IRRATIONAL EXUBERANCE

The confounding rise and rise of Adani stocks

With a combined market cap of $208 billion, Adani Group companies now command absurdly high valuations. But their shareholding structure remains curious as ever, especially with LIC upping its stake and $2 billion worth of international investments in the offing

Anand Kalyanaraman, Seetharaman G, 21 Apr 2022

After a dip last June, following a controversy over its foreign investors, most Adani stocks have again surged, pushing their valuations to ridiculous highs

There have been intriguing changes in the shareholding pattern. IPO-bound insurance behemoth LIC has increased its stake in many Adani stocks at high valuations

There has been a major rejig of foreign investor holdings too—ostensibly to combat criticism over shareholdings being concentrated in a few hands

The valuation bubble could burst, however, contingent as the Adani Group is on the Indian government and its policies

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HIDE SUMMARY

In April 2021, not one Adani Group company was among India's 20 most valuable listed companies. Now, there are three—Adani Green Energy, Adani Transmission, and Adani Total Gas. With a market capitalisation of over Rs 4,54,000 crore (~$59 billion), Adani Green is worth almost as much as State Bank of India, the country's largest bank, and more than Bharti Airtel, India's second-biggest telco.

Valuations, already unreasonable to begin with, are now just completely out of whack. For instance, Adani Green is trading at a trailing price-to-earnings (P/E) multiple of 1,109X, compared to peer Tata Power's 47X. And Adani Total Gas's trailing P/E multiple is 473X, compared to Indraprastha Gas' 18X.

"These are absurd stocks to own. There's no way you can justify these valuations," says one source.
And investments are flowing in.

The Abu Dhabi-based IHC is investing a mammoth $2 billion in Adani Green Energy, Adani Transmission, and Adani Total Gas. This is on top of the investments worth $3.2 billion that French oil major Total has already poured in.

More importantly, IPO-bound LIC has upped its stakes in multiple Adani Group companies.

The Adani Group's incredible run on the bourses has made its chairman Gautam Adani the world's sixth-richest individual, with a net worth of $120 billion. But that fortune rests on a shaky foundation, and that's not just because these valuations are hard to sustain over the long term.

Earlier this month, when International Holding Company (IHC) agreed to invest in three Adani Group companies, it wasn't the first international strategic investor to do so. Nor was the amount of money on the table an anomaly.

The Abu Dhabi-based investment firm is investing a mammoth $2 billion in clean energy producer Adani Green Energy, power transmission company Adani Transmission, and city gas distributor Adani Total Gas. Before IHC, French energy giant TotalEnergies SE invested in Adani Gas—which later became Adani Total Gas—and Adani Green in 2019 and 2021, respectively, pumping $3.1 billion into the publicly listed companies.

It's not just international investors. State-owned behemoth Life Insurance Corporation, which is heading towards an initial public offering (IPO), also upped its stakes in Adani Total Gas, Adani Transmission, and Adani Enterprises over the past few quarters.

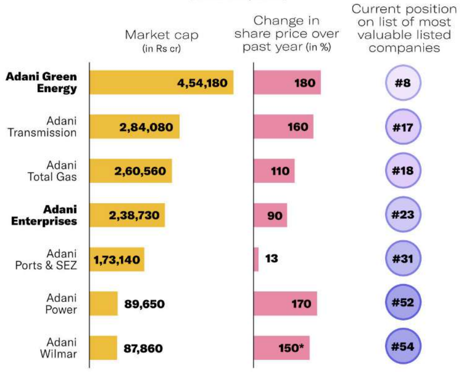
Much of these additional stake purchases would have been very costly—five of the seven listed Adani Group companies have seen a gravity-defying rally over the past year.

In April 2021, not one Adani Group company was among India's 20 most valuable listed companies, according to capital markets data provider Prime Database. Now, there are three—Adani Green Energy, Adani Transmission, and Adani Total Gas. With a market capitalisation of over Rs 4,54,000 crore (~$59 billion), Adani Green is worth almost as much as State Bank of India, the country's largest bank, and more than Bharti Airtel, India's second-biggest telco.

The big gulf

Adani Green is worth almost 2X of Adani Enterprises, the group's flagship firm

(As on 19 April '22)



*Since 8 February, the day of Adani Wilmar's listing

THE KEN

Graphic by Adhithi Priya R, 20 Apr '22

Source: BSE

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"These are absurd stocks to own. There's no way you can justify these valuations. It's all in the name—Adani Total Gas," says a senior executive with one of India's top mutual fund houses. He and a few others *The Ken* spoke to requested anonymity since they did not want to be seen talking about these companies.

One factor that could have driven up share prices is the supply-demand mismatch.

In April 2021, *The Ken* reported on the shareholding patterns in Adani group companies, noting that several of them shared common foreign portfolio investors (FPIs). And strangely, several of them had negligible investments in non-Adani companies. As a result, the percentage of shares effectively available for trading by the public was just about 5% in Adani Total Gas and 11% in Adani Green. The comparable figure for Indraprastha Gas is 55%, and for Tata Power, 53%.

The Ken's story set off a debate in mainstream media, with Adani Group shares falling as much as 25%. In what is ostensibly a response to this criticism, only one FPI owns more than 1% of Adani Green now, compared to 10 in December 2020. But that FPI—Asia Investment Corporation (Mauritius)—is still heavily invested in the Adani Group, with 93% of its holdings in Adani companies.

Meanwhile, the number of FPIs with a stake in Adani Green has risen by 40% to over 530. That makes it harder to establish the actual quantum of shares available for trading since only stakes of over 1% are disclosed to the stock exchanges. A similar pattern is seen in other Adani stocks too.

The Adani Group's incredible run on the bourses has made its chairman Gautam Adani the world's sixth-richest individual, with a net worth of $120 billion. But that fortune rests on a shaky foundation, and that's not just because these valuations are hard to sustain over the long term.

Six out of the seven listed Adani companies are involved in infrastructure, a sector that is inextricably tied to government projects and is vulnerable to policy changes. For instance, no new allocation of cheap domestic gas to city gas distribution (CGD) companies has been made for a year despite the government promising to prioritise supplies to the sector. This could seriously dim the prospects of Adani Total Gas and its peers, as we highlighted in our story last year.

Changing composition

As *The Ken* reported in April 2021, the FPIs that invested in multiple

Adani company stocks were all largely unknown names. FPIs such as Elara India Opportunities Fund, Albula Investment Fund, Cresta Fund, Lts Investment Fund, and Vespera Fund all held a stake in Adani Total Gas as of December 2020, while also holding many other Adani stocks. In addition, these FPIs had stayed put in these Adani stocks for many years. Conspicuous by their absence were well-known domestic institutional investors (DII), including mutual funds.

Subsequently, news that India's securities depository, the National Securities Depository Limited (NSDL), had frozen the accounts of some of the FPIs involved—Albula, Cresta, and APMS—hammered the Adani stocks. The Adani Group refuted the news, and the stocks recouped their losses and then some.

However, the public criticism that followed seems to have prompted the rejig referenced earlier—more FPIs holding smaller stakes in Adani stocks. Meanwhile, the total number of FPIs holding stake in the Adani stocks has gone up.

Many more FPIs

Adani Green	Adani Total Gas	Adani Enterprises
379 in Dec 2020 to 532 in Mar 2022	97 in Dec 2020 to 469 in Dec 2021	109 in Dec 2020 to 375 in Mar 2022

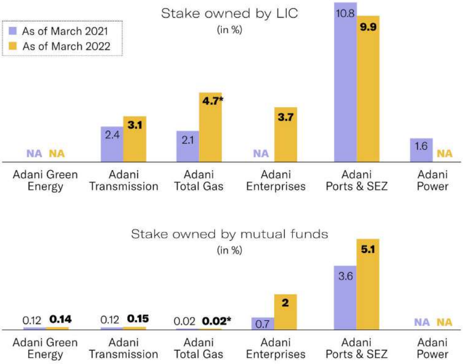
Despite this, there are fewer FPIs mentioned in the shareholding patterns of Adani stocks as only parties with more than 1% stake require disclosure. This is why Asia Investment Corporation (Mauritius) Ltd is the only FPI that's currently part of Adani Green Energy's shareholding pattern. A similar pattern can be seen in Adani Total Gas—FPIs disclosed dropped from six in December 2020 to four as of December 2021, the latest period for which data is available for the company. Overall, FPI stakes in Adani stocks have come down by a few percentage points.

The Adani Group did not respond to *The Ken's* emailed questions on the reasons behind the change in shareholding pattern. But the rejig in FPI shareholding and the shares now being held by a wider set of FPIs might help the Adani Group dilute criticisms of concentration of public-shareholding in a few hands, as well as allegations of round-tripping of funds.

The most intriguing change, however, is the increased interest from IPO-bound LIC. The insurance company's stake in multiple Adani Group companies has gone up over the last few quarters.

Price no bar

Despite Adani shares being much pricier than their peers, LIC has bought more of them. But mutual funds have stayed away



*As of December 2021; March 2022 data not available
Note: Adani Wilmar not included since it went public in January 2022

THE KEN Graphic by Adhithi Priya R, 20 Apr '22 Source: BSE

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LIC's motivation to make these expensive buys is not clear. Especially when public sector competitors to Adani stocks, such as city gas distributor Indraprastha Gas and electricity transmitter Power Grid Corporation, were available for considerably less.

Indeed, apart from LIC, the shareholding of other domestic institutional investors—including mutual funds—in Adani stocks has remained negligible. Even this has come largely from passive vehicles such as ETFs or index funds, which mandatorily invest in Adani stocks—Adani Ports, Adani Enterprises, Adani Green and Adani Transmission—that are now part of the Nifty 50 or Nifty 100 indices.

The LIC and Total enigma

The LIC holding is sort of a badge of honour for the Adani Group, one that could help take the edge off the criticism that no major DII has a meaningful stake in many of its stocks.

That said, LIC has also pared some of its Adani holdings. It brought down its stake in Adani Ports (it's still a very significant ~10%, though) and exited its stake in Adani Power. In Adani Green, there has been only one insurer investor since September 2021, and its stake has risen from 0.18% to 0.65% as of March 2022. This might well be LIC, given that in most Adani stocks, LIC is the only insurer investor.

The other intriguing investor is TotalEnergies, which is curious not for its holding but rather its classification. While Total's 37.4% stake in Adani Total Gas is classified as 'promoter' holding, its 20% stake in Adani Green Energy is shown under 'public' shareholding. Total had acquired its stake in Adani Green in January 2021 through the buyout of two Adani group entities—Universal Trade and Investments, and Acme Trade and Investments—that were earlier shown as promoter entities.

Total's classification as a public shareholder in Adani Green seems to have been done with an eye on keeping the overall promoter shareholding within 75%, as mandated by market regulator Sebi. The classification helps the company in other ways too, such as optically improving Adani Green's free float. This may have aided the stock's entry into the Nifty 100 index, which, in turn, results in fund flows from passive investment vehicles such as ETFs and index funds.

But the effective free float in Adani Green will likely be lower to the extent of Total's stake, given that Total is a strategic long-term investor, has a joint venture with Adani Green, and also has a seat on the company's board. "An investor with up to 25% can be classified under public shareholders. But if the free float is reduced as a result, then that defeats the purpose of the Sebi requirement on minimum public shareholding," says Shriram Subramanian, founder of proxy advisory firm InGovern.

Media reports last year said that Sebi was examining public shareholding and actual free float in listed companies. While Ajay Tyagi, the then-Sebi chairman, had said that the exercise was not against any specific company, he also added that some of the free floats were held by institutional shareholders, who hold them till maturity. The outcome of Sebi's review is not known, yet.

Heady valuations

Meanwhile, after the dip last June, most Adani stocks have again shot up like a rocket on boosters, pushing their valuations to ridiculous highs.

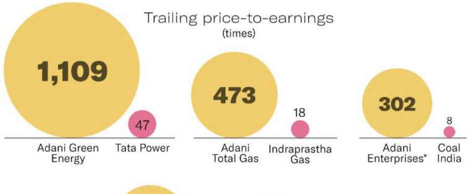
Consider these numbers. The trailing P/E multiple of Adani Green now stands at close to 1,100X, many orders higher than the nearly 50X of Tata Power. This, despite the revenue of Tata Power being 9X higher and its profit being thrice that of Adani Green's. Similarly, the P/E multiple of Adani Total Gas—at about 500X—is many leagues above the ~20X of Indraprastha Gas, despite the latter's revenue and profit being nearly nearly thrice the former's.

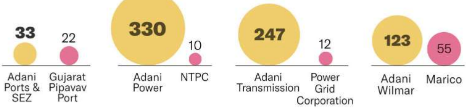
The massive chasm in valuations vis-a-vis the competition is also apparent in Adani Enterprises, Adani Power, and Adani Transmission. This is also notwithstanding the high debt levels and leverage of many of the Adani stocks.

Out of whack

The valuations of most Adani stocks are way above its peers

(As of 20 April '22)





*Mining and related operations is a significant part of the diversified business of Adani Enterprises

THE KEN Graphic by Adhithi Priya R, 20 Apr '22 Source: Screener.in

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The exception to this seems to be Adani Ports and SEZ. The stock's price-to-earnings multiple of 33X is not way off the 22X of smaller player Gujarat Pipavav Port. "Investors only like Adani Ports and Adani Enterprises in the group. They have assets that, over the long term, will mirror the economic growth of the country," says a senior executive with one of the top fund houses quoted earlier. "You can disagree on the valuation, but they are not uninvestable."

The argument seems to hold better in the case of Adani Ports. It is the dominant port operator in India, and has the highest consolidated profit—about Rs 5,000 crore ($650 million) in the trailing twelve months ended December 2021—among the group's companies. Interestingly, the 13% rally in the Adani Ports stock over the past year is lower than the nearly 20% rise in the Nifty 50 index.

A look at the shareholding pattern seems to offer some clues as to why this is the case. Unlike most other Adani stocks that sported common FPIs at least until the recent past, the FPIs holding more than 1% in Adani Ports over the past few years have been different. Such as Camas Investments Pte Ltd, Citigroup Global Markets Mauritius Private Limited, Europacific Growth Fund, New World Fund Inc, and Baytree Investments (Mauritius) Pte Ltd.

Also, unlike the common FPIs whose investments were mostly heavily concentrated largely in Adani stocks, FPIs in Adani Ports seem to have diversified their portfolio across multiple stocks, according to data from market information provider Trendlyne. As of March 2022, Camas Investments Pte—the only FPI with more than 1% stake in Adani Ports—also has sizable investments in AU Small Finance Bank, Bandhan Bank, and HDFC AMC.

Not surprisingly, mutual funds seem partial to Adani Ports; they own 5% of Adani Ports, but own less than 0.25% of most other Adani companies. "For an investor, there has to be a business first, then profitability, then valuation, and then comes liquidity," says a fund manager with a domestic mutual fund house. "Only Adani Ports crosses the first three barriers."

Adani Ports may be an exception, but the shareholding pattern of most Adani stocks continues to be a key risk factor to their heady valuations. But that's not the only risk they have to contend with.

The government overhang

In India, the government makes it incredibly difficult to be an infrastructure company. Whether you want to build solar farms, airports, or city gas networks—all of which the Adani Group does—the starting point is bidding for projects awarded by the government. What you can charge consumers to recoup your investment is also determined by the administration.

"That's why you don't value an infrastructure company at more than 15-20X their earnings," says the fund manager quoted earlier. Of the six listed Adani companies that are in the infrastructure space, only one—Adani Ports—is valued anywhere close to that level. The rest are all way above the range.

And these six companies account for 95% of the Adani Group's overall market cap. So, the problem of absurd valuations is compounded by a potentially huge downside from a change in government or policy.

Gautam Adani is perceived to be close to Prime Minister Narendra Modi, who was chief minister of Gujarat, Adani's home state, till 2014. An energy analyst went so far as to call him " Modi's Rockefeller".

When the government decided to privatise six airports in 2018, it did away with the criterion that bidders had to have had prior experience in the sector. The government claimed this was done to encourage competition. And Adani Enterprises, which was new to the business, bagged all six airports. This was despite the finance ministry reportedly recommending that no bidder be allowed to bag more than two airports.

"With Adani, you carry the risk of political patronage and invest accordingly," says the senior executive of one of India's top mutual fund houses quoted earlier.

The problems that the Adani Group faces are not just specific to the infrastructure conglomerate, however. The CGD impasse mentioned earlier is a case in point. In clean energy, too, investors have to factor in the possibility of state-owned utilities not honouring power purchase agreements signed with the likes of Adani Green Energy. With concerns like these, Adani Group companies' sky-high valuations make little sense.

As can be expected of an infrastructure-heavy operation, the Adani Group's debt rose by two-thirds between the years ended March 2015 and March 2021, to over Rs 1,56,000 crore ($20.4 billion). But what sets Adani companies apart from their peers is their ability to also raise billions of dollars in equity from global names such as Total and IHC.

This has been made possible by the rally, since investors want in on companies whose shares have only gone up and up. At the same time, these investments also further fuel the stock surge, creating a virtuous cycle for the Adani Group. An informed institutional or retail investor, though, may not have the stomach or the means to join this party.

Image credit: Sawyer Bengston/ Unsplash

Adani · Adani Enterprises · Adani Green · Adani Ports · Adani Power · Adani Total Gas
Adani Transmission · Gautam Adani · LIC

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