Incwert Valuation Chronicles
Series 3 I 2020

An insight into **Holdco Discount**

Holding company or "Conglomerate" discount analysed across major sectors in India in the past 5 years

March 2020

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Valuation | Research

Foreword

We are pleased to come out with our holding company discount ("HoldCo Discount") study based on the analysis of select listed holding companies across major sectors in India during the past 5 years.

The study could be of importance to the valuation professionals when dealing with the question on the quantum of discount to be applied for valuing the holding of a minority shareholder in an entity that is essentially an investment vehicle. The empirical evidence is based on market data which can be considered to be a reliable basis when addressing the holding in a private enterprise which is a conglomerate.

A holding company or conglomerate discount occurs when a holding company's market capitalisation is less than the sum of the investments and other net assets that it holds. The level of discount is the difference between the aggregate value of each investment in the conglomerate and its market capitalisation.

The results indicate that the discounts, influenced by several factors – industry sector, timing within the economic cycle, multi-layer subsidiaries, reporting complexity and market capitalization, vary across time and sectors.

We hope you find the results of our study of interest and value.

Key findings of our HoldCo Discount study, 2020 are:

- Current median Holdco discount is approximately **68 per cent** across major sectors in India.
- Median Holdco discount has increased by around 10 percentage points in the last 5 years.
- Holdco discount during the last 5 years has remained in the range of 45 per cent to 70 per cent.

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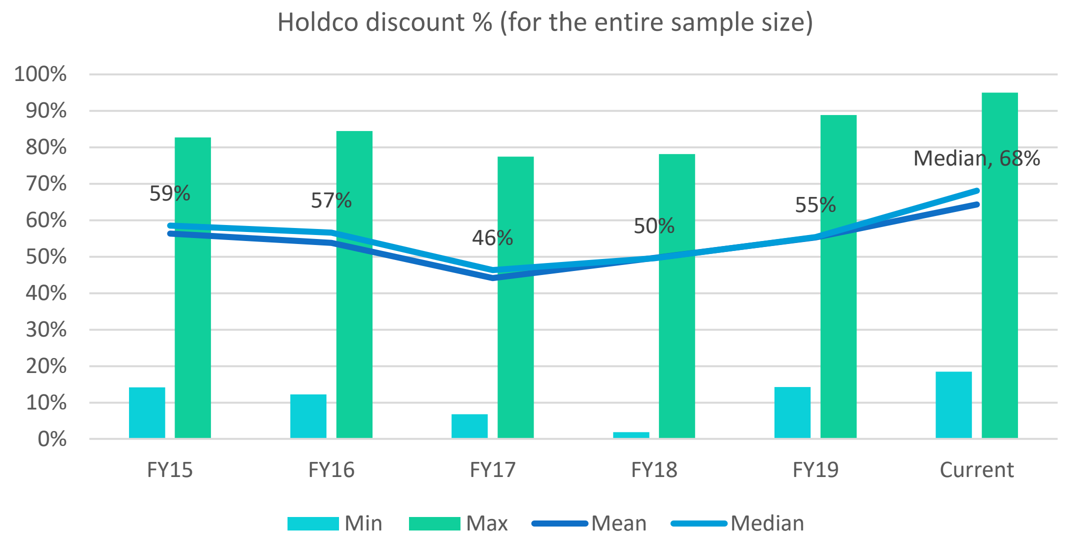
Median of Holdco discount during the last 5 years has been in the range of 45 per cent to 70 per cent

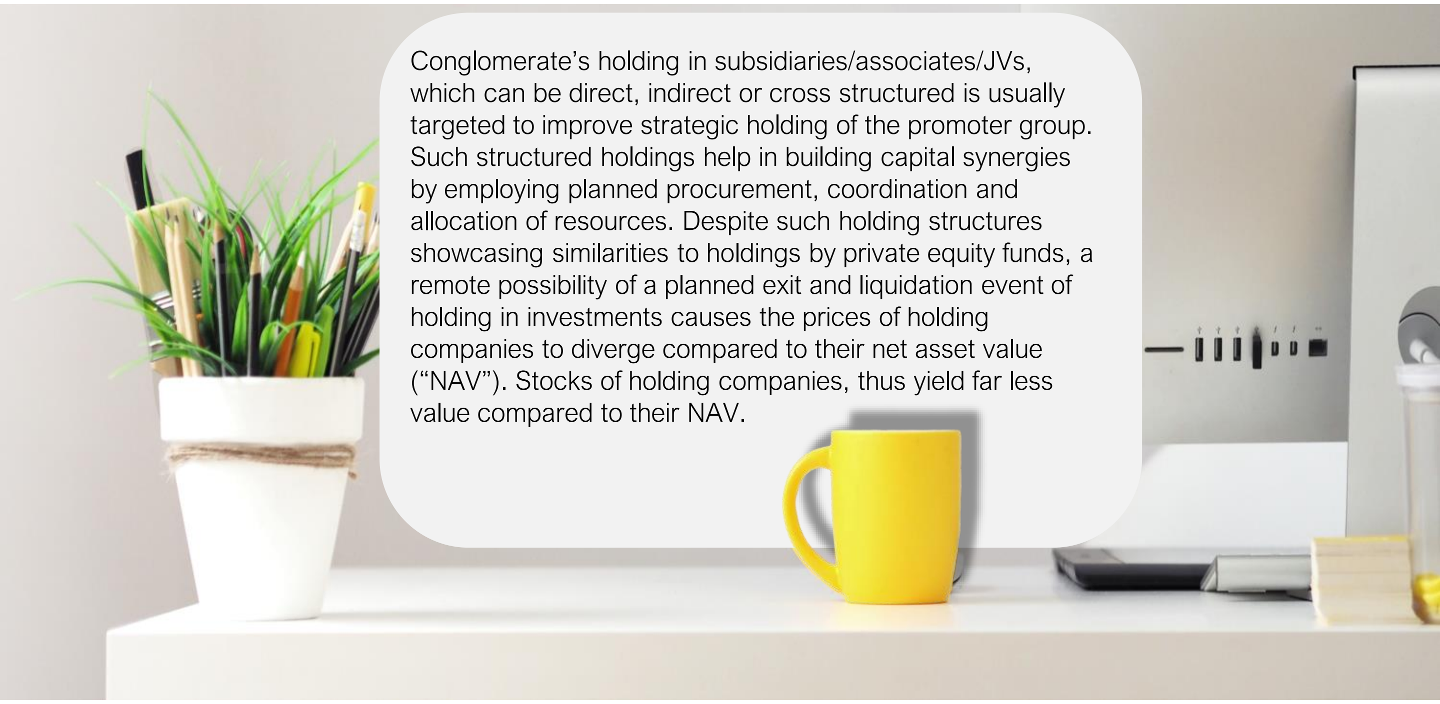


Note: 1) Sample size of 27 listed enterprises which are conglomerates or holding companies has been considered.
2) Current figures reflects the data as on 28 February 2020

Source: Incwert analysis based on annual reports of companies selected for the study and market price from NSE/BSE

The range of discount is driven by:

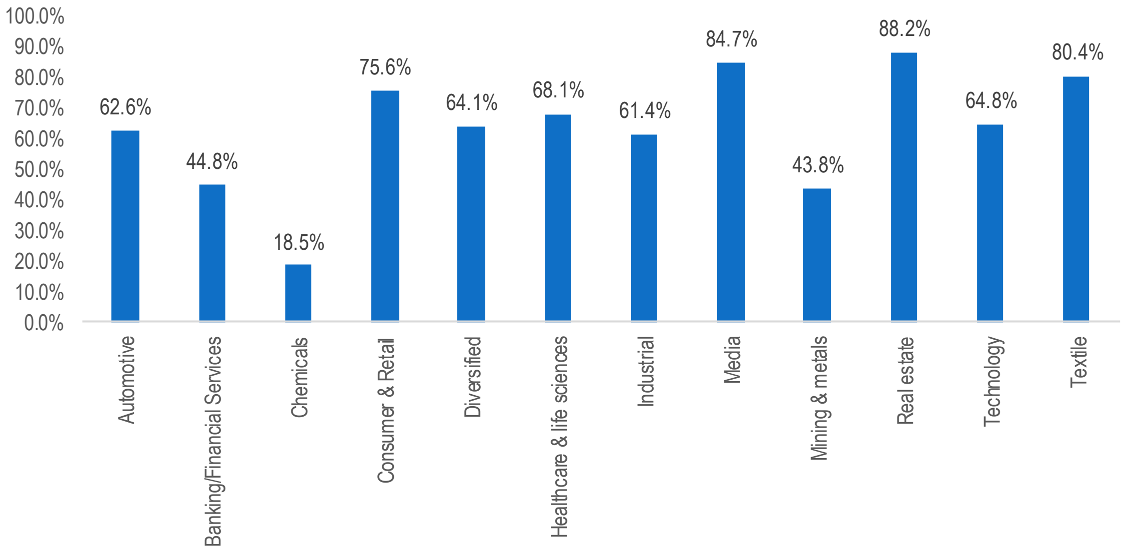
- Industry, sector and timing within the economic cycle
- Quality of investments held by the Holding Co
- Level of earnings from dividend and interest, and subsequent distribution to shareholders of Holdco
- The complexity of reporting structure. Minority shareholders tend to discount companies that have complex structures as information on businesses may not be available/ accessible on time
- Multi-layer of subsidiaries results in the parking of assets/liabilities in SPVs. Marginal investors at times, do not have relevant information to value such subsidiaries/ investments.
- Cross holding in other private companies which potentially results in lack of comprehensibility
- Cascading effect of dividend distribution tax in a multi-tier structure.



Conglomerate's holding in subsidiaries/associates/JVs, which can be direct, indirect or cross structured is usually targeted to improve strategic holding of the promoter group. Such structured holdings help in building capital synergies by employing planned procurement, coordination and allocation of resources. Despite such holding structures showcasing similarities to holdings by private equity funds, a remote possibility of a planned exit and liquidation event of holding in investments causes the prices of holding companies to diverge compared to their net asset value ("NAV"). Stocks of holding companies, thus yield far less value compared to their NAV.

Current median Holdco discount across the select set of companies is c.68 per cent

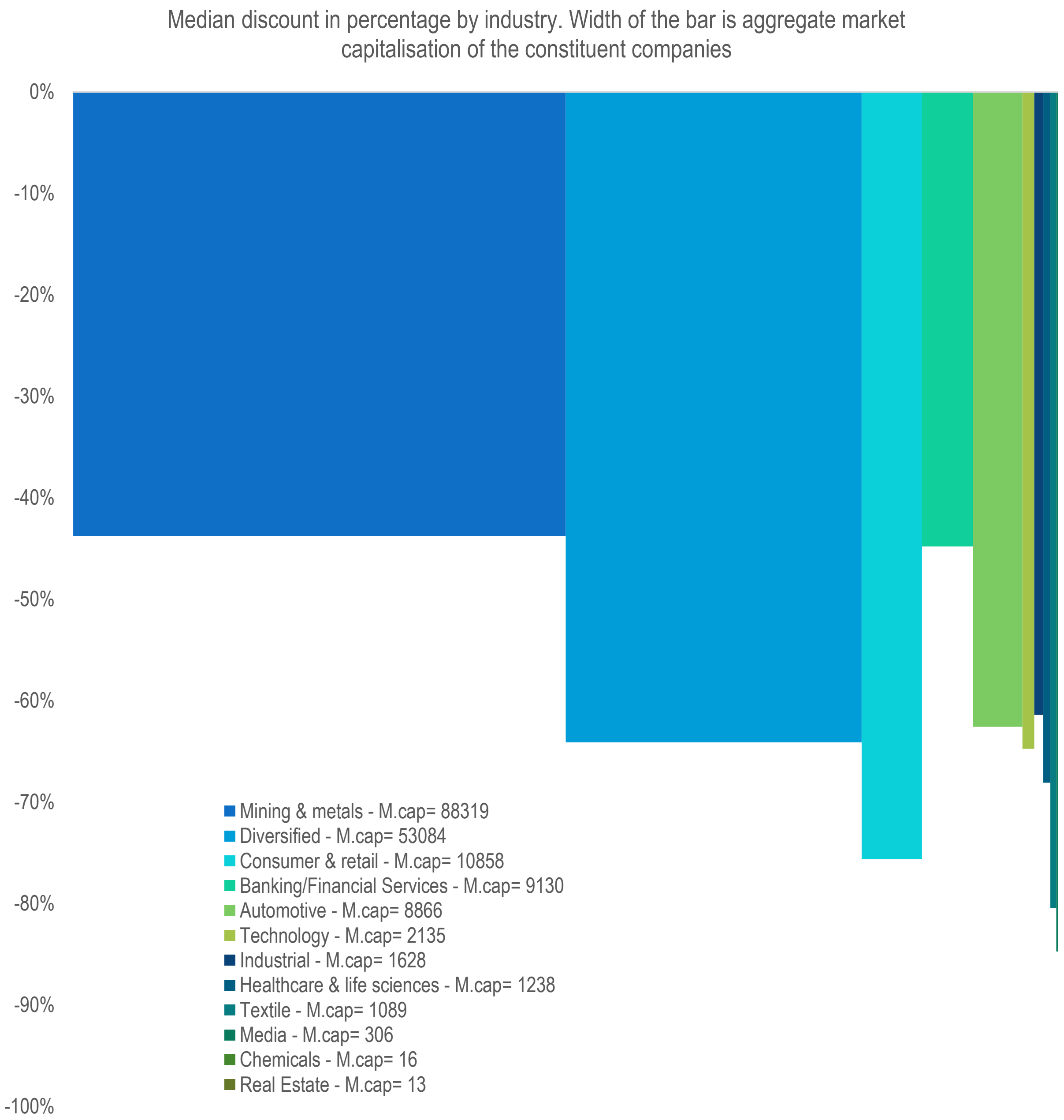
Median holding company discount for current period across all sectors



Note: 1) Sample size of 27 listed enterprises which are conglomerates or holding companies has been considered.
2) Current figures reflects the data as on 28 February 2020

Source: Incwert analysis based on annual reports of companies selected for the study and market price from NSE/BSE

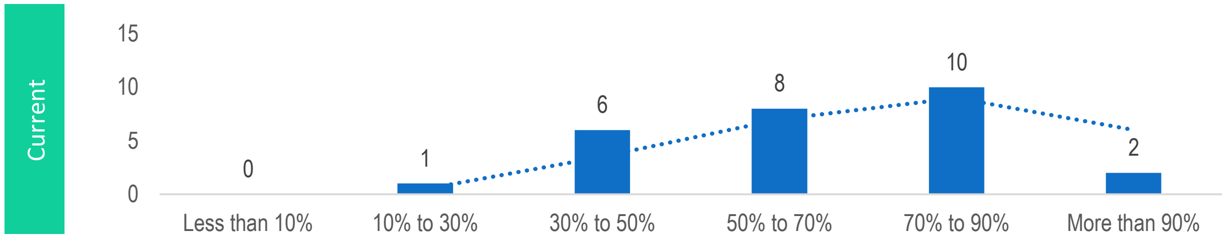
Mining & Metals followed by Diversified sector have the highest weight in the distribution of Holdco discount

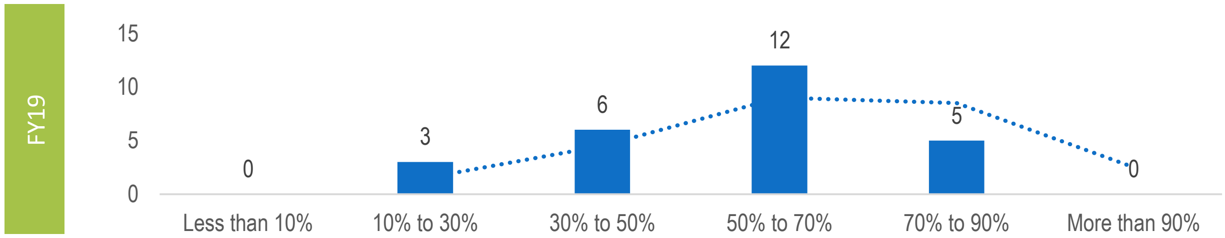


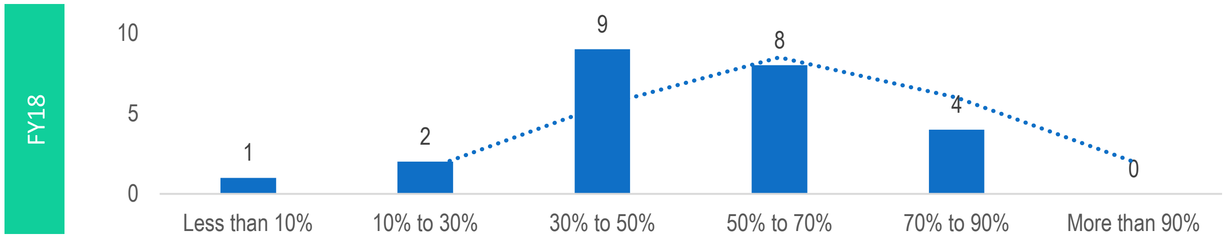
Note: 1) Sample size of 27 listed enterprises which are conglomerates or holding companies has been considered.
2) Current figures reflects the data as on 28 February 2020

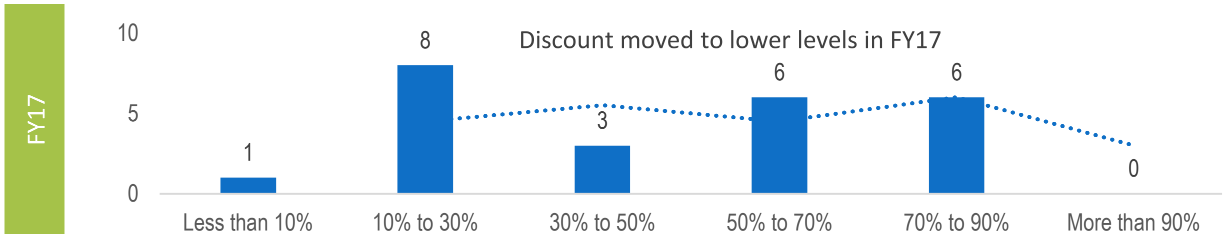
Source: Incwert analysis based on annual reports of companies selected for the study and market price from NSE/BSE

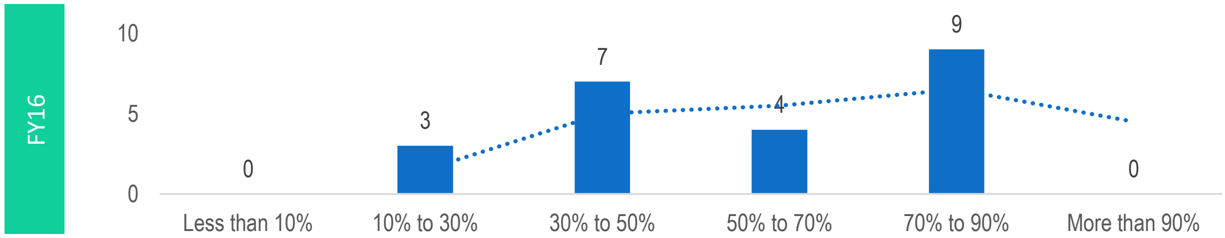
Variability in skewness and kurtosis observed in the distribution of companies for Holdco discount

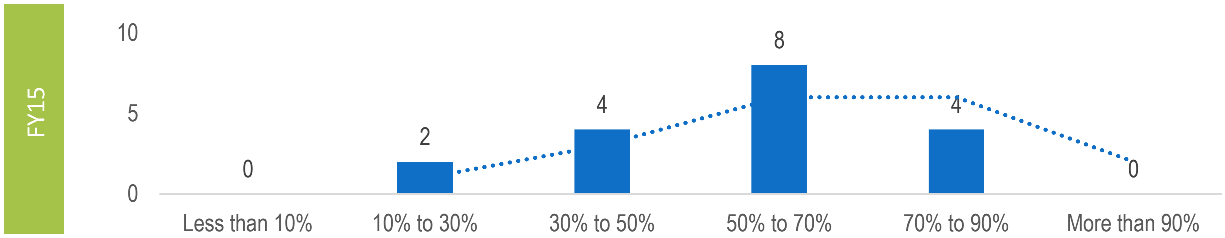












Note: 1) Sample size of 27 listed enterprises which are conglomerates or holding companies has been considered.
2) Current figures reflects the data as on 28 February 2020
3) X-axis represents the level of discount and Y-axis represents the number of companies

Source: Incwert analysis based on annual reports of companies selected for the study and market price from NSE/BSE

Our methodology

- We have analysed listed holding companies ("Holdcos") in India across all major sectors having listed investments and are trading at discount in the market over the 5-year period ending February 2020.

- The implied holding company discount is calculated by comparing the market value of the listed holding company with its total value of holdings.

  Holding company discount (INR) = Total value of holdings- Market value of holding company

  $$\text{Holding company discount (\%)} = \frac{\text{(Total value of holdings- Market value of holding company)}}{\text{Total value of holdings}}$$

- Net Asset Value (NAV) method has been used for ascertaining the total value of holdings.

  Net Asset Value = Total value of assets - Total value of liabilities

- Total value of assets include long term and short-term investments in subsidiaries, associates, joint venture and equity shares (quoted and unquoted); gross block; other current assets

- Total value of liabilities includes all current and non-current liabilities.

- Listed investments in subsidiaries, associates and joint ventures are taken at market value and rest investments on book value. Investments in subsidiaries, associates and joint ventures are calculated just by multiplying % holding with its market value.

- All other assets and liabilities are considered at book value.

Subsidiaries, associates and joint ventures listed on stock exchanges in India have been revalued based on their period end market price

Other net assets have been considered at book value

Understanding the Holdco study…

1 What is Holding company

A conglomerate or a holding company typically exhibits the following characteristics:

- does not have any material business operations of its own;
- exists mostly to own assets via holding controlling stock or membership interests in other companies;
- primary revenue is dividend income and interest earnings;
- operating income tends to be consistently less than the value of the assets that it holds.

2 Why Holding company discount arises

- Holding companies are more complex to analyze and determine the true value versus the value of its operating assets
- Holding companies tend to be a sum of disjointed businesses which an investor is forced to buy even though he/she does not like a specific investment of holdco
- Holding companies are mostly promoter-driven companies and hence the actions may not suit the return and risk objectives of minority shareholders
- Holding companies usually are valued based on the liquidation value of the investments. However, such liquidation value may not be realised as the holding company will rarely sell their investments in group companies due to strategic/synergistic benefits.
- Internal policies could prevent the holding company from realising the value of shares which may also get factored into the discounted pricing.

3 Limitations

- The value of holdings other than quoted investments in subsidiaries/associates is taken at book value.
- For the current period (till February 2020) the value of holdings other than quoted investments in subsidiaries/associates is taken same as of 31 March 2019.
- Current period % holding is taken the same as on 31 March 2019.
- Value roll-up has been performed for the first level of holdings. Investments of step-down subsidiaries/associates have not been considered.
- Market prices as at the period end have been considered.

Reference | Incwert Publications

Reference Material:
- Company filings and other publicly available information
- NSE/BSE
- Incwert analysis

Photo credit:
- Unsplash.com

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Valuation challenges in AIF (Pg. 69-80)
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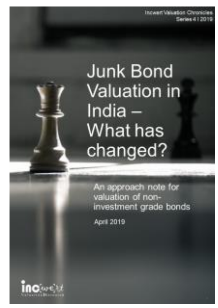

IBC Quarterly Flash
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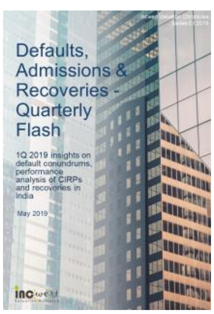

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IBC Quarterly Flash
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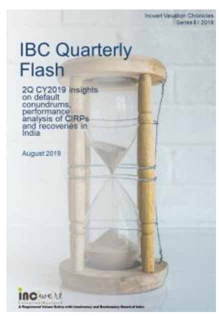

AMC listing & valuation
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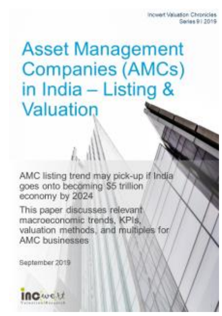

India Control Premium
- Oct 2019

India Beta Study
- Jan 2020

Risk free rate in a negative yield economy
- Feb 2020

Management | Advisory Board

Sunit Khandelwal
Director

Sunit has worked across a range of sectors such as Infrastructure, real estate, FMCG, retail, engineering, clean energy, healthcare, IT/ ITeS, and other manufacturing industries.

Qualifications:
Chartered Accountant (ICAI)
B.Com (Hon.) – St. Xavier's College
Registered Valuer with IBBI

Sunit has an overall experience of over 13 years in valuation advisory, transaction advisory and M&A advisory.

As a valuation professional, Sunit has undertaken valuation of businesses for transactions, fund raising, strategic decision making, and corporate restructuring. He has also undertaken valuation of intangible assets, option valuation, litigation support, private equity portfolio valuation and valuation for reporting purposes such as purchase price allocation and impairment test under IFRS and Indian GAAP.

In past he has worked with KPMG India (as Associate Director), BDO, Grant Thornton, KPMG UK, and DBDBS a boutique M&A advisory firm.

Sunit is also an active speaker on valuation at National Institute of Finance Management (NIFM).

Punit Khandelwal
Director

Punit has worked across leveraged loans, distressed debt, insolvency/ bankruptcy situations and high-yield asset classes.

Qualifications:
Chartered Accountant (ICAI)
Chartered Financial Analyst (ICFAI)
CFA Level 2 (US)
MS in Finance (ICFAI)
B.Com (Hons.) – St Xavier's College
Registered Valuer with IBBI

Punit brings with him 15 years of experience in sell-side and buy-side advisory across equity and fixed income. He has worked on several bespoke valuations and lent research support to dozens of asset managers/investment bankers/brokers/consulting firms across the globe.

In the fixed income segment, he worked as a fundamental analyst across the capital structure: leveraged loans, distressed debt, insolvency/bankruptcy situations and high-yield asset classes. He has also helped sell-side & consulting firms increase their market presence by coming up with thematic and white label papers.

He started his career as an analyst with Zacks Investment Research & then was a part of a UK based CLO manager's research team. Then he moved on to set up research practices for couple of startups before moving onto become Global Head of Research at one of the largest BPO/KPO in the world and then finally co-founded Incwert.

He won 40 under 40 Alternative Professionals Awards 2020 by AIWMI

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