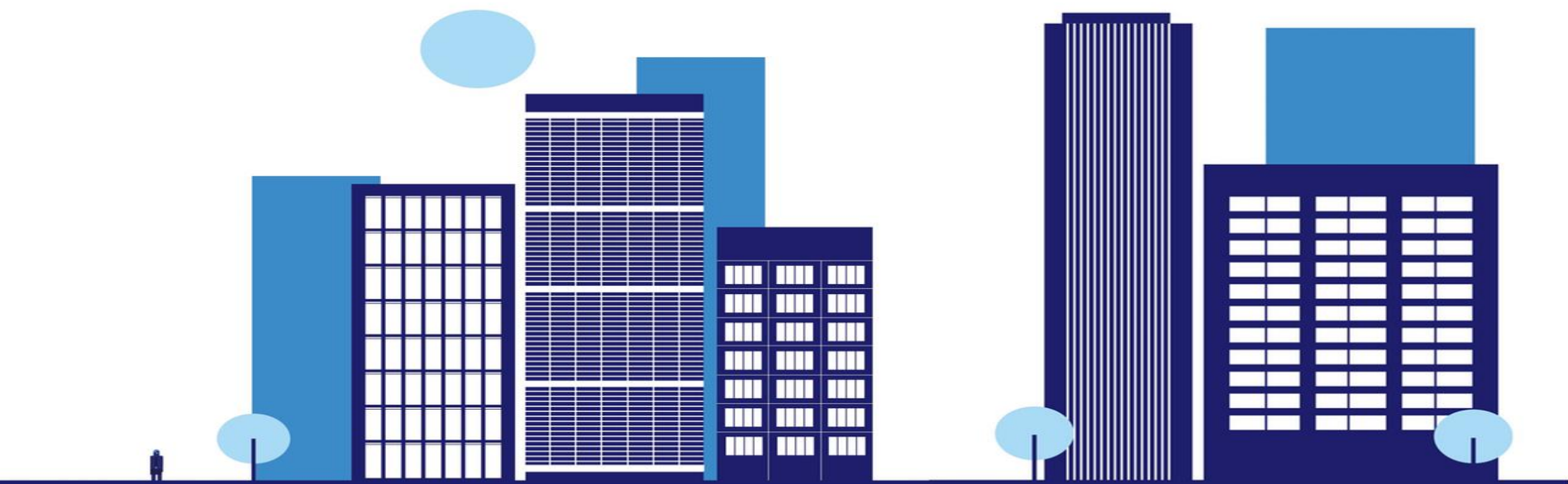


# Holding Companies

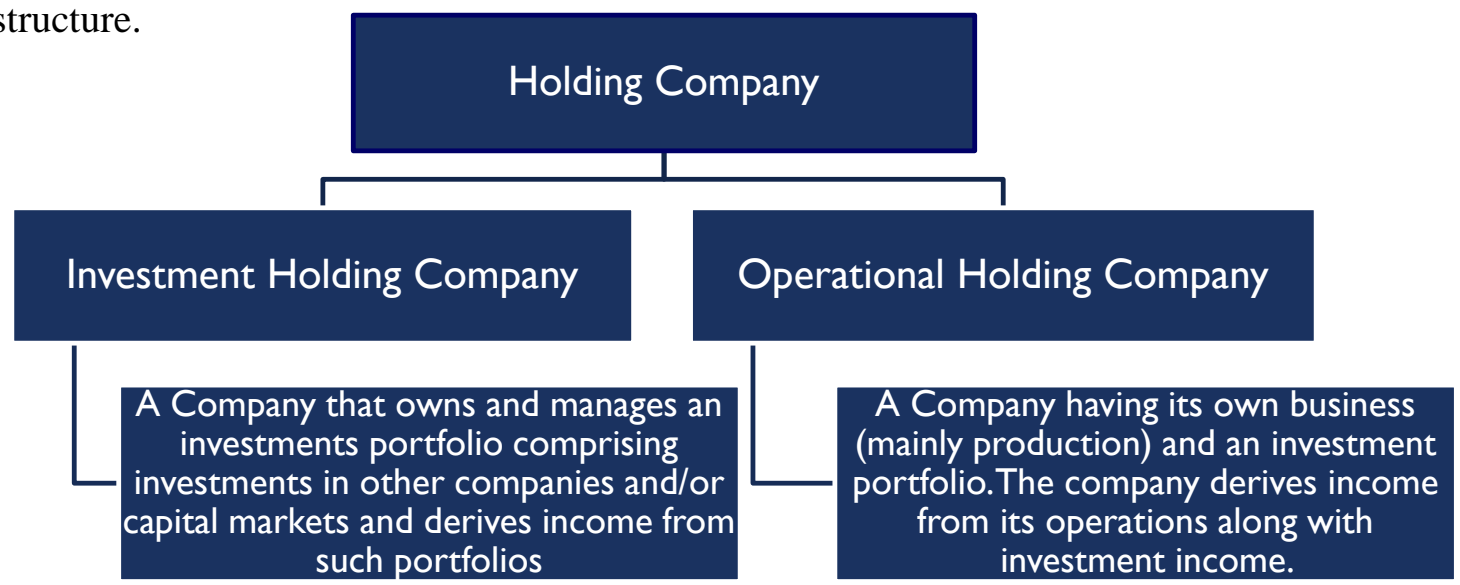
## An Overview



August 2020

# INTRODUCTION | TYPES OF HOLDCO

- PACRA defines a holding company (HoldCo) as an entity which is primarily involved in holding controlling and/or non-controlling stakes in other companies for the purpose of generating capital gains and/or dividend income.
- As per Companies Act 2017, a holding Company means a company which is another company's holding company if, but only if, that other company is its subsidiary.
- The investment portfolio is built to capitalize on opportunities and to diversify the risk.
- The holding company can be classified in two broad categories on the basis of the underlying structure.



# INVESTMENT PORTFOLIO

- The classification of the investment portfolio can be done at three levels based on its relationship with the HoldCo.
- The degree of economic and financial significance plays an important role in categorizing the investment portfolio.
  - Core : The entities where the HoldCo/group has operational control and are essentially a part of the HoldCo usually as subsidiaries or through significant shareholding. Financial stress for core entities will have a significant effect on the Holdco's credit profile. It is very unlikely that the HoldCo may decide to divest.
  - Strategic: These entities may not act as flagship companies. Group can have partnerships in these companies. Core investments can translate into strategic investment upon divestiture of holdings.
  - Trading: Least integrated entities. HoldCo classifies these as HFT and has clear intention to sell in near-term. Primarily held to make gains in short-term. The key risk involved here is market risk.

# HOLDING COMPANIES IN PAKISTAN

- Through the establishment of the HoldCo structure, the business houses felt that they could manage their investment portfolio in a more efficient manner by focusing on:
  - Succession planning and allocation among sponsors
  - Performance monitoring of investee companies,
  - Efficient allocation of capital,
  - Management of talent within group companies
- The performance of a holding company is determined by:
  - Subsidiaries net working capital & cash-flow management
  - Debt structure & Dividend Income
- The trend in Pakistan is increasing towards the investment holding companies as key business houses have established their investment HoldCos.

# MAJOR HOLDING COMPANIES

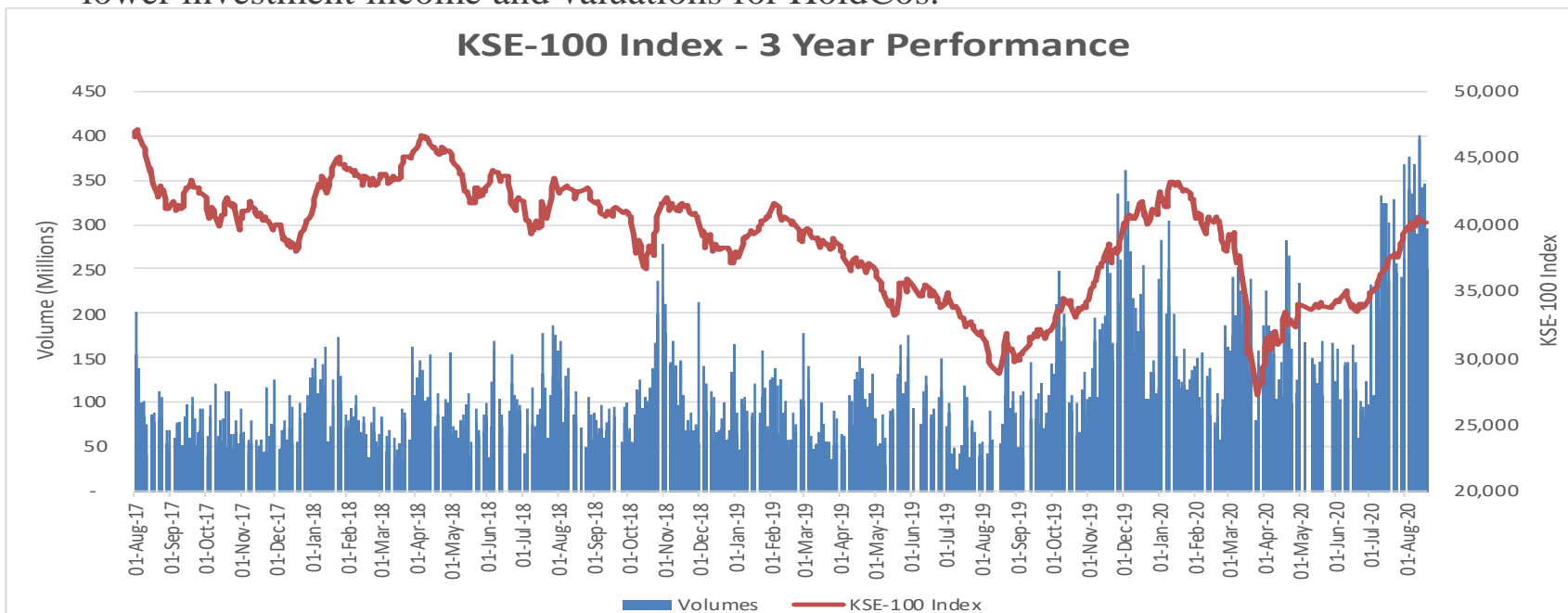
PKR in Mln

Description	Engro Corporation	Mega Conglomerate	Jahangir Siddiqui & Co	IGI Holdings	Packages	Dawood Hercules Corporation	Nishat
<b>Balance Sheet</b>	<b>Mar-20</b>	<b>Mar-20</b>	<b>Mar-20</b>	<b>Mar-20</b>	<b>Mar-20</b>	<b>Mar-20</b>	<b>Mar-20</b>
Long-term Ratings	AA+	AA-	AA	AA	AA	AA	AA
Short-term Ratings	A1+	A1	A1+	A1+	A1+	A1+	A1+
<b>Investment book</b>							
L.T Investments	26,437	26,160	22,445	15,742	42,787	24,722	32,317
Total Assets	95,153	27,513	25,210	16,095	63,401	40,088	104,775
Consolidated L.T Investments	30,012	30,527	108,920	58,920	30,688	31,426	47,575
Consolidated Total Assets	581,902	46,786	495,937	75,985	101,099	608,839	155,398
Total Debt	305	22,500	4,342	1,628	8,509	9,040	30,045
Consolidated Debt	185,026	22,472	61,663	3,500	29,666	193,593	37,385
Total Equity	85,876	(1,403)	21,105	14,126	48,194	30,087	65,429
Consolidated Equity	201,720	13,419	32,218	46,018	53,920	212,999	104,047
<b>Income Statement</b>							
Dividend Income	382	257	463	440	-	35	1,578
Capital Gains*		-	-	-	-	-	-
Total Revenue	382	257	456	440	6,412	(1,027)	50,052
Consolidated Revenue	44,977	6,424	14,659	2,341	16,491	44,977	73,260
Net Income	780	(1,667)	(29)	352	199	(1,517)	2,915
Consolidated Net Income	5,940	734	365	41	(60)	4,424	6,798

# KSE-100 INDEX PERFORMANCE

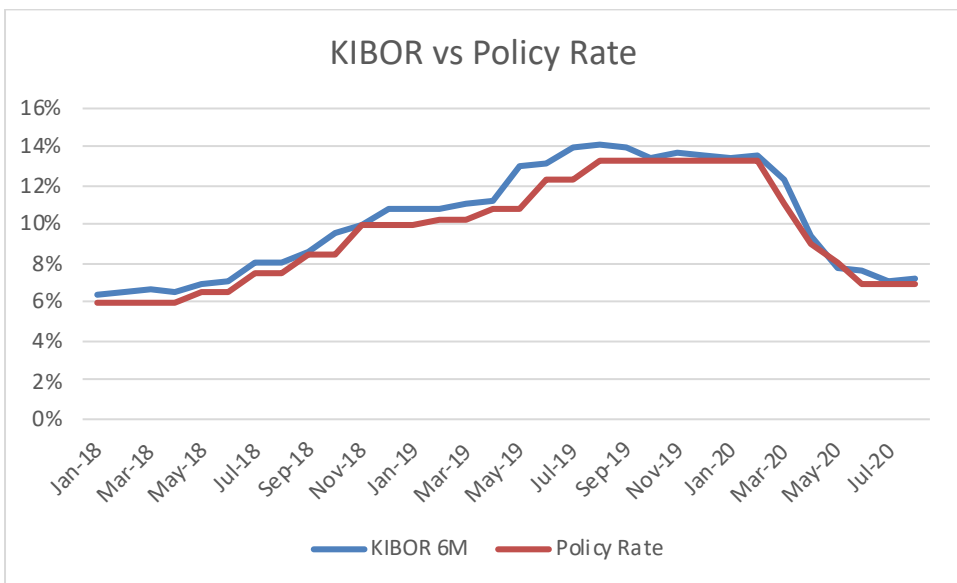
- The HoldCos hold significant amount of investments, mainly listed companies as core, strategic and trading in their portfolio. Equity market performance plays a vital role in determining the value the investment portfolio and related income
- Overall the performance of PSX 100 index remained under pressure during FY20 (~1% return on YoY Basis), reflecting in lower investment income and valuations for HoldCos.

KSE-100 Annual Returns		
FY18	FY19	FY20
-6%	-19%	1%



# INTEREST RATE TRENDS

- HoldCos can have significant amount of debt or cash, depending on maturity profile on investments, on own balance sheets or on books of subsidiary companies. Hence, HoldCos are exposed to interest rates fluctuation.
- Interest rates have been rising throughout FY19 and 9MFY20. This put pressure on leveraged HoldCos due to higher finance costs.
- Interests rates have been cut by a cumulative 625bps to curb the effects of COVID outbreak. This will significantly reduce finance cost, while cash surplus HoldCos will have lower returns on cash equivalent investments.



Average Interest Rates		
FY18	FY19	FY20
6%	10%	12%

# KEY CHALLENGES

- In an operational holding company major resource allocation is involved in operations and management of core operations, while creating a structure to monitor investment portfolio.
- Investment management framework for monitoring performance of investee companies needs attention in line with international best practices.
- Borrowing patterns are not clearly established between the HoldCo and operational entities.
- Inter-corporate dividends within the group companies were exempt from tax. However, the Finance Act, 2016, withdrew the exemption to inter-corporate dividend to such companies that fall within the scheme of section 59B availing group relief (Clause 103A, Part I, Second Schedule of the Income Tax Ordinance, 2001).

## **Restoration of Exemption in Tax Laws (Second Amendment) Ordinance, 2019**

- The said act restored tax exemption on 100% inter-corporate dividend for the companies that fall within the scheme of group relief under section 59B.

Exemptions of intercorporate dividend encourages group companies to diversify their businesses in an efficient manner and promotes group formation and consolidation.





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