

CASE  
**2**

*ACCOUNTING FRAUD SERIES*

# NMC Health

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NMC Health plc (“NMC” or the “Company”) was the largest private healthcare operator in the United Arab Emirates (“UAE”). Following its Initial Public Offering (“IPO”) in 2012 on the London Stock Exchange, NMC used leverage and acquisitions to accelerate its growth. From 2012 to 2018, NMC’s revenues grew from \$490m (converted from GBP to USD) to \$2.1b and its market capitalization increased from \$665m to \$11b, making NMC’s three largest individual shareholders billionaires.

In late 2019, an activist short seller released a report raising doubts about NMC’s financial reporting.<sup>1</sup> NMC’s board subsequently initiated an internal investigation which discovered a complex web of undisclosed debt facilities that the board had not approved. The board disclosed that the \$2.1b debt balance reported on the June 2019 balance sheet was under-reported by over \$4b. Shortly thereafter, NMC was de-listed from the London Stock Exchange and filed for bankruptcy.

## NMC HEALTH’S BUSINESS

### History

In 1974, Indian pharmacist B.R. Shetty opened New Medical Center (“NMC”), a small clinic and pharmacy in Abu Dhabi.<sup>2</sup> Despite NMC’s size, its opening was an important milestone for the UAE as the clinic became the first private healthcare facility in the country.<sup>3</sup> To offset the early challenges of being a first mover in a new market, NMC opened a distribution business shortly thereafter. This business distributed medical equipment and supplies throughout the UAE and achieved early success.

Through aggressive acquisitions and greenfield expansions, NMC grew rapidly. Over the years, NMC expanded significantly both geographically (Sharjah 1996; Dubai 1999; Spain 2015; Saudi Arabia 2016; Denmark 2016; Oman 2018; Egypt 2017; Sweden 2018; Kenya 2018; UK 2018) and across service lines (Operational Management 2012; Maternity & Fertility 2015; Long-Term & Home Care 2015), ultimately becoming a major player in the UAE’s private healthcare network.

In 2012, NMC listed on the London Stock Exchange. NMC began trading at a \$665m valuation and within five years the Company was valued at \$11b, representing an incredible 16.5x growth or 75% compound annual growth rate (“CAGR”).

### Verticals

At its peak in 2018, NMC operated in five main verticals: Multi-Specialty, Products & Consumer Goods, Maternity & Fertility, Long-term & Home Care, and Operational Management. Over half of its F18 revenue came from the Multi-Specialty vertical, which operated private hospital facilities that provided a range of specialty healthcare services to patients including nephrology, neurology, oncology, cardiology, urology, cosmetics, pediatrics, and orthopedics. Another quarter of NMC’s revenue came from the Products & Consumer Goods vertical, through which NMC sold products ranging from pharmaceuticals, scientific equipment, and medical supplies to veterinarian products and fast-moving consumer goods.<sup>4</sup>

## UAE OIL: A ROBUST TAILWIND THAT ULTIMATELY SUBSIDED

A key part of NMC’s growth story was the robust demand for healthcare within the UAE; however, this demand subsided over time.

<sup>1</sup> <https://www.muddywatersresearch.com/research/nmc/mw-is-short-nmc/>

<sup>2</sup> <https://nmc.ae/aboutus>

<sup>3</sup> <https://www.reuters.com/article/nmc-health-stocks-history-idUSL8N2AA39D>

<sup>4</sup> NMC 2018 Annual Report

The UAE offered helpful demographics for a healthcare business: a wealthy, growing and generally unhealthy population. The UAE holds the eighth largest oil reserve in the world and 5.6% of the World's total (42% more than the US).<sup>5</sup> From 1971 to 2018, UAE's population expanded at a 7.7% CAGR.<sup>6</sup> And in 2015, the UAE ranked 16th worldwide in diabetes prevalence with an estimated 19% of the population suffering from the disease.<sup>7</sup>

The UAE also increased its investment in healthcare over time. The key regulatory changes occurred in 2005 (implemented in 2007) and 2013 (phased over time) when the governments introduced mandatory insurance in Abu Dhabi and Dubai respectively, effectively mandating employers to provide basic health coverage for workforces and their families.<sup>8</sup> Following the mandate implementation in Abu Dhabi, the health authority reported a 62% CAGR in outpatient visits and 29% CAGR in inpatient visits from 2007 to 2010.<sup>9</sup>

Over time, however, the economic environment became less favorable. As the oil price per barrel fell from ~\$80-100+ in 2011-2013 to ~\$40-60 in 2014-2017, the population growth began to slow, falling to only 1% CAGR from 2014-2017. Struggling companies who were forced to provide healthcare coverage under law cut costs by lowering the scope of benefits within their plans. Patient volumes through NMC facilities decreased, and in 2016, Abu Dhabi's Department of Health reported a decrease in "Persons Insured by Health Insurance Companies," effectively signaling that NMC's end market was declining.

However, the high volume of acquisitions in NMC's income statement obfuscated the Company's lack of organic growth.

## EXPANSION AND LEVERAGE

NMC was an aggressive acquirer, leveraging inorganic opportunities to expand the size and scope of the business. From 2012 to 2018, NMC increased from 5 to 100+ facilities, from 1 to 17 countries (including Saudi Arabia, Dubai, UK, Spain, Latvia, Brazil, Italy, Sweden, Kenya, etc.), and from 1 care area (Multi-Specialty) to 4 (Maternity & Fertility, Long-Term & Home Care, Operation Management). During this period, NMC spent \$1.8b to acquire 29+ businesses.

NMC's leverage increased over time. Largely due to acquisition activity, NMC added \$1.4b of net debt from 2012 to 2018 and in December 2018, the Company's reported leverage was 3.1x (net debt to EBITDA). Additionally, before 2019, NMC's leverage was perhaps under-reported given that lease commitments were excluded from management's figure; however, NMC's 2019 implementation of a new lease accounting standard, IFRS 16, further increased the Company's leverage because it forced the Company to capitalize a greater share of its lease commitments.

NMC's debt was also getting increasingly expensive. From 2015 to 2018, NMC spent an estimated \$65m in transaction financing fees as the Company consistently re-financed its long-term debt (Exhibit 2). NMC's interest expense rose rapidly (Exhibit 3), and in 2018 it represented 36% of operating income.

## GOVERNANCE & INCENTIVE STRUCTURE

NMC was effectively controlled by three individuals: Saeed Butti Al Qebaisi ("Al Qebaisi") (2018: 17.4% of common share ownership),<sup>10</sup> Bin Yousef (2018: 14.4%), and Dr. BR Shetty (2018: 15.8%). Shetty was NMC's Founder, and Al Qebaisi and Bin Yousef were relatives and prominent investors in the UAE. Shetty and Bin

<sup>5</sup> <https://worldpopulationreview.com/country-rankings/oil-reserves-by-country>

<sup>6</sup> <https://datacommons.org/place/country/ARE?category=Economics>

<sup>7</sup> <https://www.europeanpharmaceuticalreview.com/news/29281/merck-kicks-off-capacity-advancement-program-cap-collaboration-emirates-diabetes-society-eds-first-time-united-arab-emirates/>

<sup>8</sup> <https://thelawreviews.co.uk/title/the-healthcare-law-review/united-arab-emirates#:~:text=Collectively%2C%20the%20measures%20adopted%20by,rankings%20as%20of%20May%202022>

<sup>9</sup> <https://www.actuarialpost.co.uk/article/mandatory-health-insurance-announced-in-dubai-5709.htm>

<sup>10</sup> S&P Capital IQ



Yousef sat on NMC's board. At the peak in August 2018, the three owned a combined stake of 48% in NMC, worth \$5.2b. The ownership group's focus on share price performance was further compounded by significant share pledges: to obtain financing for other investments, Bin Yousef and Al Qebaisi had pledged 44% of their NMC shares.<sup>11</sup> Following an overhaul in the executive team structure in August 2017, Shetty stepped down as CEO and Executive Vice-Chairman which led to changes in the CEO, CFO, and CIO positions.

Further, as the years progressed, EBITDA became an increasingly important metric for determining the CEO's compensation. In 2016, EBITDA margin had a 25% total weighting in determining the CEO's bonus. The weighting became 50% in 2017 and increased to 100% in 2018.<sup>12</sup> However, EBITDA was potentially not a useful proxy for NMC's cash generation; adjusting for finance costs, NMC's free cash flow conversion to EBITDA was only 47% in 2018.<sup>13</sup> While a free cash flow metric was never considered in management's compensation, poor free cash flow would pressure the Company to take on more debt.

NMC also outsourced its internal audit function, and as it was not a requirement for UK-listed firms, the Company did not need ongoing assessments of its internal controls by the external auditor.

## FINANCIAL IRREGULARITIES

From 2013 to June 2019, NMC met broker revenue expectations in 12 of the 13 reporting periods, and consistently met or upgraded their earnings guidance. During the same period, NMC reported 25% CAGR revenue growth and 28.5% average EBITDA margins. Management seemed in total control of the business, and a confident CEO felt that its high group EBITDA margins would be sustainable over the long-term.<sup>14</sup> Underneath the tremendous growth story, however, weaknesses in NMC's financial statements began to appear.

NMC's transactions with related parties increased significantly from 2012 to 2018. In 2018, 7.8% of NMC's costs were purchased from related parties, compared to <1% in 2012. On the balance sheet, by 2018, 36.7% of NMC's total payables were owed to related parties. At the same time, NMC's income from related parties increased significantly in 2018, and on the balance sheet, the amounts due from related parties accelerated fourfold in 2018. Nevertheless, qualitative related-party disclosures in the annual report remained relatively unchanged. Further, even if these related-party transactions were appropriately and completely disclosed, related-party payments can increase the risk of unreliable financial statements or of misuse of company funds.

One significant related-party transaction was NMC's January 2018 acquisition of 70% of CosmeSurge, a leading plastic, laser, and cosmetic surgery provider in Dubai, for \$170 million. NMC bought CosmeSurge from Abu Dhabi investment group KBBO whose Chairman, Khalifa Butti Omeir Bin Yousef ("Bin Yousef"), was also a significant shareholder in NMC (Bin Yousef was NMC's Executive Vice Chairman and owned 14.4% of NMC).<sup>15</sup> NMC stated in its financial statements that the purchase price was paid at "arm's length;" however, it is unclear how management reached this conclusion because, as disclosed by NMC, the counterparty was a related party to the Company. Further, due to the related-party nature of the transaction, short sellers publicly questioned whether the valuation and related transaction price actually represented an arm's-length transaction.<sup>16</sup>

Another notable transaction was NMC's acquisition of Aspen UK in August 2018, which represented the Company's first foray into a developed market. In a press release, NMC disclosed Aspen's enterprise value at only £10m, which was curiously different than the seller's, Tenet Healthcare, disclosed consideration for the same asset

<sup>11</sup> <https://www.investegate.co.uk/nmc-health-plc--nmc-/rns/statement-regarding-major-shareholdings/202002141132150813D/>

<sup>12</sup> 2018 Annual Report

<sup>13</sup> Management reported EBITDA divided by reported operating cash flow less interest expense in financing cash flow less \$65m (proxy for normalized capex spend)

<sup>14</sup> <https://www.investegate.co.uk/nmc-health-plc--nmc-/rns/financial-report--full-year-ended-31-dec-2018/201903070700171021S/>  
<sup>15</sup> <https://wam.ac/en/details/1395302661656#:~:text=CosmeSurge%20and%20related%20business%20have.across%20a%20variety%20of%20sectors;> S&P Capital IQ

<sup>16</sup> <https://www.muddywatersresearch.com/research/nmc/mw-is-short-nmc/>

at £252m (Exhibit 1). Short sellers publicly pointed out that Tenet had previously reported \$320 million in capital lease obligations associated with Aspen that NMC did not report.<sup>17</sup>

NMC appeared to be entering a cash crunch, though there were signals that NMC was attempting to conceal the crunch. From 2013 to 2018, the overdue balance within NMC's accounts receivables increased from 29% to 37% while management's impairment of accounts receivables as a percentage of overdue balances curiously fell from 20% to 15% over the same time frame.<sup>18</sup> The concentration within NMC's accounts receivable balance also grew as the Top 5 customers accounted for 53% of NMC's receivables in 2018 (up from 42% in 2013).<sup>19</sup> Additionally, the growth of NMC's trade payables outpaced the growth in cost of goods sold, and despite management denials, short sellers publicly reported that NMC was relying on external financing arrangements, collateralized by NMC's assets, to extend its payment terms to suppliers.<sup>20</sup> Publicly, NMC may have been overstating its operating cash flow; the Company did not deduct interest when calculating its operating cash flow, a unique and controversial definition considering the fundamental nature of M&A (and leverage) to NMC's business model.

## THE COLLAPSE

NMC's share price peaked in August 2018 when the Company's market capitalization reached \$11b. Between August 2018 and December 2019, however, NMC's share price fell 37% as investors grew increasingly wary about several factors including NMC's accounting, the pace of M&A, leverage, and the maturing end-markets in the UAE.

In December 2019, a short seller published a report on NMC highlighting several concerns including highly inflated construction costs paid to related parties, an overstated cash balance, "too-good-to-be-true" margins, understated debt, and numerous governance red flags.<sup>21</sup>

The following day, NMC management denied all allegations as "baseless and misleading," re-affirmed its leverage guidance for 2019, and called the ~50% share price decline "very material, and ... unwarranted." Nonetheless, NMC launched an independent review to provide "additional reassurance to shareholders."<sup>22</sup>

In January 2020, Al Qebaisi and Bin Yousef's sold a combined 15% of NMC for \$493m, reducing their collective ownership from 32% to 17%.<sup>23</sup>

By February 7th, 2020, NMC's share price had fallen 82% from its August 2018 peak. There were also reports that Bin Yousef and Al Qebaisi had notified NMC that Shetty had pledged their shares as security for loans "they were not party to".<sup>24,25</sup> The following day, the UK financial regulator, the Financial Conduct Authority, began making enquiries and officially launched an investigation on February 27th.<sup>26</sup>

On March 10th, NMC's board announced that they had found \$2.7b in debt facilities that had not been previously disclosed or approved by the board.<sup>27</sup> This was over double the \$2.1b that NMC had reported on its most recent balance sheet from June 2019. On March 12th, NMC issued a subsequent press release that the independent

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<sup>17</sup> <https://www.muddywatersresearch.com/research/nmc/mw-is-short-nmc/>

<sup>18</sup> 2013 and 2018 NMC Annual Reports

<sup>19</sup> 2013 and 2018 NMC Annual Reports

<sup>20</sup> <https://www.muddywatersresearch.com/research/nmc/mw-is-short-nmc/>

<sup>21</sup> <https://www.muddywatersresearch.com/research/nmc/mw-is-short-nmc/>

<sup>22</sup> <https://cf-cdn.nmc.ae/Uploads/InvestorRelations/nmc-health-plc-response-to-recent-report-19-dec-2019-adb66d0b-4047-4d4d-94f2-fb9a84d2d301.pdf>

<sup>23</sup> <https://financialpost.com/pmnbusiness-pmn/nmc-health-tumbles-after-major-investors-sell-shares-worth-493-mln>

<sup>24</sup> <https://cf-cdn.nmc.ae/Uploads/InvestorRelations/nmc-health-plc-statement-regarding-major-shareholdings-10-feb-2020-54c90b23-f3b3-4ace-a995-0ff1187967ea.pdf>

<sup>25</sup> <https://www.reuters.com/article/us-nmc-health-moves-idUKKBN20810C>

<sup>26</sup> <https://www.ftlondon.com/articles/nmc-health-suspends-shares-in-wake-of-ceo-sacking-20200227>

<sup>27</sup> <https://cf-cdn.nmc.ae/Uploads/InvestorRelations/nmc-health-plc-update-on-financial-position-10-mar-2020-3083cdf0-b719-4b3b-9ee0-896bbd9941d9.pdf>

committee had discovered evidence leading to suspected fraudulent behavior.<sup>28</sup> Two weeks later, NMC said that they had found more unreported debt and that the total estimated debt appeared to be \$6.6b funded through a complex web of over 75 debt facilities from 80+ financial institutions. NMC was subsequently placed into receivership on April 9th, 2020.<sup>29</sup>

## DISCUSSION QUESTIONS

1. Put yourself in the shoes of an investor. What were the “red flags” that could have prompted suspicion about potentially fraudulent activity?
2. What incentive(s) existed that could have encouraged fraudulent behavior at NMC? Consider the nature of the metrics used to determine compensation, market pressures, and other factors.
3. What opportunities existed that could have enabled fraudulent behavior to occur and avoid detection? Consider the ownership structure of the Company, audit requirements, and other factors.

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<sup>28</sup> <https://www.arabianbusiness.com/gcc/uae/442749-probe-into-uaes-nmc-health-uncovers-suspected-fraudulent-behaviour>

<sup>29</sup> <https://www.ft.com/content/b597e326-6dc2-11ea-89df-41bea055720b>

## Exhibit 1

*NMC Press Release*

### **Acquisition of UK-based Aspen Healthcare: Establishing Centers of Excellence in GCC with capability enhancement program**

NMC has acquired 100% of the equity of Aspen Healthcare (“Aspen”) from Tenet Healthcare for an Enterprise Value of **GBP 10m**. Aspen operates a network of nine facilities across the UK including four hospitals, three of which are based in Greater London (Parkside Hospital, The Holly Private Hospital and Highgate Hospital).

*Tenet’s 8K*

#### **Item 2.01. Completion of Acquisition or Disposition of Assets.**

On August 17, 2018, Tenet Healthcare Corporation (the “Company”) completed the sale of all of the outstanding equity interests of its wholly owned subsidiary HCN European Surgery Center Holdings Limited (“Aspen”) to NMC Healthcare UK Limited for total consideration of approximately **£252 million** (approximately \$332 million using an exchange rate of £1.0 = \$1.3197 at June 30, 2018), comprised of an initial base cash purchase price of approximately \$12 million and the buyer’s assumption of approximately \$320 million of liabilities, which were recorded as liabilities held for sale as of June 30, 2018 (the “Transaction”). The Transaction is subject to customary purchase price adjustments. Aspen owned and operated all of the Company’s assets in the United Kingdom, including four acute care hospitals, one cancer center and four outpatient facilities. The Company classified Aspen as Held for Sale in September 2017 and suspended depreciation at that time.

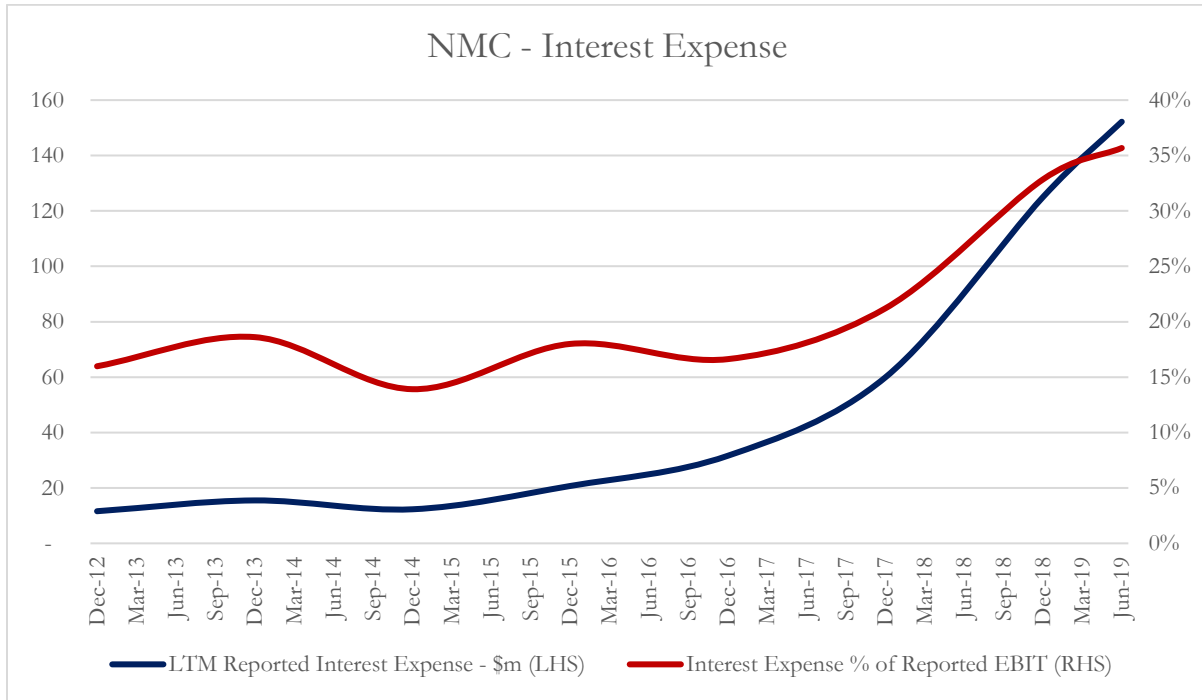
## Exhibit 2<sup>30</sup>

	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>
Long-Term Bank Debt	223	250	207	575	829	1,192	1,041
New Bank Debt	316	525	264	823	632	671	1,533
<i>% of PY LT Debt Re-financed</i>	<i>N/A</i>	<i>235%</i>	<i>105%</i>	<i>398%</i>	<i>110%</i>	<i>81%</i>	<i>129%</i>

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<sup>30</sup> S&P Capital IQ

**Exhibit 3<sup>31</sup>**



<sup>31</sup> S&P Capital IQ