporations operating in diverse sectors. It analyzes the company's board structure, accounting practices, and disclosure policies, among other factors. The study employs a mixed-methods approach, including a review of the company's annual reports, governance documents, relevant literature, and interviews with key stakeholders. It argues the relevance of players like Hindenburg and the need for good corporate governance practices for companies' long-term sustainability and success. The paper concludes by discussing the implications of these findings for the company's performance and reputation and for its stakeholders, including shareholders, employees, and customers.*

1. Introduction

The Hindenburg report (Hindenburg, 2023) is an investigative report published by Hindenburg Research, a financial research firm, alleging that the Adani Group, one of India's largest multinational conglomerates, engaged in fraudulent practices, misrepresenting its financial performance, and violating environmental regulations. The report raised concerns about the company's corporate governance practices, which led to a significant drop in Adani's share prices and prompted regulatory investigations.

Adani is India's 2nd largest conglomerate (Investing.com, 2022), with operations in diverse energy, infrastructure, logistics, and agribusiness sectors.

The Adani Group has a reputation for being a dominant player in several sectors, with a focus on growth and expansion. This is mirrored in the conglomerate's motto- "Growth with Goodness." The group has taken on considerable debt to fuel its expansion spree.

1.1 Is Debt on balance sheet a sin?

Post various bankruptcies, NPAs of banks, and the risk of promoters losing control and being branded as defaulters, debt has been deemed akin to a sin that must be avoided at all costs. Can this view sustain? Certainly not. Moreover, gone are the days when banks used to nurture NPA accounts as their offspring. The welcome changes post the new bankruptcy law are rational behavior on the part of both borrowers and equally strong and prompt action of lenders at the first sign of a problem. The new bankruptcy law is a boon for lenders and investors and a deterrent for borrowers to overstretch.

The timing of the Hindenburg report is quite interesting since it was just around the time when Adani group's flagship company – Adani Enterprises, came out with its ₹20,000 crore FPO.[1] Even though the FPO sailed through minutes before the markets closed. A day

[1] Follow On Public Offer

later was not good for the shares of Adani Enterprises. The share price nosedived 28%; Adani Enterprises withdrew its fully subscribed FPO amid the falling scenario.

This study examines the impact of the Hindenburg report on the Adani group from a corporate governance perspective. It employs a mixed-methods approach, including a review of the company's annual reports, governance documents, relevant literature, and interviews with key stakeholders.

2. Board Structure

2.1 Adani Group Leadership

A 22-member leadership team (Adani Group, n.d.) leads the Adani group, which employs 23000+ people across the globe. This team has at least seven members of the Adani family.

Hindenburg, through its report, also brings to our notice that Gautam Adani is the chairman of 6 of the 7 listed Adani companies. This leads to what is known as key-man risk. The risks associated with the same include:

- **Overcommitment:** An individual, leading multiple companies, may need more time and attention to each company, leading to ineffective oversight and decision-making. This can result in poor performance, inadequate risk management, and missed opportunities.
- **Reduced Investor Confidence:** Investors may perceive a need for more independent oversight and potential conflicts of interest, which can reduce their confidence in the companies and their management. This can result in declining shareholder value and difficulty attracting new investors.

Decision-making authority in a company, such as its leadership team consisting primarily of family members, can undermine decision-making. This is because family members may have personal relationships and interests that can conflict with the company's and its stakeholders' best interests. Family members may also be more likely to prioritize their interests over the company's interests, which can result in decisions that are not optimal for the business.

2.2 Accusations of fraud against directors

Gautam Adani's younger brother, Rajesh Adani, has been arrested twice on allegations of tax evasion and undervaluation of imported goods in 1999 and 2010 (Indian Express, 2010). Moreover, he was also accused of planning a fraudulent diamond trading scheme by the Directorate of Revenue Intelligence (DRI). Usually, when an executive is accused of being the brains behind a plot to defraud the government and is repeatedly detained on suspicion of fraud-related offenses, that executive is fired. In certain nations, they are imprisoned. Interestingly, they advance at the Adani Group. Rajesh Adani, who presently holds the position of managing director for the Adani Group, is an "essential" member of the organization skilled at "building its business ties."

3. Accounting Practices

3.1 CFO woes at Adani listed companies

The ports-to-power conglomerate has had a significant turnover in its CFO roles. Most large enterprises aim to have stability in their executive management. While Gautam Adani and his family have been heavily involved in Adani Enterprises and the other listed entities, they have needed help to retain Chief Financial Officers.

3.2 Suspicious Auditor

Most large companies hire credible, well-known external auditing firms to give investors confidence that a capable team is independently reviewing their financials. The conglomerate's flagship listed entity, Adani Enterprises has 156 subsidiaries, many more affiliates, and joint ventures; one would expect a large, highly experienced team to be monitoring its labyrinthian corporate structure.

However, Adani Group has shunned this approach, choosing a tiny auditor named Shah Dhandharia to oversee the audits for the public company. The tiny firm reported having only four partners and 11 total employees. Given the complexity of Adani Enterprises, employing a small, relatively unheard-of auditor raises questions about the scrutiny of the audits.

There have been a series of crucial accounting red flags at other Adani group companies, which are audited all or in part by "Big-4" firms like Deloitte or affiliates of Ernst & Young (Annual Report, 2023).

3.3 Disclosure Policies and Stock Parking

Hindenburg alleges that an Adani family member, through several close associates, manages a vast labyrinth of offshore shell entities. These entities have no apparent signs of operations. Despite this, they have collectively moved billions of dollars into Indian Adani publicly listed and private entities, often without required disclosure of the related party nature of the deals.

Offshore funds domiciled in Mauritius (Business Standard, n.d.)are suspected of manipulating the stock prices of Adani-listed entities. These 'public' funds have little to no diversification beyond Adani-listed companies and are structured to conceal their actual beneficiaries. Furthermore, these funds then seem to be used to engineer Adani's accounting (whether by bolstering its reported profit or cash flows), cushioning its capital balances to make listed entities appear more creditworthy or moved back out to other parts of the Adani empire where capital is needed.

4. Effect of the Report

The Adani Group vehemently refuted the allegations, but investors quickly left. By February 8, the $236 billion company was valued at just $127 billion. Moreover, they have had significant knock-on effects.

Despite the FPO being completely subscribed, Gautam Adani decided to cancel it due to the enormous decline in the value of Adani equities. Adani claimed that the board chose to safeguard investors' interests and that the funds raised would be refunded. A historic FPO for the Indian stock market that was scheduled to take place had to be canceled. As a result, investor confidence was further damaged, and Adani's stock continued to decline.

4.1 Response of the Adani Group to the report

The accusations made in the Hindenburg Research report have been contested, and Adani Group has filed a lawsuit against the research company. In reaction to the article, the company has released several statements disputing the claims and defending its business operations.

Adani Group is plotting a comeback strategy focused on addressing investor concerns around debt, consolidating operations, and fighting off allegations with the help of a top-shelf U.S. crisis communication and legal teams. It has brought in Kekst CNC as a global communications advisor and engaged American law firm Wachtell, Lipton, Rosen, and Katz to fight back against Hindenburg's allegations.

The group has repaid USD 1.11 billion to release pledged shares in Adani Ports & Special Economic Zone Ltd, Adani Green Energy Ltd, and Adani Transmission Ltd. It will prepay a USD 500 million bridge loan that was taken to finance the purchase of Holcim Ltd cement assets (Sreedhar, 2023).

4.2 RBI seeks details from Indian banks

The RBI reached out to major banks which are lenders to the group and engaged with them to verify their exposure details. As per reports, the Adani group has ₹47.1 thousand crore exposure to PSU banks and ₹15.1 thousand crore exposure to private banks[2].

4.2.1 Are lending banks at risk?

'Banks will sink.' 'Public money in PSU / Private banks is lost.' Such statements make one wonder whether those making these statements understand how the banks lend money. Is the market price or market capitalization the benchmark for banks' lending?

Any banker worth their salt will know that banks lend money with an eye on cash flow from the project to service its loans. Charge over assets and pledge of shares is a secondary consideration to morally bind the borrower as a fallback provision. Banks consider the Debt/Equity Ratio, Debt Service Coverage Ratio (DSCR), and the payback period. And security cover as a fallback.

Any banker would know that credit appraisal techniques vastly differ from industry to industry. Any volatile industry will always require a higher DSCR, and the payback period would be shorter. In contrast, infrastructure or utility companies will have a much lower DSCR, a long gestation and payback period due to lower volatility, and extended project life. No banker will ever require a road project payback to be the same as payback for consumer goods.

It is against this backdrop that one finds that except for Adani Wilmar, Cement companies, and trading, all other Adani companies are infrastructure and utilities, where the payback period runs into decades

5. Conclusion

5.1 Half-Truths

In many places, the short seller has been economical with the truth and has selectively chosen to give only one part of the event, probably intending to cause an injury that might not be as severe if the other part of the event was given alongside. For example, in the point related to the arrest of Mr. Rajesh Adani and the DRI case in 2005, The report fails to mention that the case went up to the Supreme Court of India, and the DRI case was dismissed. Thus, taking the sting out of the event. By not revealing the case dismissal by Hon'ble SC, Hindenburg has attempted to mislead investors (although it covered itself with various disclaimers).

6. Parting Words

Hindenburg's short-sell report comes when multinationals are increasingly considering India as one of their target countries as they diversify away from China. Infrastructure expenditure, therefore, is among the priorities for the world's largest democracy to attract and better serve foreign direct investors (FDIs).

This is where the Adani Group fits in, especially with its close ties to the incumbent Modi government. Its diverse array of interests includes power generation and transmission, renewable energy, natural gas, mining, and a variety of significant infrastructure projects. With the collapse in Adani companies' share prices, equity may be extremely difficult to secure,

[2] Data on bank exposure was taken from the Adani group presentation in response to a Credit Insights report.

given severe corporate governance concerns. Raising long-term debt may be problematic and on exorbitant terms, and lenders may demand high-quality security. Experts believe the only viable solution for Adani may be divesting quality assets, such as its recent Gujarat Ambuja and ACC cement acquisitions, to reduce group debt.

Although the loss in billions does not adversely affect the Adani group in its long-term growth, it indeed has had an impact on the stock market investors of India. The citizens can look forward to stronger regulations from the Securities and Exchange Board of India and an explanation from the Union on how to invest confidently amidst the volatility of the Indian stock market.

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