■ PERSPECTIVE

Hindenburg Short Selling Saga

It's All About Money, Honey!

While only time will tell about the credibility of its accusations against the Adani Group, Hindenburg did achieve its objective as the target stocks fell between 30% and 80% and that is a juicy outcome for any short seller.

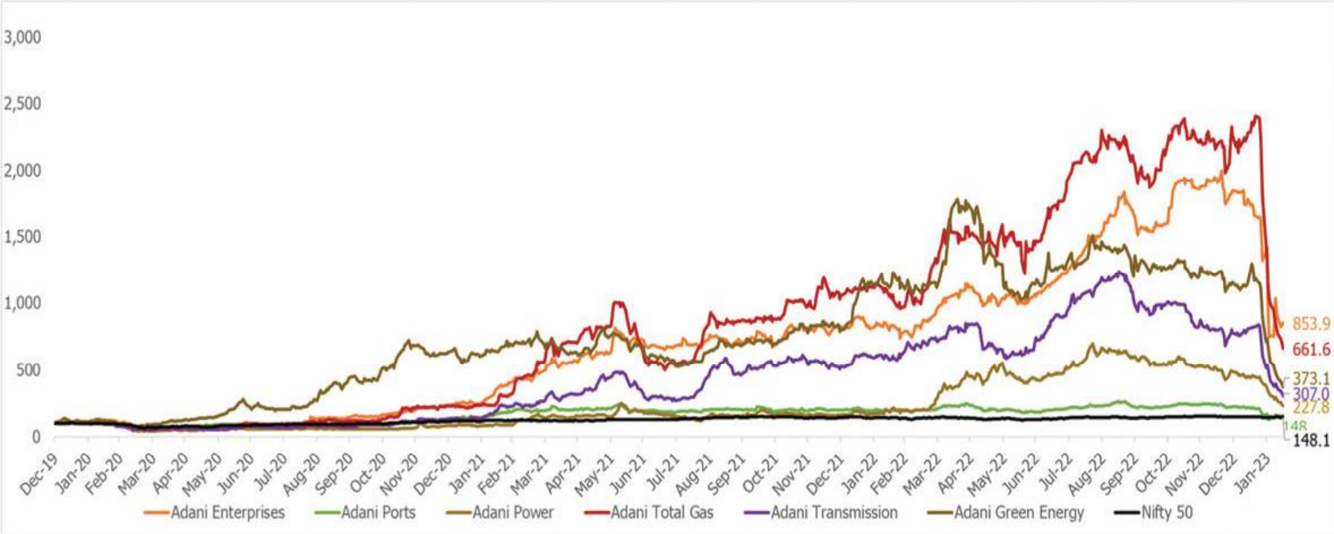
– By **M R Raghu,** CFA, FRM, FCMA, CEO - MARMORE MENA Intelligence

Indian capital market, probably for the first time, is getting a taste of the global short-selling bite through the Hindenburg-Adani short- selling saga that wiped out more than $125 bn in market capitalization. Adani Group's listed stocks tumbled across the board after a scathing research report from Hindenburg, a New York-based short seller, which was published on January 24, 2023. Post the publication of the report, the market capitalization of Adani Group stocks plummeted from nearly ₹19 lakh cr to ₹8.7 lakh cr, all in just 15 trading sessions.

While a lot has been said about this drama that is still playing out, my focus is to look at this from the standpoint of four key stakeholders, viz., the Adani Group (the target), Hindenburg (the short seller), Securities and Exchange Board of India (SEBI) (the regulator) and Investors (both retail and institutional).

Before we get into that, it will be instructive to explain short selling as an instrument employed by famed short sellers to call foul on companies that they deem flush with bad news. Most of the celebrated short sellers come from the US financial system that provides several legal and regulatory protections, which makes it difficult to pursue damages. Though long-term stock market investing is all about making money, in the short-term, there are as many companies falling as rising. Investors are trained effortlessly to profit from increasing share prices (buy low and sell high), while sophisticated investors like short sellers reverse this process (sell high and buy low) and make good money. But there is a catch! In a long bet, where one buys low with the hope of selling high, the maximum loss is a known function, as technically the stock price can only go down to zero. However, in a short bet, where one sells high and buys low, the maximum possible loss is unlimited, as share prices can go up endlessly. Hence, short sellers should be doubly careful while playing the 'short' game. This also explains why regulators have strin-

Adani Stocks Performance Vs. Nifty 50 (Rebased 2019 end = 100)



gent requirements while dealing with short selling. Short selling also involves selling first and buying later, which implies that the short seller should be in a position to borrow stocks. This is contingent on free-float. The table below provides a glimpse of celebrated short sellers and the stocks on which they made money by shorting the target companies.

There are several ways to short sell, like direct stocks, derivatives, options, futures, offshore, onshore, etc. Short selling also needs good free float for direct trading, in the absence of which derivatives are resorted to. Local regulations for derivatives are quite stringent, and hence short sellers prefer the offshore route.

It is interesting to note that many of these short sellers are based out of US,

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while their target companies are mainly emerging markets (mostly China) as it is easy to spot companies with poor governance though many of them do not offer the comfort of adequate free-float (as promoters tend to hold a large chunk). In some cases, short sellers also spot companies with outdated business models threatened by technology disruptions ripe in sectors like auto, media, retail, etc.

Let us now turn our attention to the Hindenburg-Adani row from the angle of the four key stakeholders:

1. **Adani Group (The target):** Adani Group experienced a meteoric rise in its fortunes to the point where they became the second-largest conglom-

Making Merry
Select Stocks Where Short Sellers Earned Massive Profits

	Short-seller	Institution	Target stocks/Group
1	Michael Bury	Scion Capital	US Housing bubble
2	Bill Ackman	Pershing Square	Herbalife
3	Carson Block	Muddy Waters	Sino-Forest and Noble groups
4	Andrew Left	Citron Research	Valeant Pharma, Tesla, GameStop, and Evergrande
5	Jim Chanos	Kynikos Associates	Enron, Tyco
6	David Einhorn	Green Light Capital	Lehman Bros, Green Mountain Coffee Roasters
7	Marc Cohodes	Hedge Fund	Home capital Group, Mimedx Group
8	Nathan Anderson	Hindeburg	Adani Group, Nikola, Clover Health

Source: ChatGPT, Wikipedia

In the Eye of the Storm
Adani Group Firms Face Heat Post Hindenburg Report

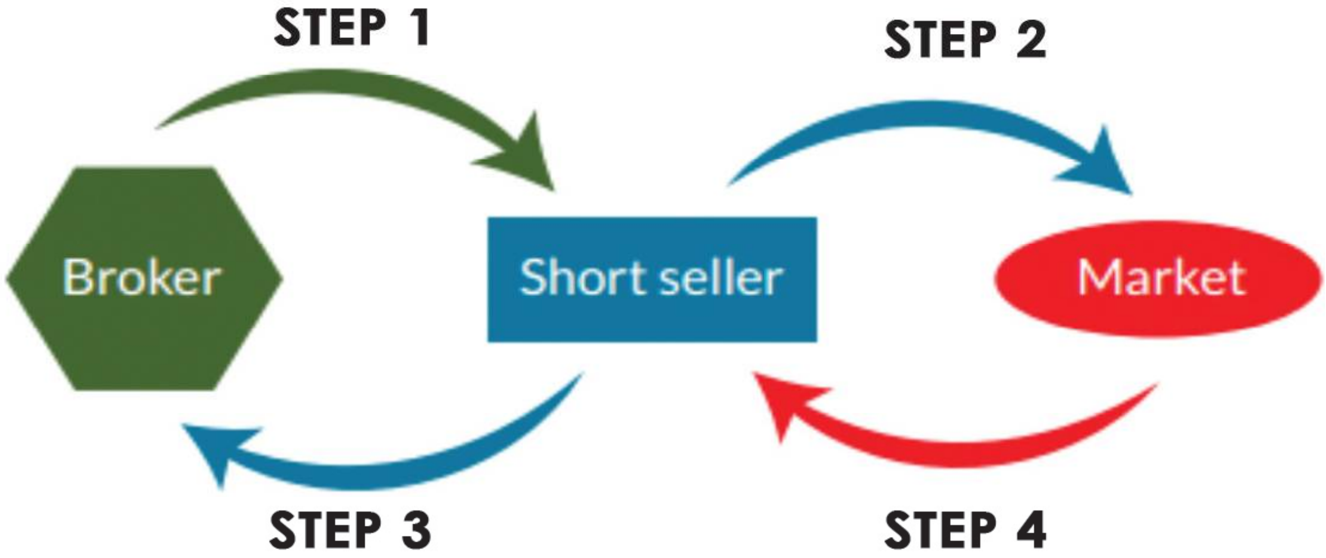
Name	Business	M Cap (₹ in cr)	From 52 Wk. High (%)	From 52 Wk. Low (%)	Close Price	1Y (%)	3Y* (%)	5Y* (%)	10Y* (%)	P/E	P/B	Free Float (%)	Revenue Growth (%)	PAT Growth (%)	Debt/ Equity (x)
Adani Enterprises	Conglomerate	202,426	–57.1	76.6	1,796.6	3.4	92.3	68.7	53.2	97.7	8.8	20.9	124.7	305.4	1.89
Adani Ports	Ports Operator	122,685	–41.6	46.1	577.2	–22.1	16.7	7.3	14.5	23.4	3.1	36.3	14.0	2.4	1.14
Adani Power	Thermal power Generation	54,201	–65.8	36.0	147.8	16.6	36.9	35.5	11.2	5.4	2.9	24.0	66.6	3,527.6	2.65
Adani Wilmar Ltd.	FMCG – Oil & Packed foods	51,569	–52.5	36.9	417.4	10.7	–	–	–	70.3	6.8	12.1	N.A.	N.A.	0.36
Adani Total Gas	Natural Gas Distribution	118,155	–74.4	–5.0	1,022.6	–39.4	83.3	–	–	223.3	49.0	21.4	65.2	–12.7	0.43
Ambuja Cements Ltd.	Cement Manufacturing	68,343	–41.8	26.9	347.8	–3.6	19.5	6.2	6.2	35.9	2.1	36.7	7.2	–30.3	0.02
ACC	Cement Manufacturing	34,714	–33.9	8.6	1,841.7	–17.8	9.0	2.2	3.9	53.7	2.4	41.0	7.8	–65.1	0.01
Adani Transmission	Power transmission – Operating & Maintenance	113,277	–77.1	–4.8	968.6	–49.9	45.5	36.6	–	113.6	11.3	20.9	17.3	–14.0	3.02
Adani Green Energy	Renewable power generation	98,179	–79.8	–0.8	616.3	–68.1	45.9	–	–	167.1	39.6	18.2	42.9	16.0	20.21
NDTV	Media	1,268	–63.9	53.3	206.9	24.8	85.2	35.8	11.5	14.6	5.5	21.2	18.2	24.7	0.09
Nifty 50	**Benchmark**	14,195,546	–4.5	18.8	18,035.9	4.1	14.4	11.5	11.8	21.3	4.2	–	–	–	–

Note: * - Returns are Annualized.

Source: Refinitiv; Price, Returns, P/E, P/B, are based on Feb 15 close price, Revenue & PAT growth are for Last 12 months year-on-year % change; D/E is based on recent quarter

erate in India after Tatas. It comprises 10 stocks primarily focused on infrastructure. The rise of Adani Group coincided with India's capex spending on infrastructure, and the valuation for many of Adani Group's stocks sky rocketed in a very short time. Infrastructure is as much a debt game as equity, and hence the Adani Group benefited a lot by this meteoric rise in its share price, as it allowed it to raise more debt than before (due to the debt equity ratio advantage). Adani Group's debt rose two-fold in two years, with 30% of it designated in foreign currency. Also, domestic banks financed 18% of that debt. The group exactly did that which Hindenburg highlighted as a key risk, though one can easily find many global companies with such a debt-equity structure. The rapid fall in Adani Group stock price (see the table) made it to go down from the second biggest to fourth biggest in terms of market cap. Also, it had several other consequences for the group, including canceling a planned FPO issue and planned takeovers. The group was also forced to reduce the leverage (through early repayment) and firefight the negative press that ensued after the stock price meltdown.

2. **Hindenburg (The short-seller):** Hindenburg is a relatively lesser known short seller in the US, compared to other celebrated names. Short sellers attack rarely, but when they do, it is with brute force. Many of them prefer to be anonymous, as the idea is not to get fame but to make money. In this case, Hindeburg published a report that highlighted several issues, including poor governance, stock manipulation, accounting fraud, shell companies, leverage, and audit firms, which, however, are too small for the second-largest conglomerate. While only time will tell about the credibility of these accusations, Hindenburg did achieve its objective as the target stocks fell between 30% and 80%, and that is a juicy outcome for any short seller. As explained earlier, there are several ways to short sell, and Hindenburg targeted international bonds and derivatives



through the offshore route so that it could avoid locking horns with local regulations and dealing with poor free float.

3. **SEBI (The regulator):** The regulator angle to this saga is very interesting. There were questions on how stable is our Indian capital markets when a relatively unknown US-based short seller can inflict a $125 billion loss in market valuation within 15 days. In my opinion, the rigor of local capital market regulations can be measured by the market impact of the Adani saga. While the stock price of Adani Group stocks fell precipitously, the broader market (read Sensex) in fact rose by 0.5% in the 15 trading sessions, implying that the market participants (including foreign investors) showed broader confidence in the Indian macroeconomic story. In cases like this, where media loves to conduct quick trial, regulators normally tread a cautious path. It is not their job to pander to media frenzy, and on the contrary, most of the times, they silently go to work, studying the issue threadbare and coming up with long-term policy solutions. If we take global examples, in the last 12 years, three research firms published negative reports on 18 companies. In all these cases, it took anywhere from 1 to 2 years for regulators to conclude the investigation, and only in 15% of the cases, they imposed fines. Hence, regulators never show knee-jerk reactions, and this is what SEBI has done as well. In fact, to their credit, SEBI already introduced a mechanism called Additional Surveillance Measures (ASM) some time back in order to capture trading interests in stocks with high volatility. I feel, apart from the strong India macro story, the robustness of the regulatory environment can also be a key reason why the Adani short selling saga did not transmit to the broader market.

4. **Investors:** The last angle is the investor angle. Many of the retail and institutional investors who enjoyed the rapid rise in the stock price of Adani Group stocks suffered a great deal after the stock price collapse. Nevertheless, investors who entered these stocks, say, three or five years ago, are still laughing their way to the bank; it was probably those investors who entered during the last year or so ended up on the losing side. Foreign investors suffered more losses courtesy MSCI's flip-flop on its decision to adjust the weights of the Adani Group stocks in its indices post the report; although retail investors too have suffered as stocks lost close to a quarter of their value after the index provider said, in what seems a knee-jerk reaction on its part, that it would review the free-float m-cap of the group's eight stocks. Many investors focused on short-term trading also must have experienced the "catching the falling knife" syndrome in this episode. From an investor's point of view, it is very difficult to say what lessons can be learned from this, as one cannot predict the next target company in this game.

If you keep aside profit motive angle and profits earned by Hindenburg for time being, there are several positives from this saga that emerge. They include a greater focus on governance and capital structure. The episode is bound to force business groups to turn their focus on improving investor engagement, transparency in operations, and proactive communication to ward off short sellers.

While targeting Nifty 50 stocks can produce magnifying impact (like the current case), it does not solve the broader problem of poor governance among mid and small-cap stocks. Maybe these are out of bounds for celebrated short-sellers, as these companies may not have international bonds or may be low on free float. It will be good if regulations evolve towards this aspect of our capital market. ■

Reference # 20M-2023-03-04-01