

## Ideas @ Edelweiss Multi Strategy Funds – Holding Company Discounts



India has over a hundred listed holding companies that hold shares of sister concerns. Some of the holding companies like Tata Investment Corporation are pure investment vehicles while others like Adani Enterprises have operating businesses of their own. However, the one common feature of all of them is a huge discount to their net value or the listed value of their stock holdings. For example, Bajaj Holdings & Investments holds 39.16% in Bajaj Finserv, 31.49% in Bajaj Auto and 24% in Maharashtra Scooters among other assets. The combined value of just these three assets is 28,632 cr. In contrast, the market cap of Bajaj Holdings & Investments is 15,380 cr implying a 46.28% holding company discount. This discount is often attributable to a lack of controlling stake, the long term of investments, liquidation costs, limits to arbitrage and other factors. In our opinion, the size of the holding company discount, its variation across time and across companies is arbitrary and is accepted at face value by research analysts without any critical examination. In this month's Ideas @ Edelweiss Multi Strategy Funds, we explain how to think about holding companies by presenting an analogous vehicle - the mutual fund as well as how to invest in these unique opportunities.

A mutual fund, like a holding company, has large amounts of long-term holdings that would have significant market impact if they were liquidated and does not give its unit holders a say in either how capital is allocated or how the fund is run. Furthermore, a mutual fund cannot be sold intra-day like the stock of a holding company, and spreads its investments across multiple industries and promoter groups increasing the so-called sum-of-the-parts discount. But yet, mutual funds do not trade at a discount to their NAV! The one thing that works in favor of a mutual fund is that dividends are tax-free in the hands of investors while a holding company pays a 16.22% dividend distribution tax (DDT) on payouts to investors. If a company were valued using the dividend discount model, this implies that the fair holding company discount should be the DDT rate or 16.22% presently.

Holding companies can test the patience of investors because the holding company discount is relatively stable and the price of the holding company often tracks that of its underlying investments. Hence, we recommend that investors select holding companies based on the attractiveness of the underlying businesses and the quality of management. Any convergence of the holding company discount due to a liquidation, demerger, delisting, takeover or a re-rating is a bonus. In the presence of a catalyst, a holding company can be a phenomenal investment but investors should take care that there is an adequate margin of safety in absence of any convergence. This "mezzanine" style of thinking permeates a lot of our thinking including that on holding companies and is one that can produce very attractive risk adjusted returns.