Flash update: Henderson European Focus (HEFT) and Henderson EuroTrust (HNE) proposed merger

What are the benefits of the Proposed merger of Henderson European Focus Trust (HEFT) and Henderson EuroTrust (HNE)?

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- **The boards of Henderson European Focus Trust (HEFT) and Henderson EuroTrust (HNE) have together proposed a merger of the two trusts, with HEFT to be the continuing trust. The new name will be Henderson European Trust (HET). Below we will refer to HNE and HEFT where we are discussing technical details relating to the two trusts, and HET when we are referring to the continuing trust.**

- **HET will be co-managed by Tom O'Hara and Jamie Ross, co-lead and lead portfolio managers of HEFT and HNE respectively. The investment strategy will centre around a concentrated portfolio of European "global champions", typically large, established, and well-managed businesses operating internationally but based in Europe. The team will not adopt a particular style bias but will seek to make investments with long-term prospects associated with long-term global trends.**

- **The merger will be implemented by way of a liquidation and rollover of the assets of HNE into HEFT, with HNE shareholders receiving new shares in HEFT calculated on a formula asset value basis. See Kepler View below for an explanation of this.**

- **Cost contribution. Manager Janus Henderson is committed to contributing to the costs of both sets of shareholders, aiming to make the proposals cost-neutral for shareholders in HET.**

- **Cash Alternative. Both trusts will offer an option to take some cash instead of shares. HEFT, as the ongoing vehicle, will make a tender offer for up to 5% of shares at a 2% discount to NAV, less the costs of the transaction. HNE will, as part of its liquidation and rollover into HEFT, offer shareholders the chance to take part or all of their holding in cash, again at a 2% discount less costs, and again with an aggregate limit of 5% of the overall share capital of the trust. See Kepler View, below, for further explanation of this mechanism.**

- **Dividends. As part of the transaction, HNE is liquidating and therefore will pay out substantially all of its net income. HEFT intends to pay out an enlarged interim dividend prior to completion to ensure that its existing shareholders receive a dividend in line with HEFTs previous financial year of 4.35p per share. This will likely require a smaller final dividend from the combined trust in respect of the current financial year, ending 30/09/ 2024. It is expected that the dividend cycle for HET will be normalised for the financial year ending 30/09/2025.**

- **Discount and premium management. The board of HET will monitor the premium/discount to NAV at which the shares trade and may use buyback and issuance powers if appropriate. In addition, HET will introduce a performance-related conditional tender offer. If the combined trust has underperformed its benchmark in the five years to 30/09/2029, the board will propose a 25% tender offer, to be priced at a 2% discount to NAV, less the costs of implementing the tender. Should the conditions for the tender be met, it will be subject to shareholder approval.**

- **Management fee. HET's management fee will be 0.60% of net assets up to £500m, 0.50% on net assets between £500m and £1bn and 0.45% thereafter. Both HEFT and HNE currently charge 0.65% on net assets up to £300m and 0.55% thereafter, so the new fee structure represents a reduction. Together with other cost savings, the ongoing charges figure (OCF) for HET is estimated to be 0.70% (HEFT: 0.80%, HNE: 0.79%).**

Kepler View

The key to this proposal is that neither set of shareholders is being asked to approve a significant change in the investment strategy, with the resulting continuing trust still investing predominantly in large European companies, often with global business, principally with the objective of generating capital growth and with a pragmatic approach to investment style. The main benefits of the transaction, discussed below, are therefore scale and the associated cost savings and liquidity in the shares that this will bring. Both trusts have the same benchmark, the FTSE World Europe ex UK Index, and HET will also use this benchmark. Both managers have outperformed the benchmark over the five years to 31/03/2024, **Henderson European Focus Trust (HEFT)** producing an NAV total return of 78.7% and **Henderson EuroTrust (HNE)** 67.0% compared to the benchmark's 60.8% (Source: Janus Henderson, five years to 31/01/2024).

Formal announcements of transactions such as this are necessarily framed in very specific language that may not be familiar to all investors. In very straightforward terms, HNE is liquidating and passing the proceeds of that liquidation over to HEFT, which is referred to as a 'rollover'. HNE shareholders will receive new shares of an equivalent value in HEFT, creating a larger single trust.

This is a very standard transaction structure in the investment trust sector and does not create any tax events for shareholders. Readers of the formal announcement will see the term 'FAV', or formula asset value, referred to several times. This is simply each trust's net asset value, adjusted for the costs of the transaction, calculated at the last possible moment before the merger of the two trusts is completed. In this particular transaction, shareholders of the two trusts who elected to remain in the continuing trust will not see any material difference between the FAV and their NAV, as the manager Janus Henderson has committed to make a contribution that will make up the difference. So, for practical purposes, shareholders are swapping NAV for NAV on a level playing field. Because NAV of course moves around every day as the portfolio value rises and falls, it is not practical to put actual numbers in such an announcement, and shareholders will be, for practical purposes, fully invested in European equities throughout the process.

Both trusts are offering a cash option, structured slightly differently in each case simply because one trust is continuing and one is liquidating, and each is therefore using the most appropriate method of returning cash, but essentially these are offered on the same terms. Again, investors not familiar with such transactions may find the formal language rather dense. In simple terms, a shareholder can elect for any percentage they want to be returned to them in cash but they will only have anything over 5% of this election fulfilled to the extent that other shareholders do not take up the cash offer. In other words, a maximum of 5% of the share capital of each trust can be redeemed in this way. In electing for cash, shareholders are accepting a price on the shares that are cashed-in at a 2% discount to the FAV, plus their pro rata share of the costs of the transaction. Any shares rolled over into the continuing trust will not suffer these costs.

In terms of the main benefits of the transaction, it is widely accepted in the investment trust sector that larger investment trusts, on average, have a broader appeal to investors because first, it is generally easier and may be cheaper to buy and sell shares because larger trusts are usually more liquid and often have lower bid offer spreads. The combined trust in this transaction will likely be a FTSE 250 constituent, which will give it greater prominence with a wider universe of potential investors. Second, investment trusts do have some fixed costs, and so a larger asset base will reduce the percentage effect of these on shareholder returns. Additionally, the combined trust will have a lower management fee, and the combination is expected to lead to a lower ongoing charges figure. Finally larger trusts may be able to negotiate better terms on debt as lenders see larger trusts as lower risk. No specific plans are in the announcement other than to note that the limit on gearing will be 20%. HEFT already has long-term debt at the very competitive average interest cost of 1.57%.

Overall then, shareholders will see only relatively small changes to the investment strategy, with the fundamental investment proposition remaining, while fixed and variable costs are reduced, which for a long-term investor can make a significant difference.

Shareholders of both HEFT and HNE will receive more detailed documentation and instructions on what to do next during May, with the intention for shareholder meetings and the conclusion of the transaction in June 2024.

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