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Henderson Global Investors

Q3 Interim Management Statement

Thursday 29 October 2015

Andrew Formica, Chief Executive

Thank you for joining us all on the call. With me today are Rob Gambi, our CIO, Phil Wagstaff, the Global Head of Distribution, and also Roger Thompson, our CFO. What we wanted to do was just give you a quick overview of the third quarter Trading Statement that we just put out. I'm going to ask Rob to give you some colour on the investment performance that we outlined in there, Phil will then talk a bit about the flows, and Roger will update on the Perennial acquisitions in Australia which we expect to close on Sunday. So, Rob.

Rob Gambi, Chief Investment Officer

Thanks Andrew. Third quarter was a challenging quarter for investors in which equity indices were significantly negative and credit and emerging market concerns weighed on investor confidence. In a period when many major equity indices were bottom quartile, active fund managers helped clients mitigate their losses. At Henderson, our focus on active fund management as well as our strength in income, European assets and less volatile Absolute Return Strategies, meant that we continue to outperform the market. On a relative basis, 82% of our assets outperformed over three years, and 73% over one year.

The investment performance highlights for the quarter are as follows. Our European Equity Strategy remained on-point with consistently strong three year performance. Global Equities' performance improved driven by the income styles which make up over 30% of assets under management in this capability. In Global Fixed Income the three year number remained consistently strong and performance improved over one year. In Alternatives, performance also stayed strong with the lower volatility styles doing their job in helping clients protect and preserve capital.

The standout performance story at the moment however is Geneva in the US, now rebranded Henderson Geneva Capital Management. You will remember that Geneva had been going through a period of under-performance when we closed our acquisition of the business in October last year, but we said consistently that we have confidence in our investment style and process. Sure enough, as Geneva's quality growth investment style in small and mid-cap US equities came back into favour, their performance came good. The Mid Cap fund is now over 8% ahead of benchmarks since the transaction closed, and the Small Cap fund is 11% ahead.

You will remember that Henderson Geneva has an important sub-advisory relationship with Nationwide. The sub-advised funds were among the best performers in their category for the year ended 30 September, both ranked within the top fifth percentile. Flows at Geneva have now stabilised and the small cap pipeline in particular is looking more positive.

In summary, our investment performance has remained consistently strong this quarter. This strength extends to many of the diversifying new styles we've added, such as high yield, corporate bonds and emerging markets. While our current performance continues to be driven by our core areas of strength, we're also building for the future.

And with that I'll hand over to you, Phil.

Phil Wagstaff, Global Head of Distribution

Thanks Rob. Hello everyone. As Rob says, investment performance has been excellent across our range, and as you'd expect that has had an impact on flows. We delivered net flows of £1.3bn in the quarter, with all three of our major retail ranges: that's SICAVs; UK Retail; and US Mutuals, holding up well in what have been quite challenging markets.

So if I start with the SICAVs. The diversified nature of our product range was the key to our success here, I think. There was continued demand for European equities as a relative value play, notably from South American clients who were historically overweight in emerging markets. We also saw increased net flows into absolute return, particularly in fixed income dominated markets like Spain and Italy where products like Henderson Gartmore UK Absolute Return are currently offering better returns than fixed income with similar levels of volatility.

In the UK, net flows across the industry interactive managers have remained at the lower levels that we were experiencing earlier in the year. Having said that, client demand for absolute return and income remain strong, and in that our UK Property and UK Absolute Return Funds remain the best sellers in our OIEC range. We're also seeing good flows into European equities as well as improving flows into our Strategic Bond Fund. We're continuing to promote some of our other strong and developing track records to further diversify the business, for example in global equity income and with our global emerging market equity managers.

In the US we're continuing to see strong demand in the US mutual book for European, international and global equities, but there are also some promising developments as we seek to broaden our US business. The First Trust Dynamic Europe Equity Income Fund, which is a closed ended fund which we recently launched with the help of our lead underwriter Wells Fargo Advisors, just added £208m to our AUM this quarter. All parties involved, including other syndicate members like UBS and Morgan Stanley who participated because of the strength of their existing relationships with Henderson, were delighted with the success of this launch. We had over 240 sales people focused on this during September, and it's really helped us increase our brand awareness across the US retail market.

All-in-all progress in our US business is excellent. As Rob said, performance has come good at Henderson Geneva and as a consequence their flow outlook is improving. Our fund range is broadening with new funds like Dividend and Income Builder just having reached their three year track record in August and having a five star Morningstar rating. And our distribution relationships are deepening, whether it's with Morgan Stanley, UBS and Nationwide, or with our new partners such as First Trust.

Let me finish with a few words on where we are with our Institutional business. We saw a small net outflow in the quarter, £200m. Institutional momentum remains strong however, we're pleased over recent quarters with a series of nice wins in the UK for our Outcome Fixed Income Strategies such as Diversified Credit and Total Return Bond. We also have business at risk on the other side of this trade in more traditional core sterling credit mandates. In the third quarter the balance tipped towards outflows from traditional UK mandates and clients making one-off asset allocation changes.

So as we've said in this morning's announcement we're expecting Institutional flows to be negative in the fourth quarter. There will be outflows of around £420m associated with the planned run-off of our private equity business, and other negatives in the pipeline like a large existing client involved in a corporate transaction, meaning that they are likely to restructure their portfolio, could take the net of other ins and outs to a similar number again. Nevertheless, we're pleased with the way our Institutional business is evolving and are optimistic about the longer-term prospects, particularly given the strong pipeline of global Institutional quality investment strategies building towards their three year track records.

So to summarise, it's been a really strong quarter for flows with good distribution progress in all of our major markets.

Now I will hand you over to talk to Roger about the Perennial acquisitions in Australia.

Roger Thompson, Chief Financial Officer

Thanks Phil. You will remember that the strategic rationale for our Perennial acquisitions is that they significantly advance our business plan for Australia, adding investment management capabilities in Fixed Interest and in Australian equities, and significantly extending our distribution reach through their platform presence and Institutional client base.

We've been really pleased with the way things have gone since the announcement of the Perennial acquisitions. The reaction of clients and key distribution partners has been positive, flows have been strong at Perennial Fixed Interest, and performance has improved really well at Perennial Growth Management. Both businesses with take on the Henderson brand immediately at close. With the unit holder vote to transition the responsible entity to Henderson Australia successfully concluded yesterday, we're on track to close on Sunday 1 November, so I wanted to make sure that you've got the information you need to build these acquisitions into your models.

Closing AUM will be around A$10.8bn, that's around £5bn, split 80/20 Fixed Income: Equity and also around 80/20 Institutional: Retail. The IR team's got a more detailed AUM split if you need it. Revenue margins averaged 22 basis points, 45bps on the Retail business and 15 on the Institutional side.

I suggest you model the Perennial AUM at an operating margin just north of 30% on a fully allocated basis, which takes into account the cost of adding distribution and operational headcount to support the investment management teams we've bought, as well as our broader growth plans in Australia.

Following these acquisitions we expect one-off transaction and integration costs to go up by around £4m to £5m in the second half. The capital cost of the Perennial acquisitions is around £40m.

As you incorporate Perennial and mark-to-market it's probably just worth noting that it's going to be hard for us to exactly match our first half operating margins at the full year with markets at their current levels; something I know those of you who have already updated have already picked up on.

With that I'll hand you back to Andrew to conclude the call.

Andrew Formica

Thanks Roger. Just a few words in conclusion from me. I think, as Rob has said, the third quarter was a period when our active managers have delivered clear value to our clients. Phil also highlighted that our flows remain strong in Retail, and in Institutional, despite the near-term outflows, we're pleased with the progress we're making in developing our business. And on the acquisitions front, it's great to see our confidence in the Henderson Geneva team rewarded as their performance comes good. And I'd like to take this opportunity to welcome our new colleagues from Perennial to Henderson.

At the moment the industry feel it's a bit like in the Rugby World Cup group of death with choppy markets and increasing regulatory demands making it tough for all of us. But Henderson feels a bit like Australia: having got through that and very happy with the progress we've made, whilst we're not there yet and over the line I think we're pretty pleased with the position we've got ourselves in.

So with that I'll open up the lines and take any questions.

Q&A session

Question 1

Hubert Lam, Morgan Stanley

Good morning everybody, just three questions from me. Firstly, Andrew you talk about regulatory pressures, I was just wondering anything specific you mean by that. Any upcoming regulation or is it just the existing ones that we all know about?

Second question, I guess you point to pressure on institutional particularly in the UK mainstream fixed income mandate, how many assets do you have in that currently?

And the last question on performance fees. Now that we've finished Q3, I was just wondering if you had any guidance for the full-year performance fees at this point in time? Thanks.

Andrew Formica

I'll pick up the first and third points, and I'll let Phil pick you up on the middle point.

In terms of regulatory pressure, I don't think there's anything new. MiFID II is just an extreme amount of work. As you know, it comes into effect on 1st January 2017. We're still getting the delegated acts through and the full details of what we need to do. The sheer volume of change required operationally, structurally for example is just a lot.

I guess the unknown regulatory item out there that does worry me is obviously the planned or announced competitive review of the asset management industry by the FCA. The terms of reference associated with that are due out next month, so we'll get a better sense of that. And that's to be conducted over 2016. I've never known of any industry to have a competitive review that's come out and said it's all fine, no change is required. So I think regulatory pressure will continue. That won't have really any impact until 2017/2018 once the review is concluded, and any recommendations are put forward. But it just doesn't appear that we're out of the sight of that.

I guess on a positive note, I don't know if you saw the comments from Tracey McDermott, the acting CEO of the FCA, the other day which was recognising that regulation has probably gone too far and dominating too many businesses and stifling innovation and competitiveness. And that was quite refreshing to hear that for the first time. Whether that actually leads to any change in the FCA, and we do have obviously the CEO appointment expected at any point soon, that would certainly be welcome. But in the absence of that the feeling is that the regulatory change agenda that the asset management industry is under is going to persist for a number of years.

On performance fees, markets obviously have been weak, but also our investment performance, particularly in Absolute Return funds have been strong, so I wouldn't be shifting any of the guidance we've given previously. I'm not going to give you any further update on that but I guess we're broadly comfortable with where consensus is out there.

Phil, did you want to pick up the point on institutional?

Phil Wagstaff

Yes, Hubert, our institutional AUM is about £30bn. If you think about approximately two-thirds of that being fixed income that will give you a flavour of where we are. But I think it goes without saying that we have been losing some old sterling credit mandates over the last few years, so obviously as that book gets smaller the ability for that to impact us as we move forward is much reduced.

<u>Question 2</u>

David McCann, Numis

Morning guys, two from me. I just wanted to clarify one of the points that was made during your comments on the size of the net institutional pipeline expected to go out in Q4. You said that it would be similar to the prior period. I just wanted to clarify: does that mean that we should expect £420m from the non-private equity book or did you mean more of a £200m outflow that you saw in Q2? I just wanted to clarify what the size of that net pipeline was, it wasn't quite clear in the comment.

The second question: do you have any kind of comment on the outlook for the Retail flow book? Thank you.

Phil Wagstaff

I'll pick that up. When we closed the private equity funds we were expecting £420m of outflow. And our best estimate of where we are in Q4 is that we could be around the same number again out in other institutional strategies. Obviously we don't know, but that's the best guidance I think we can give you.

Does that answer your question?

David McCann

Yes, so that would be £840m then.

Phil Wagstaff

And on the retail side again volatile markets are making it very difficult to predict where we're going to be month by month, but we've had a reasonable run rate in all our three ranges so far this year. That has continued through October and I see no reason right now to give you any cause for concern.

Question 3

Daniel Garrod, Barclays

Just a quick one from me on the Perennial acquisitions. I think when you detailed those two books back in June it was a very similar figure, around £5bn, A$10.8bn but perhaps can you provide any colour around whether there have been outflows, how the market movements have affected that asset figure since that time? Thank you.

Roger Thompson

We're seeing continued inflows into Perennial Fixed Interest, so that was A$8.1bn when we announced and is A$8.6bn at the end of September. So there's some good continued flow there from core platforms. In Perennial Growth there have been some small outflows, particularly from the SRI strategy, but again we're talking relatively small numbers so it was about A$80m out. PGM was A$2.6bn on announcement, it's A$2.2bn on close. But as I said, the really pleasing thing is the strength in investment performance over the last period.

Daniel Garrod

So it's pretty flat. Net net the movement in one versus the movement in the other they balanced each other out, that sounded like.

Roger Thompson

Yes correct. Up A$0.5bn down A$0.4bn

Andrew Formica

And we had all clients novate over, so there wasn't any client who didn't move over.

Question 4

Arnaud Giblat, Exane BNP

Good morning, it's Arnaud Giblat here from Exane. Three very quick questions. Could you maybe give us an update as well in terms of the flows you've seen since closing on Geneva, particularly in this quarter, and whether the contingent might reflect those change in flows?

The second question is on the Institutional flows, the outflows you're flagging here for Q4. It seems a lot of it is in fixed interest, I'm wondering if maybe they're coming out at a lower margin than the back book of institutional.

And finally, you mentioned that your Dividend and Income Builder has reached a five star rating through your track record, should we be expecting flows coming through soon on that fund?

Andrew Formica

I'll get Roger to do the first one on Geneva and I'll get Phil to pick up the institutional flows and the Dividend and Income Builder outlook.

Roger Thompson

So Geneva has been significantly improving ever since we took it on, the biggest outflows were in the first two quarters. Q2 of this year was flatter, Q3 is almost flat completely, small cap is slightly in, the improvement in performance came sooner there and that is now in inflow. Mid cap was nearly flat in the third quarter. So performance is now pretty flat and with a really nice pipeline, particularly in small cap, so we're quite hopeful around the near future for the full growth, particularly in small cap.

Phil's going to talk about overall margins, but I thought I'd also mention private equity margin because that was the other part of the outflow in the second half; you should think about that coming off. The overall private equity book was a higher margin but in our run rate at the half year, because of the run off of that private equity business, private equity is in at our average margin, so should be taking 420 out at our average margin. Phil, more on the overall book?

Phil Wagstaff

Yes, just on the institutional flows in Q4, yes all the ones we're expecting of any size are in fixed income and as you'd expect that obviously has a lower margin, if you add to that the fact that we're expecting the possibility of a large one to go out, that's even lower margin than the average margin, so yes, as you say, the impact on revenues will be less than the headline AUM.

And on your US mutual question on three year Dividend and Income fund, I wish it was that simple that you get a three year track record, a 5-star Morningstar rating and flows start pouring in, it won't happen that quickly, what it will enable us to do is to get the retail distribution team to focus on it, it will get intermediaries and wirehouses to look at it more closely and it will start to build over time, but it won't all happen overnight.

<u>Question 5</u>

David Humphreys, JCP

Good morning gentlemen, two questions if I may. Firstly, Andrew, in response to the regulatory pressure question that was asked earlier, can you give us something a bit more definitive on the state of play with ESMA's initiatives and what that might mean for you from a cost perspective?

Andrew Formica

Yes. Sorry, I thought you said two questions. I think you're referring to the update on particularly the Dealing Commission and separation of research payment through that. David, at this stage we still don't have any definitive outcome, we keep getting whisper noises of changes and amendments and the like. The latest is that it'll move to ability for individual countries to interpret the rules which gives some leeway but the risk is that the UK takes a divergent view from others.

We have heard via the FCA that they are unlikely to challenge a European position so that if a European adopts a stance that the UK won't adopt a different one to that. We don't know at this stage, we are still waiting, I think the fact that it's taken so long probably indicates that there is a groundswell to not go to the measure that was originally announced, but we just have to wait and see. It's now expected in sort of mid November, but they've been expecting it at every month and it keeps getting pushed back. It is due to be implemented by the beginning of 2017. I can't see if they announce, even in mid November, a significant change that any way it could be done by then, so there would probably be delay in terms of implementation, but again that's difficult to do under European regulation but it's possible.

And in terms of the impact for us, even if it was to come in, and I would still say I think the balance of probabilities is it won't, if it was to come in we believe we'd be able to mitigate the vast majority of costs through amending contractual obligations, either with clients or trustees and funds, but again, until we see the details, I can't give you the definitive view of that; but I would see it as more having an operational cost in terms of setting up systems to be able to do it rather than a hard cost that it comes to our account, but we won't know until we know the rules.

In terms of if they don't unbundle but require a greater use of CSAs and all of that, that will have minimal cost for us, given we've already been operating under that approach. There may be some disclosure and client issues that we'd have to adopt but otherwise we'd be in pretty good shape under that scenario.

David Humphreys

Thanks for that. The second question I guess is related to Roger's commentary about margin pressures emerging in the second half. Are you at a stage yet where you need to change tack on any of your investments or start to think about how you manage costs, particularly for the institutional business?

Phil Wagstaff

I think the answer to that is no, David. The comment is really just that with lower market levels then obviously our revenues are lower. We continue to manage our cost base and think we do that well. And no, you know, this is a long term business and that's how we manage it.

<u>Question 6</u>

Nigel Pittaway, Citigroup

Hi guys, I was largely going to ask that second question David asked, but I mean just further clarification on the operating margin at current market levels, I presume you are sort of meaning current market levels rather than those at 30th September?

Roger Thompson

Yes, they're a bit better than they were aren't they which is nice.

Nigel Pittaway

Yes, quite a bit better.

Roger Thompson

So I guess all I'm saying, Nigel, is the first half of the year average levels are still higher than they are now.

Concluding Comments: Andrew Formica

Thank you very much, thanks all for taking the time to get an update following our statement we put out today. If there's any follow-up questions feel free to come back to Miriam and the team; and otherwise for those in Australia, obviously I know who you'll be cheering for and those in England, I hope you support us as well. Thanks a lot.