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Perpetual-Pendal merger creates Aussie investment champion to take on the world

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Perpetual CEO Rob Adams will run the newly merged entity.

Perpetual's $2.5bn bid for rival investment manager Pendal looks strikingly similar to its offer for the company only five months ago.

The difference is slightly more cash thrown in as a sweetener, which is being funded by debt paid down by Perpetual over three years.

Unlike in April, when Pendal rejected Perpetual's offer, this time its negotiating power has eroded as it heads into a weaker economy, creating tougher conditions in the near-term future for all investment managers.

Today, Pendal shareholders get one Perpetual share for every 7.5 shares they own plus $1.976 of cash for each Pendal share, totalling up to $756m of cash overall.

Last time, Perpetual also offered 7.5 shares for every Pendal share, but the extra cash component was $1.67 per share or $639.6m of cash in total, valuing Pendal at $2.4bn excluding debt as opposed to $2.5bn today.

Pendal's position is a difficult one in that it would be hard to prove right now that the shareholders would be better off rejecting a bid by Perpetual based on its own future performance.

Pendal issued a profit warning in July when it said its funds under management had fallen to $111bn for the June quarter, down from $124.9bn at March.

With Perpetual's Rob Adams running the newly merged entity, the logic is that the US-based Pendal boss Nick Good moves elsewhere, with a major global fund manager like Blackrock or BGI expected to chase him down for a new role.

While there was chatter in the market earlier in the week about unrest within Pendal's funds management ranks about a merger, that has been appeased – for now at least – by the announcement that the Pendal and Perpetual teams and brands would be kept separate.

Yet there is a sense of inevitability that eventually the two businesses will blend together over the medium term, starting with some employee attrition, differing allocations of resources as some parts of the business grow faster than others and the eventual merging of funds in Australia because they are no longer viable separately.

But this also largely depends on how well the merged entity preforms.

Bringing Perpetual and Pendal together makes sense, say analysts and experts, as the industry faces structural change and economic headwinds in the short term.

The Australian investment management champion with $201bn of funds under management will withstand the conditions better and enable plenty of firepower for global mergers and acquisitions.

Perpetual's 39 per cent increase in annual net profit to $101.2m on Thursday was better than analysts predicted, and is considered to be doing a good job in growing earnings.

But a sell-off in its shares that closed down more than 9 per cent was perhaps linked to a view that the earnings benefits of bringing both businesses together will not be as high as the market had hoped for.

Perpetual said synergies would be $60m annually, pre tax, with full run rate synergies to be delivered two years after deal completion.

Perpetual's net debt to earnings before interest, tax, depreciation and amortisation increases to 1.3 times from about 1 times as part of the deal and will decrease to as little as 0.8 times over three years.

On the face of it, it may appear that this would be at the expense of dividend payments, but the company says that the deal buys Perpetual staff at a time both groups were trying to recruit in the global distribution space, for which money had already been allocated.

Bank of America surfaced on the ticket with Goldman Sachs for Perpetual, while Pendal is advised by Macquarie Capital and Adara Partners, along with law firm KWM.