WealthCE

Arbitrage: Holding Company

An investment holding company owns and controls many other investments. Holding companies usually produce no product or services, existing only to own shares of other companies. They can also hold other assets or investments, such as real estate and intellectual property. Holding companies are protected from the liabilities created by their subsidiary firms, but can still appoint and control chairmen or executive management who are responsible. They also add another layer of separation between holding company owners and liabilities or responsibility for created legal or criminal risks.

Holding company values are equivalent to the firm's Net Asset Value. The formula for net asset value is below.

Net Asset Value = Market Value Assets - Liabilities

Hedge funds can calculate holding company values on a per share basis by dividing a firm's net asset value by shares outstanding. The formula for per share net asset value is below.

Net Asset Value Per Share = (Market Value Assets - Liabilities)/Shares Outstanding

If hedge funds think the firm's Net Asset Value is undervalued, they purchase shares of the holding company and short sell assets held by the company on the open market. If hedge funds think the firm's Net Asset Value is overvalued, they open short sale positions on the holding company while purchasing shares in assets held by the company on the open market. In both cases, they earn profit if the price differences converge. They lose if the price differences increase in distance.