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Adani Enterprises makes \$2.4B FPO a virtue out of necessity

The flagship of Gautam Adani's ports-to-data-centres empire has to raise more equity, but who will buy into a ridiculously high priced stock?

Anand Kalyanaraman, 28 Nov 2022

The further public offering announced by Adani Enterprises is a well-timed, strategic move with the stock price at record highs

With the fresh equity issue, the company would hope to reduce its high leverage and increase public shareholding to silence critics

But new investors could balk at the sky-high valuation of the stock, driven by the huge rally in the past two-and-a-half years

Adani Enterprises choosing the FPO route over a rights issue or a qualified institutional placement raises some tricky questions



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Asia's richest man Gautam Adani took a break from his seemingly insatiable expansion spree in the past week but still made news all right.

The flagship of his sprawling, eponymous empire set the ball rolling on India's largest-ever fundraise through a further public offering (FPO)—a process by which companies already listed on the stock exchange issue shares to the public.

The Rs 20,000 crore (\$2.4 billion) fresh equity-issue plan announced by Adani Enterprises Ltd (AEL) on 25 November is a well-timed, strategic move to monetise the stock's eye-popping rally over the past two-and-a-half years. An expected move (as *The Ken* had written in September).

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In conversation with
Amrish Rau
CEO at Pine Labs

AEL is the incubator in which most of the group's new businesses, from airports and metals to petrochemicals and media, are housed. But it lacks big cash flows and relies heavily on debt to fund its dizzying array of new ventures through equity, loans, and guarantees.

To continue to be a magnanimous parent and, more importantly, to keep its leverage under control, AEL has to raise more equity.

It's doing it now, at a time and price of its choosing.

The company has seen its shares surge a mind-boggling 30X since the start of the pandemic in 2020. Its market capitalisation now stands at Rs 4,45,000 crore (\$54 billion), earning it a place in the benchmark Nifty 50 index. The stock's valuations are in the stratosphere. From the company's perspective, it's a great time to sell.

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It will also help AEL make a virtue—of broadening its investor base—out of a fundraising necessity.

In April 2021, *The Ken* reported on the peculiar shareholding patterns in the Adani group companies, noting that several 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 in the Adani stocks was very low. *The Ken's* story set off a debate in mainstream media.

Since then, there has been a major rejig of foreign-investor holdings in the Adani stocks, ostensibly to combat criticism over shareholdings being concentrated in a few hands. *The Ken* highlighted these intriguing shareholding changes in April 2022.

With the planned equity issue now, the company hopes to increase public shareholding and silence the critics.

Ergo, for AEL and its promoters, it's killing many birds with one stone.

One, the issue of equity shares would be at top dollar. So, big money in, with a small dilution of existing shareholders, including the promoter group. Next, it will provide funds for growth and improve AEL's leverage levels. Finally, it will reduce the inconvenient noise about low public shareholding in the stock. So far, so good.

High on debt

AEL's net debt (gross debt minus cash) of over US\$5B, as of March, was more than 10X its Ebitda, per a report in August by CreditSights, an arm of ratings-and-data provider Fitch Group.



But what's nifty for the seller is not necessarily good for buyers.

Sell hype, buy hope

The AEL stock is on a gravity-defying climb—it's doubled since June in an iffy market—and now hovers around its all-time highs. At Rs 3,900 (\$48), the stock's price-to-trailing earnings valuation is 360X, many leagues higher than its Nifty 50 counterparts and other conglomerate stocks in India.

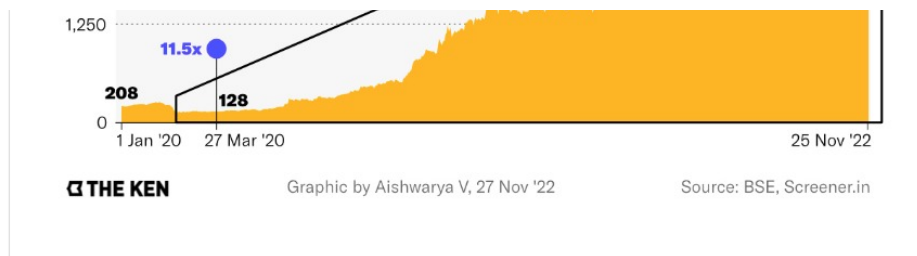
But the AEL stock's valuation seems divorced from the company's fundamentals. Its consolidated earnings-per-share (EPS) of Rs 10.8 (\$0.13) for the twelve months ended September 2022 is only marginally higher than the Rs 10.4 (\$0.12) for the year ended March 2020. The wild optimism about the stock seems to rest on hopes of an all-encompassing, all-dominating empire in the distant future.

But the best-laid plans of mice and men often go awry, as Scottish poet Robert Burns wrote over two centuries ago.

Up, up and away

The Adani Enterprises stock price and valuation have shot up nearly 30 times since March 2020





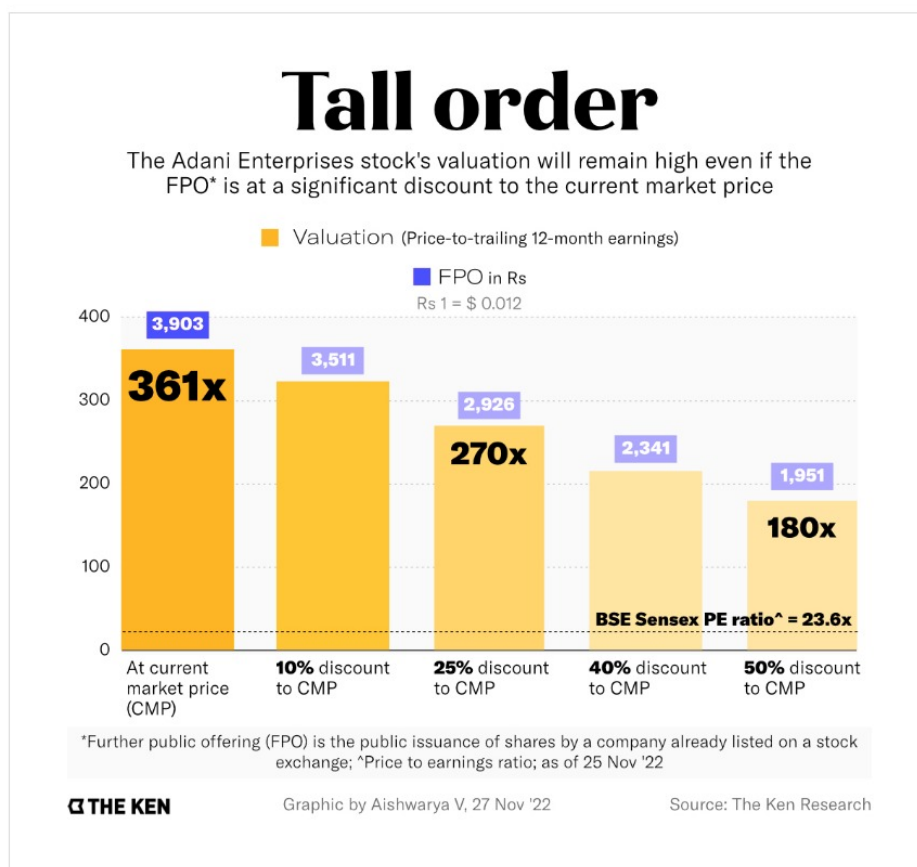
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For this hope, investors in the FPO will be paying a king's ransom and more.

Now, it's fair to assume that AEL's FPO will come at a good discount. Else, investors have no reason to prefer it over the open market.

For instance, the FPO of Yes Bank in July 2020 was priced at a discount of 55% to the market price, while that of edible-oil maker Ruchi Soya earlier in 2022 was at a 40% discount. Public-sector miner NMDC's FPO in 2010 came at a discount of about 20%.

But here's the thing. Even with a big 25% discount to the current market price, the AEL stock's price-to-earnings valuation will be a massive 270X. At a 50% discount, too, the valuation is a huge 180X. For perspective, the IT major Tata Consultancy Services (TCS) trades at a valuation of 31X, consumer-goods leader Hindustan Unilever quotes at 61X, while oil-to-telecom behemoth Reliance Industries is at 28X.



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This is great for the company and existing shareholders. At the current market price, to raise Rs 20,000 crore (\$2.4 billion) in an FPO, the dilution in the stock will be just about 4.5%. Assuming a 10% or 25% discount to the current price, the stock dilution at 5% or 6% will not be too high either.

But for new investors, it's a mighty price to pay.

Beauty, of course, lies in the eyes of the beholder. And there will always be those who are beholden, even at expensive valuations, for reasons best known to them. For instance, Life Insurance Corporation of India (LIC). As we had written in September, the only domestic investor of note in AEL is the state-run insurance behemoth, whose stake has tripled in the past year to nearly 4%.

Other domestic institutional investors, including mutual funds, have mostly stayed away from AEL, with their total stake at just ~1%. Even this would have largely come from passive vehicles such as exchange-traded funds (ETFs) or index funds, which mandatorily invest in the Adani stocks that are now part of the Nifty 50 or Nifty 100 indices.

Besides the FPIs under a cloud, there are only a couple of institutional investors with a meaningful stake in AEL. They are financial-services group Nomura Singapore Ltd ODI and the UAE-based International Holding Company (IHC). The latter invested in May 2022.

Oddly, IHC's stake of ~3.5% in the name of Green Enterprises Investment Holding Rsc has been categorised under non-institutions, though it is a global strategic-investment company. But for this, the stake of non-institutions (largely individuals) in AEL has stayed at just 2-3% in the past few years.

The choice of the proposed fund-raising mechanism: an FPO instead of a rights issue or a qualified institutional placement (QIP), is also an odd fish.

Hobson's choice

A rights issue gives all existing shareholders of a company the right to participate in a fundraise in proportion to their shareholding or to renounce their entitlement for a consideration. In a QIP, shares are allotted to select institutional investors. An FPO, on the other hand, is open to everyone, including individuals, institutions, and existing shareholders.

FPOs are similar to initial public offerings (IPOs) but for companies that are already listed. And most companies in India do not seem to prefer FPOs.

Over the past 10 years, there have been just four FPOs in India compared to about 150 rights issues, shows data from market information provider Primedatabase. The number of QIPs, at about 250 in this period, has also been significantly higher than FPOs.

In 2020, Reliance Industries came out with India's biggest rights issue of ~Rs 53,000 crore (\$6.5 billion), while public-sector banking giant State Bank of India (SBI) launched India's largest QIP of Rs 15,000 crore (\$1.8 billion) in 2017.

Rights issues and FPOs could take a few months to complete and entail a significant discount to the market price. In QIPs, that can be executed quickly, the issue price is generally around the prevailing market price.

AEL itself opted for a rights issue and a QIP in 2010 and a preferential equity issue to IHC earlier in 2022, according to Primedatabase. The group's companies have so far not done any FPO.

Why, then, has AEL opted for an FPO over a rights issue or, more importantly, a QIP?

One argument can be that the company wants to widen its base by bringing in new investors, especially in the non-institutional (individual) category, in response to the criticism about concentrated shareholdings. It is a fair point, even if it is basic and simplistic.

"The company probably wants to signal that there is public demand for the stock and that it's not a closed club," a corporate-finance expert tells *The Ken*. They and others mentioned in the story declined to be named as they don't want to be seen commenting on the matter.

The other opinion is there might be little institutional appetite for the AEL stock at the current exalted valuations, which throws out QIP as an option.

"If the company has already passed the hat around institutions and not found support, and an FPO is seen as an alternative, then it is something to worry about," says the corporate finance expert.

Another corporate finance expert thinks that a QIP would involve sophisticated investors and tougher questions. An FPO is the easier choice, they add, with retail investors not really focused on valuations but more on the narrative.

Also, in a rights issue, the existing shareholders—including the promoters—would essentially have to "eat their own cooking".

Could it be that the existing shareholders themselves find the stock's valuations unpalatable? Quite possibly, echo both the experts quoted above.

The upcoming FPO will be a key moment for AEL, in any case, thinks the first corporate-finance expert. "It will be a litmus test with regard to whether the price run-up is all right and if the valuation narrative is being accepted," they say.

As it stands, individual investors seem to be keeping away from the stock, as seen by the stagnant 2-3% shareholding over the past few years. But the question remains, 'will the discount carrot dangled in the FPO be enough to draw them?'

The other expert says that LIC's participation in the FPO needs to be watched as other domestic institutions are unlikely to be interested. "If the issue ends up being bailed out by LIC, it will be hugely criticised," they add.

Whichever way this pans out, there's a lot at stake for everyone involved—most importantly for AEL. It could determine whether the company's stock surge-fundraise-stock surge virtuous cycle can go on.

With additional input from Seetharaman G

Image credit: Jackman Chiu/Unsplash

Adani

Adani Enterprises

Adani Group

FPI

FPO

Gautam Adani

LIC

Valuations

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A certified Chartered Accountant, Anand chose to pack the power of numbers with words when he left a career of seven years in accounting, putting together MIS reports, and investment research to enter journalism. Before joining The Ken, Anand was Deputy Editor at The Hindu BusinessLine, a newspaper he worked at for 11 years.

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