Henderson Group PLC HGG.AX HGG AU

FINANCIALS

NOMURA
EQUITY RESEARCH

TIAA-CREF JV is dilutive but has sound logic

Deal appears 6% dilutive but creates options; new A$3.30 TP captures market/FX moves

June 25, 2013

Rating Remains	**Buy**
Target price Reduced from 3.40	AUD 3.30
Closing price June 25, 2013	AUD 2.38
Potential upside	+38.7%

HGG's property agreement with TIAA-CREF appears 6% dilutive

We estimate HGG's recently announced deal with TIAA-CREF to sell its US real estate business and partner with TIAA-CREF on HGG's remaining European and Asian real estate businesses is mildly earnings dilutive (c.6%) in FY14 and beyond. However, the announced partnership has sound logic and creates strategic options, previously unavailable to HGG, that we believe neutralise its dilutive impact:

- TIAA-CREF anticipates investing US$1.5bn into the combined business, which should provide renewed impetus to HGG's sub-scale property portfolio, in our view.
- HGG can dedicate more resources to its core equity and FI franchises.
- Both parties have agreed to explore further commercial arrangements that may further HGG's expansion into the US.
- Net cash proceeds of £100mn will result in a much strengthened balance sheet and create additional 'optionality' for management.

Underlying flow trends continue along positive direction of travel

Yesterday's announcement included little detail on current trading conditions. However, management comments during the call suggested that despite recent market volatility, underlying flows had continued along a 'positive direction of travel' during the 2Q13.

Trimming target price to A$3.30, reiterating our Buy rating

We have reduced our TP and earnings forecasts for recent market movements. We exclude the impact of the JV (expected 6% dilution) but with 39% potential upside to our revised TP, we remain comfortable with our Buy rating.

31 Dec	FY12	FY13F		FY14F		FY15F	
Currency (GBP)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	433	486	465	529	497	569	534
Reported net profit (mn)	100	108	101	137	117	160	138
Normalised net profit (mn)	127	142	135	167	147	187	165
FD normalised EPS	11.74c	12.88c	12.20c	15.15c	13.34c	16.94c	14.94c
FD norm. EPS growth (%)	-5.4	9.7	4.0	17.7	9.3	11.8	12.0
FD normalised P/E (x)	12.9	N/A	11.9	N/A	10.6	N/A	9.5
EV/EBITDA (x)	10.3	N/A	8.5	N/A	7.1	N/A	6.0
Price/book (x)	2.1	N/A	2.0	N/A	1.9	N/A	1.8
Dividend yield (%)	4.7	N/A	5.2	N/A	5.7	N/A	6.5
ROE (%)	12.7	13.5	12.7	16.2	14.1	17.9	15.9
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash	net cash	net cash

Source: Company data, Nomura estimates

Key company data: *See page 2 for company data and detailed price/index chart.*

Anchor themes

We believe HGG is close to delivering a turnaround in net flows after years of struggling to keep pace with peers. An attractive combination of exposure to equities and retail investment management should help HGG to deliver improved flows and margins over the next few years.

Nomura vs consensus

Our near-term estimates are marginally higher than consensus estimates; longer term we expect stronger flow-driven growth.

Research analysts

Australia Insurance

Toby Langley, CFA - NAL
toby.langley@nomura.com
+61 2 8062 8436

Matthew Dunger - NAL
matthew.dunger@nomura.com
+61 2 8062 8416

See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

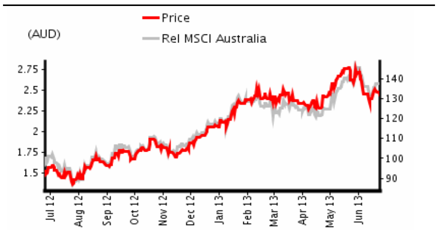
Key data on Henderson Group PLC

Income statement (GBPmn)

Year-end 31 Dec	FY11	FY12	FY13F	FY14F	FY15F
Revenue	**477**	**433**	**465**	**497**	**534**
Cost of goods sold					
Gross profit	**477**	**433**	**465**	**497**	**534**
SG&A	-304	-277	-292	-307	-323
Employee share expense					
Operating profit	**173**	**156**	**174**	**190**	**211**
EBITDA	**176**	**159**	**177**	**194**	**215**
Depreciation	-3	-3	-3	-3	-3
Amortisation	0	0	0	0	0
EBIT	173	156	174	190	211
Net interest expense	-14	-9	-5	-4	-2
Associates & JCEs	0	0	0	0	
Other income	0	0	0	0	
Earnings before tax	**159**	**147**	**169**	**187**	**209**
Income tax	-34	-20	-34	-39	-44
Net profit after tax	**126**	**127**	**135**	**148**	**165**
Minority interests	0	0	0	0	0
Other items	0	0	0	0	0
Preferred dividends	0	0	0	0	0
Normalised NPAT	**126**	**127**	**135**	**147**	**165**
Extraordinary items	-92	-27	-34	-30	-27
Reported NPAT	**34**	**100**	**101**	**117**	**138**
Dividends	-70	-78	-80	-85	-96
Transfer to reserves	**-36**	**22**	**21**	**32**	**42**
Valuation and ratio analysis					
Reported P/E (x)	44.0	15.7	15.3	12.8	10.9
Normalised P/E (x)	11.9	12.4	11.4	10.2	9.1
FD normalised P/E (x)	12.6	12.9	11.9	10.6	9.5
FD normalised P/E at price target (x)	17.5	17.9	16.5	14.7	13.2
Dividend yield (%)	4.5	4.7	5.2	5.7	6.5
Price/cashflow (x)	17.5	9.8	10.4	9.0	8.2
Price/book (x)	2.1	2.1	2.0	1.9	1.8
EV/EBITDA (x)	10.0	10.3	8.5	7.1	6.0
EV/EBIT (x)	10.2	10.5	8.6	7.2	6.1
Gross margin (%)	100.0	100.0	100.0	100.0	100.0
EBITDA margin (%)	36.9	36.7	37.9	38.9	40.2
EBIT margin (%)	36.3	36.0	37.3	38.3	39.6
Net margin (%)	7.1	23.0	21.7	23.6	25.8
Effective tax rate (%)	21.1	13.3	20.0	21.0	21.0
Dividend payout (%)	205.6	77.8	79.6	72.8	69.3
Capex to sales (%)	0.3	0.3	0.4	0.5	0.8
Capex to depreciation (x)	0.5	0.5	0.5	0.8	1.2
ROE (%)	6.0	12.7	12.7	14.1	15.9
ROA (pretax %)	15.5	11.5	13.5	15.1	17.1
Growth (%)					
Revenue	31.7	-9.2	7.5	6.9	7.4
EBITDA	57.5	-9.9	11.3	9.6	10.9
EBIT	59.4	-10.0	11.4	9.7	10.9
Normalised EPS	28.9	-6.9	3.6	9.3	12.0
Normalised FDEPS	30.8	-5.4	4.0	9.3	12.0
Per share					
Reported EPS (GBP)	3.56c	9.64c	9.53c	11.05c	12.99c
Norm EPS (GBP)	13.17c	12.26c	12.70c	13.89c	15.56c
Fully diluted norm EPS (GBP)	12.41c	11.74c	12.20c	13.34c	14.94c
Book value per share (GBP)	0.72	0.70	0.73	0.76	0.79
DPS (GBP)	0.07	0.07	0.08	0.08	0.09

Source: Company data, Nomura estimates

Relative performance chart (one year)



Source: ThomsonReuters, Nomura research

(%)	1M	3M	12M
Absolute (AUD)	-9.5	0.0	56.6
Absolute (USD)	-13.2	-11.5	44.4
Relative to index	-3.4	6.1	39.6
Market cap (USDmn)	2,450.2		
Estimated free float (%)	100.0		
52-week range (AUD)	2.81/1.33		
3-mth avg daily turnover (USDmn)	14.06		
Major shareholders (%)			
PPT	17.0		

Source: Thomson Reuters, Nomura research

Notes

Cashflow (GBPmn)

Year-end 31 Dec	FY11	FY12	FY13F	FY14F	FY15F	Notes
EBITDA	176	159	177	194	215	
Change in working capital	55	11	-4	5	3	
Other operating cashflow	-140	-3	-18	-23	-28	
Cashflow from operations	**91**	**167**	**154**	**175**	**190**	
Capital expenditure	-1	-2	-2	-2	-4	
Free cashflow	**89**	**165**	**153**	**172**	**186**	
Reduction in investments	6	4	0	0	0	
Net acquisitions	217	-5	0	0	0	
Reduction in other LT assets	0	0	0	0	0	
Addition in other LT liabilities	0	0	0	0	0	
Adjustments	4	1	0	0	0	
Cashflow after investing acts	**317**	**166**	**153**	**172**	**186**	
Cash dividends	-70	-78	-80	-85	-96	
Equity issue	-22	-4	9	0	0	
Debt issue	-107	-143	0	0	0	
Convertible debt issue	0	0	0	0	0	
Others	-20	-18	-9	-9	-9	
Cashflow from financial acts	**-219**	**-243**	**-80**	**-95**	**-105**	
Net cashflow	**97**	**-77**	**72**	**78**	**81**	
Beginning cash	177	274	197	269	347	
Ending cash	274	197	269	347	428	
Ending net debt	18	-48	-121	-198	-280	

Source: Company data, Nomura estimates

Balance sheet (GBPmn)

As at 31 Dec	FY11	FY12	FY13F	FY14F	FY15F	Notes
Cash & equivalents	274	197	269	347	428	
Marketable securities	65	59	59	59	59	
Accounts receivable	168	145	169	180	194	
Inventories	0	0	0	0	0	
Other current assets	87	85	85	85	85	
Total current assets	**594**	**485**	**582**	**671**	**766**	
LT investments	4	8	8	8	8	
Fixed assets	20	18	17	16	17	
Goodwill	0	0	0	0	0	
Other intangible assets	765	718	678	637	601	
Other LT assets	308	260	260	260	260	
Total assets	**1,690**	**1,489**	**1,544**	**1,592**	**1,652**	
Short-term debt	143	0	0	0	0	
Accounts payable	303	291	311	327	344	
Other current liabilities	119	109	109	109	109	
Total current liabilities	**566**	**400**	**420**	**436**	**453**	
Long-term debt	148	149	149	149	149	
Convertible debt						
Other LT liabilities	189	160	160	160	160	
Total liabilities	**903**	**708**	**728**	**744**	**761**	
Minority interest	0	1	1	1	2	
Preferred stock	0	0	0	0	0	
Common stock	701	732	741	741	741	
Retained earnings	70	36	56	88	130	
Proposed dividends	0	0	0	0	0	
Other equity and reserves	17	13	18	18	18	
Total shareholders' equity	**787**	**781**	**815**	**847**	**889**	
Total equity & liabilities	**1,690**	**1,489**	**1,544**	**1,592**	**1,652**	
Liquidity (x)						
Current ratio	1.05	1.21	1.39	1.54	1.69	
Interest cover	12.5	16.8	34.3	53.0	104.0	
Leverage						
Net debt/EBITDA (x)	0.10	net cash	net cash	net cash	net cash	
Net debt/equity (%)	2.2	net cash	net cash	net cash	net cash	
Activity (days)						
Days receivable	118.6	132.3	122.8	128.0	127.8	
Days inventory	na	na	na	na	na	
Days payable	na	na	na	na	na	
Cash cycle	na	na	na	na	na	

Source: Company data, Nomura estimates

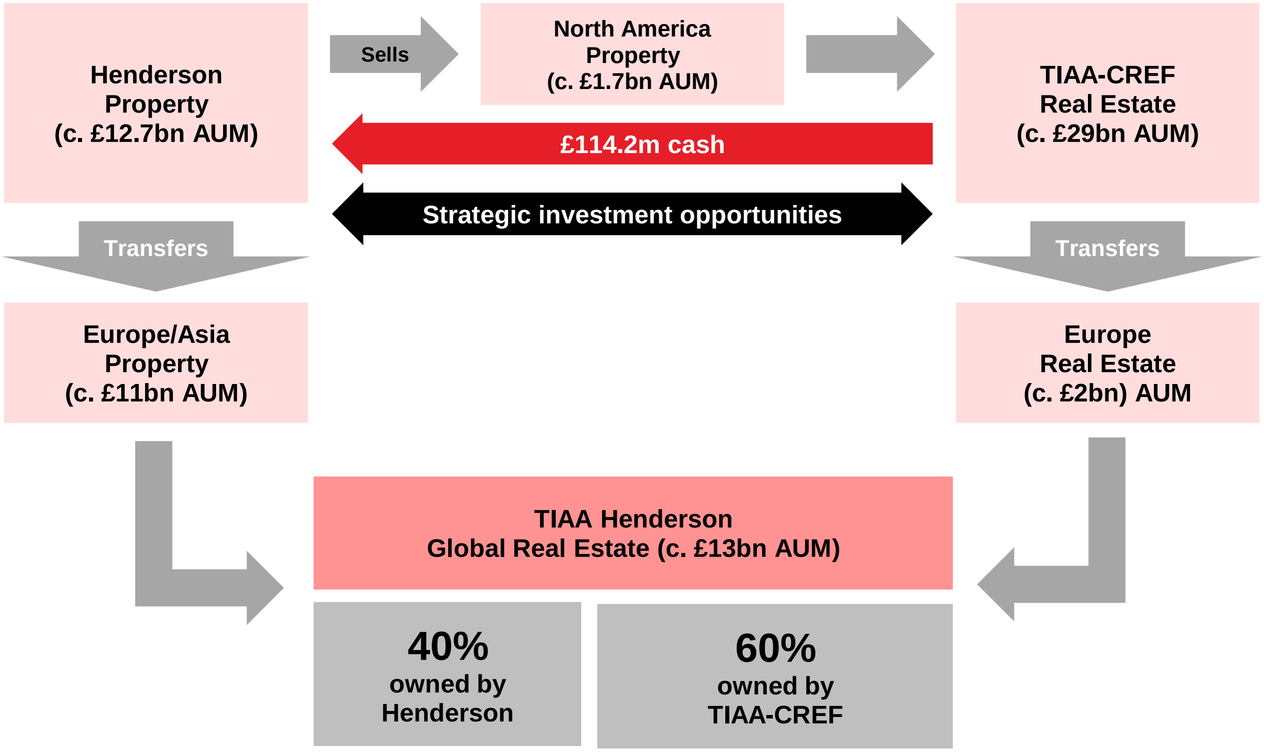
TIAA-CREF JV is dilutive, but has sound logic

HGG announces tie-up with TIAA-CREF

HGG has announced an agreement with TIAA-CREF that will see the two asset managers combine their European and Asian real estate businesses. Post this transaction, expected to be completed in early 2014, HGG will own 40% of the combined business – TIAA Henderson Global Real Estate.

HGG will also sell its US real estate business (c. £1.7bn in AUM) to TIAA-CREF. HGG will receive cash proceeds from TIAA-CREF of £114.2mn (US$176.6mn) in exchange for the US operations and the 60% holding in the combined Eurasian real estate business. The overall transaction values HGG's property business at 8.8x FY12 EBITDA. Below we show a schematic of the deal structure.

Fig. 1: Structure of announced transaction between HGG and TIAA-CREF



Source: Nomura research

We estimate the deal is 6% dilutive

We estimate the deal to be c. 6% dilutive based on company disclosures and Nomura estimates. Below we show calculations of resultant dilution based on FY12 disclosures together with sensitivity of this analysis for differing levels of assumed fee margin and return on cash proceeds received from TIAA-CREF.

Assumed fees are based on disclosed performance data (fee margin and nominal performance fees) called out by management during the analyst and investor conference call on 24 June. We have assumed the new JV delivers an EBITDA margin consistent with the old property unit, whilst the assumed tax rate used is consistent with the tax rate achieved across the broader group.

Our analysis suggests the deal is relatively insensitive to the level of returns delivered by the new-shape real estate business with the below sensitivity analysis showing limited change in dilutive impact for differing assume margin assumptions. This relative insensitivity reflects the sluggish cash returns that the resultant pile of £100mn in shareholder cash would attract. Current LIBOR rates suggest 3-6M returns of c. 50 bps versus our assumed 100bps shown below.

Were HGG to be able to deploy the proceeds received from TIAA-CREF into its business (or to set up new lines of revenue), we estimate a return of only 9% would be required to offset the dilutive impact of the deal entirely.

Fig. 2: We estimate the tie-up with TIAA-CREF is 6% dilutive to HGG's earnings
Calculation of earnings dilution from TIAA-CREF partnership

£mn	Total	Other	Property
Revenues	432.8	371.3	61.5
EBITDA	158.7	137.2	21.5
Underlying NPAT	**126.8**	**110.5**	**16.3**
EBITDA margin	36.7%	37.0%	35.0%
Underlying NPAT margin	29.3%	29.7%	26.6%
New property JV AUM (£bn)			13.0
Assumed fee margin (bps)			45
Estimated performance fees			8.2
Total estimated fees			66.7
Assumed EBITDA margin			36.7%
Estimated EBITDA			24.5
Estimated NPAT			18.6
HGG share of NPAT (40%)			7.4
Return on net proceeds at 1%			1.0
Nominal impact			-7.9
Underlying NPAT	**118.9**	**110.5**	**8.4**
Estimated earnings dilution	**-6.2%**		

Source: Company data, Nomura analysis

Fig. 3: Level of earnings dilution is relatively insensitive to assumed inputs
Sensitivity analysis on implied earnings dilution

		Return on cash resources							
		0.50%	**1.0%**	**1.5%**	**2.0%**	**2.5%**	**3.0%**	**3.5%**	**4.0%**
Fee margin (bps)	**30**	-8.3%	-7.9%	-7.6%	-7.2%	-6.8%	-6.4%	-6.0%	-5.6%
	35	-7.8%	-7.4%	-7.0%	-6.6%	-6.2%	-5.8%	-5.4%	-5.0%
	40	-7.2%	-6.8%	-6.4%	-6.0%	-5.6%	-5.2%	-4.8%	-4.4%
	45	-6.6%	-6.2%	-5.8%	-5.4%	-5.1%	-4.7%	-4.3%	-3.9%
	50	-6.1%	-5.7%	-5.3%	-4.9%	-4.5%	-4.1%	-3.7%	-3.3%
	55	-5.5%	-5.1%	-4.7%	-4.3%	-3.9%	-3.5%	-3.1%	-2.7%
	60	-4.9%	-4.5%	-4.1%	-3.7%	-3.3%	-2.9%	-2.5%	-2.2%

Source: Company data, Nomura analysis

Optionality on strategy and capital offsets near-term dilution

We expect the deal to be mildly dilutive from FY15F, with deal-related costs resulting in higher earnings dilution in FY14F. The following four-point strategic rationale stands behind HGG's willingness to accept some near-term earnings dilution:

- The partnership with TIAA-CREF will allow the combined business to tap a large source of capital to be invested alongside client money. TIAA-CREF anticipates investing US$1.5bn into the combined business over the next few years in the form of co-investment and seed capital for new funds and products. The real estate investment market has become increasingly reliant on co-investment from asset managers over recent periods. HGG's limited capacity to conduct such co-investment, given its meagre balance sheet, was seen as one of the reasons for its subscale label. By joining with TIAA-CREF the property business should benefit from renewed impetus.
- HGG will also be free to focus more closely on its core equities, fixed income and absolute return businesses. Management commentary suggests the improving momentum seen in 1Q13, a major driver of our recent upgrade (see our 17 May 2013 research note: *Henderson: Flow Rider*) has continued in 2Q13.

- HGG and TIAA-CREF have agreed to explore further potential opportunities beyond the retail sector. Given TIAA-CREF's relative clout, with US$520bn/£342.5bn of AUM, this could prove a fruitful opportunity to extend HGG's reach and range of expertise – particularly in the US market, which has been a particular area of focus for HGG.
- Net cash proceeds of c. £100mn (£114.2mn net of total deal-related costs of £14mn) would help to strengthen HGG's balance sheet and may offer additional capacity to further HGG's strategic ambitions.

Investment case remains positive

Though we have trimmed our estimates and target price to reflect recent market movements – and remain mindful of ongoing market volatility – we continue to see HGG as the most attractive play within the Australian listed wealth management space. There are three enduring reasons, in our view, for investors to look to gain exposure to HGG:

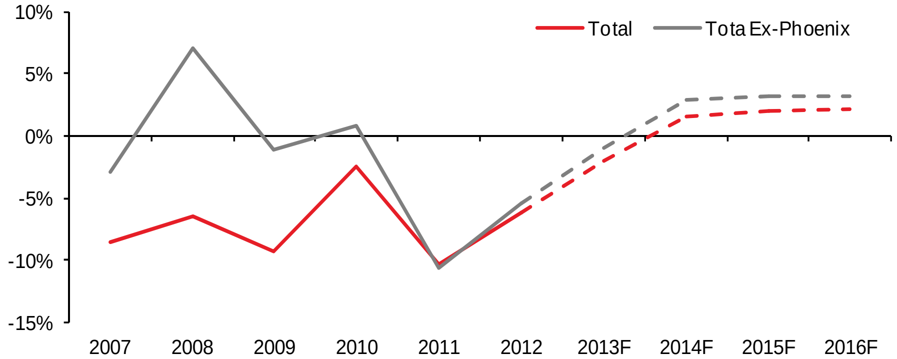
- We expect HGG to deliver a turnaround in flows through FY13F (see below) after years of outflows and underperformance versus peers.
- Though conditions have certainly deteriorated from recent highs, the UK retail investment market is benefitting from renewed confidence over the past 12 months. We see the current macro and political backdrop as more favourable than in the past three years, whilst regulatory changes around distribution are less of headwind than in prior periods.
- While recent equity market performance serves to highlight the potential volatility of equities as an asset class, we see HGG's exposure to equities (amongst the highest versus UK peers) as a long-term plus.

In addition, we see HGG's exposure to non-AUD sources of income as a further positive.

Note that although we highlight HGG's exposure to GBP-denominated sources of income as a positive, we assume no direction in our FX forecasts by valuing the business at spot.

Fig. 4: HGG has seen negative outflows for a number of years, we expect a recovery

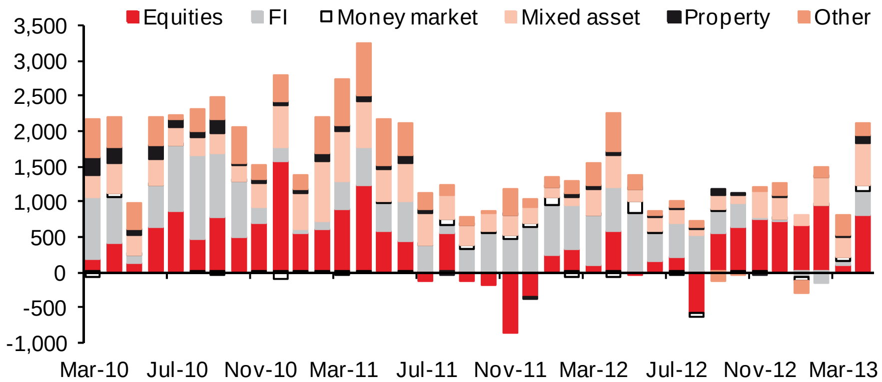
2007-2016F: HGG net flows



Source: Company data, Nomura estimates

Fig. 5: UK retail flow trends suggest growing confidence in equities

2010-2013: UK monthly retail net flows by asset class



Source: IMA, Nomura research

Valuation and earnings updates

Our updated A$3.30 target price is calculated based on our unchanged DCF methodology. Our GBP based valuation drops by 10% due to market movements and the associated drop in earnings/dividends. The 7% appreciation seen in Sterling versus the Australian dollar since our last valuation reduces the negative impact of our earnings estimate changes on our AUD target price to 3%.

Our GBP forecasts generate a deserved valuation per share of £1.98 that we convert using the current GBP:AUD spot rate of A$1.66. Our DCF valuation assumes a WACC of 10.8% (down from 11.8%), comprising an assumed beta of 1.20x, a risk free rate of 4.5% (down from 5.25%), an assumed equity risk premium of 6% and an assumed terminal growth rate of 2.5%.

Fig. 6: Summary of Nomura Henderson target price derivation

DCF Assumptions			
WACC	10.79%	10-year government bond rate	4.50%
Cost of equity	11.70%	Equity market risk premium	6.00%
Cost of debt (after tax)	6.00%	Company beta	1.20
Valuation			
PV of equity value (£mn)	2,220.0	Value/share (£)	1.98
		Value/share (A$)	3.29
		Target price (A$)	**3.30**

Source: Company data, Nomura estimates

We have revised our earnings forecasts to reflect recent market movements and FX. Our EPS estimates fall by an average 10%, while our dividend estimates decrease by 9%. We have not incorporated the estimated impact of the TIAA-CREF JV. Management guidance suggests the deal will not close until 1Q14, and we await further clarification from management (at the 1H13 results) around how any cash deemed surplus to requirements may or may not be used to create additional sources of revenue for the group. We discuss the likely dilution impact in greater detail above.

Fig. 7: Changes to our earnings and DPS forecasts

	Underlying PBT (£mn)			Norm NPAT (£mn)			EPS (pence)			DPS (pence)		
	Old	**New**	**Change**	**Old**	**New**	**Change**	**Old**	**New**	**Change**	**Old**	**New**	**Change**
2013	184.8	168.5	-8.8%	142.1	134.6	-5.3%	12.9	12.2	-5.4%	7.9	7.5	-4.9%
2014	212.1	186.8	-11.9%	167.4	147.4	-11.9%	15.2	13.3	-12.2%	9.1	8.1	-10.8%
2015	237.1	209.2	-11.7%	187.1	165.1	-11.8%	16.9	14.9	-11.6%	10.5	9.2	-12.0%

Source: Nomura estimates

Appendix A-1

Analyst Certification

I, Toby Langley, hereby certify (1) that the views expressed in this Research report accurately reflect my personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of my compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

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Materially mentioned issuers

Issuer	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Henderson Group PLC	HGG AU	AUD 2.44	24-Jun-2013	Buy	Not rated	A1,A2,A3

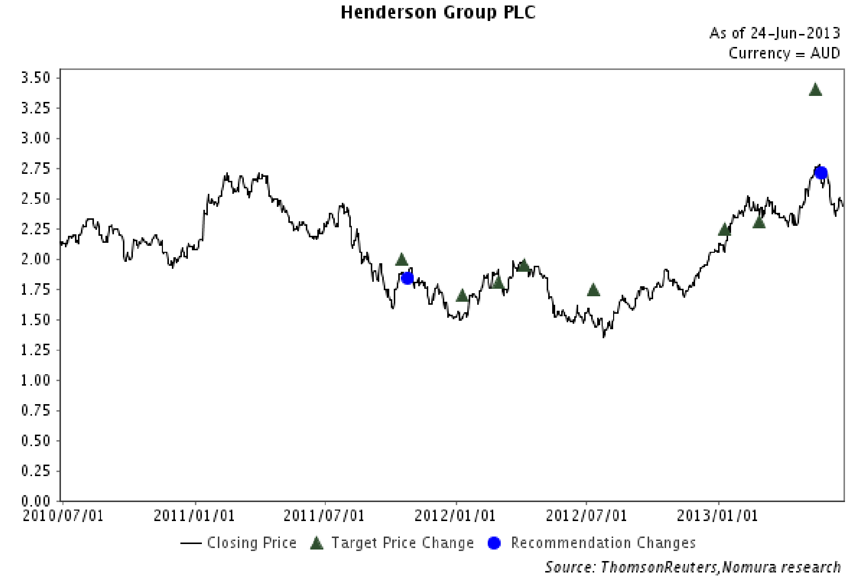
A1 Nomura Securities International, Inc has received compensation for non-investment banking products or services from the issuer in the past 12 months.

A2 Nomura Securities International, Inc had a non-investment banking securities related services client relationship with the issuer during the past 12 months.

A3 Nomura Securities International, Inc had a non-securities related services client relationship with the issuer during the past 12 months.

Henderson Group PLC (HGG AU) **AUD 2.44 (24-Jun-2013)** Buy (Sector rating: Not rated)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
17-May-13	Buy		2.76
17-May-13		3.40	2.76
27-Feb-13		2.30	2.41
10-Jan-13		2.25	2.09
10-Jul-12		1.75	1.47
04-Apr-12		1.95	1.97
29-Feb-12		1.80	1.88
10-Jan-12		1.70	1.51
17-Oct-11	Neutral		1.89
17-Oct-11		2.00	1.89

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology Our target price of A$3.30 is based on our DCF valuation of £1.98 translated at the current spot rate of AUD/GBP0.60. Our DCF valuation assumes a WACC of 10.8% (beta of 1.20, risk-free rate of 4.5%, equity risk premium of 6%), and a terminal growth rate of 2.5%. Cashflow is discounted back to 2013.

Risks that may impede the achievement of the target price Risks to the upside include: 1) a market recovery in the UK and Europe occurring earlier than anticipated, resulting in higher AUM and inflows from investors; 2) integration of Gartmore generating better synergies than expected; and 3) significant boost from distribution capabilities acquired from Gartmore, in new geographies. Risks to the downside include: 1) prolonged weakness in European markets, impacting AUM and hence revenues; and 2) integration of Gartmore not proceeding successfully, resulting in possible key staff departures or investors withdrawing funds.

Important Disclosures

Online availability of research and conflict-of-interest disclosures

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STOCKS

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SECTORS

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STOCKS

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