AMP 30/10/2018 **FAT-AUS-896**

AMP AUD $2.32 Core **HIGH** S

Big changes afoot

The October rout in global equities has frayed investor nerves, leaving them in no mood to receive anything other than good news. AMP (ASX.AMP) has already been in the dog house with investors from the fallout of the Royal Commission. Its major restructuring announcement last week, combined with the implication the final dividend will be sharply lower and the numbers showing large cash outflows at its wealth management arm, saw investors react harshly, with the shares losing approximately one-quarter of their value in one painful trading day. That more than wiped out the tentative 10% gain in shares (from low levels) in the two weeks leading up to the announcement.

We accept that we have been well off the mark on the depth to which investors would abandon the shares post the Royal Commission. We have not issued a buy recommendation for several years on AMP, and indeed issued a half sell recommendation prior to the GFC around $10. Still, we have clearly under-estimated the brand damage sustained by the company this year, and the knock to investor sentiment, which may well take many years to recover. While not an easy call, we believe it is best to move on from the shares at this juncture, and into other opportunities.

We recommend Members sell AMP.

What's new?

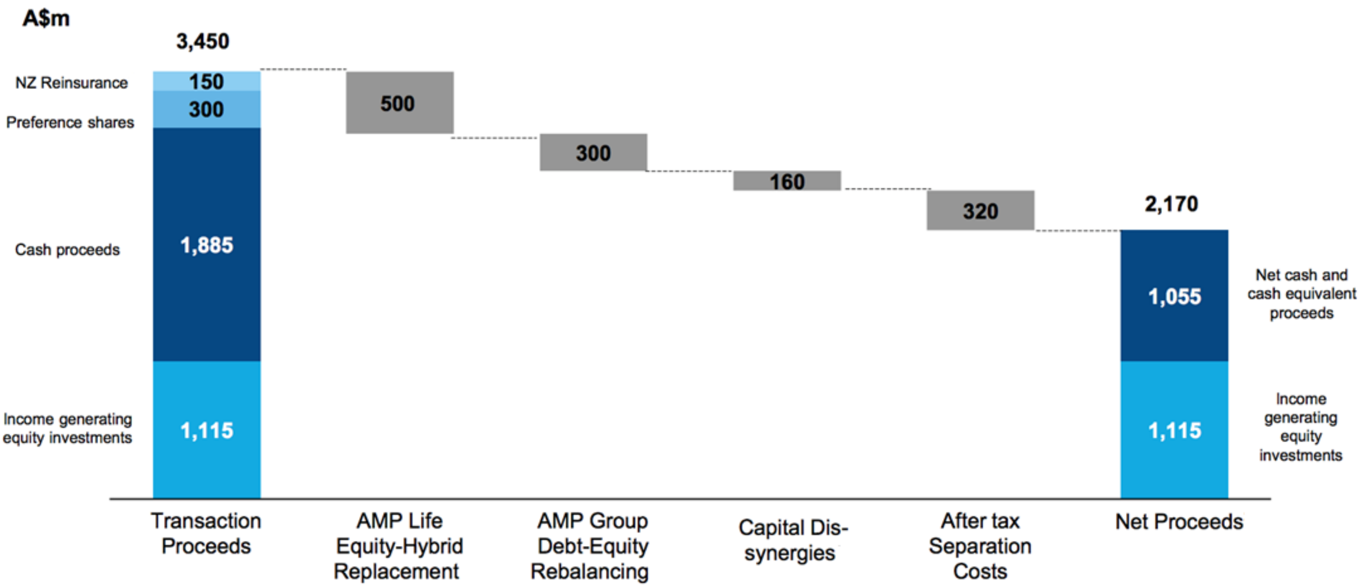
After the completion of a long-running portfolio review, AMP announced several significant changes. The largest was its agreement to sell its life insurance business to overseas-based Resolution Life for total cash and non-cash consideration of $3.3 billion in a complex transaction that will see AMP receive a mix of cash ($1.9 billion) and $300 million in additional tier 1 preference shares in AMP Life (issued on transaction completion) and $1.1 billion of other interests.

The other interest is split between an 'economic' interest in the future earnings of the AMP mature and an interest in Resolution Life. The first, in the AMP Mature business is equivalent to $600 million; expected to provide ongoing earnings to AMP of around $50 million after tax each year, assuming an annual run-off at 5%. The second is a $515 million interest in Resolution Life, which is a vehicle focused on the acquisition and management of in-force life insurance books around the world. The latter interest appears to be one that has received no value from traders in the reaction to the announcement, but Resolution has a strong track record of success in its niche. AMP expects to monetise all non-cash consideration in the future.

Although the above transaction is expected to complete in 2H19 subject to the usual conditions, Resolution Life assumes the risk and profits of the wealth protection and mature businesses from 1 July 2018. This is important, as it justifies the businesses being classed as discontinued for AMP going forward, which has implications for the dividend.

AMP also flagged that it will seek to divest its New Zealand wealth management and advice businesses through an IPO in 2019. The decision to proceed with an IPO is subject to market conditions and regulatory approvals. The businesses have pro-forma FY18 operating earnings of circa $40 million on a standalone business. An IPO would release capital for AMP.

The other restructuring announcement was the inking a binding reinsurance agreement with Swiss Re for the New Zealand retail wealth protection portfolio. The transaction is expected to release up to $150 million of capital to AMP, subject to regulatory approvals. The agreement is expected to become effective from 31 December 2018, and will cover approximately 65 per cent of the New Zealand retail wealth protection portfolio for new claims incurred from that date. The agreement is anticipated to reduce New Zealand profit margins by A$20 million on a full-year basis. The outcomes from the reinsurance deal are factored into the Resolution Life transaction. These are shown below.



Source: AMP

Net proceeds are expected to be around $2.17 billion, with cash and cash equivalents of $1.055 billion and income generating equity investments of $1.115 billion. Income generating equity investments and preference shares are expected to deliver around $110 million in investment income per annum to AMP.

We believe the discounted value of the sale of the assets, along with the complexity of the transaction are two significant factors in last week's share price tumble. The price tag represented 0.82 pro-forma embedded value of the sold businesses at 30 June 2018, excluding franking credits.

The decision to sell the life insurance arm is in-line with industry trends to exit the area due to structural and regulatory changes, hampering the ability of many to generate acceptable changes. While painful in the short-term, the outcome was widely expected, although the price wasn't as high as hoped.

AMP has 'lost its way' in recent years, and therefore transactions outlined designed to release capital, 'simplify' the business and narrow its focus on relatively higher growth and return businesses are appropriate in our view and changes are ultimately well overdue. The transactions will also strengthen the balance sheet, providing strategic flexibility and/or capital management activity. We believe the latter is a likely outcome.

The portfolio review has been underway for some time, indeed, one of the frustrations for shareholders has been the slow pace of change at the company as its share price has fallen. **The review began before the Royal Commission, but the revelations from that have certainly have accelerated the need for change to begin regaining shareholders trust, in what is almost certainly going to be a lengthy process.**

Although the 'ripping of off the Band-Aid' announcement, along with the quarterly cash flow statement saw a painful share price correction unfold, we believe it was an overreaction, with the shares drifting to levels that appear as though investors are treating it as almost an un-investable proposition.

The loss of confidence certainly has foundations given the lamentable track record at AMP and several 'false starts,' but we hold new AMP Chairman David Murray in high regard. It is no co-incidence in our view that significant changes at the beleaguered wealth giant have been flowing through since he assumed the Chairman role earlier this year in our view.

The recent changes came on the heels of several actions outlined in July that AMP was taking to reset the business, including a provision of $290 million (post-tax) for potential advice remediation. Shareholders will understandably be upset that the actions to date have resulted in further significant share price weakness. It could be that AMP is making many of the big calls to evolve the business in a condensed time frame to get them over and done with and provide a fresh slate for the incoming chief executive.

A new CEO, Francisco De Ferrari, will assume the CEO role from the beginning of December. He will succeed Mike Wilkens, who has been serving as interim CEO since April. Mr De Ferrari joins AMP after 17 years with Credit Suisse where he was CEO South East Asia and Frontier Markets and Head of Private Banking Asia Pacific.

Regarding the appointment, Chairman David Murray said, "Francesco is an outstanding leader with a strong track record in international wealth management and extensive experience in redesigning business models to drive turnaround and growth," and "Francesco is a proven change agent who will bring the strategic acumen and expertise to spearhead the transformation needed in our business."

Mr De Ferrari will have his work cut out for him. In a separate filing last week to the previously discussed transactions, AMP reported that Australian Wealth Management (AWM) suffered a net cash outflow of $1.485 billion in 3Q18 due to weak inflows and continued high capital outflows in the wake of the Royal Commission revelations. AMP's reputation has been badly tarnished by the scandals and it has clearly come at a cost to business and some large clients. Australia Post recently ditched AMP as its default superannuation provider.

Australian wealth management

	Cash inflows		Cash outflows		Net cashflows	
Cashflows by product (A$m)	**Q3 18**	**Q3 17**	**Q3 18**	**Q3 17**	**Q3 18**	**Q3 17**
North	3,894	4,314	(3,013)	(3,032)	881	1,282
AMP Flexible Super	666	1,125	(1,180)	(1,416)	(514)	(291)
Summit, Generations and iAccess	162	314	(610)	(810)	(448)	(496)
Flexible Lifetime Super (superannuation and pension)	395	406	(976)	(830)	(581)	(424)
Other retail investment and platforms	44	94	(90)	(82)	(46)	12
Total retail on AMP platforms	**5,161**	**6,253**	**(5,869)**	**(6,170)**	**(708)**	**83**
SignatureSuper and AMP Flexible Super - Employer	668	770	(760)	(651)	(92)	119
Other corporate superannuation	421	349	(709)	(482)	(288)	(133)
Total corporate superannuation	**1,089**	**1,119**	**(1,469)**	**(1,133)**	**(380)**	**(14)**
Total retail and corporate superannuation on AMP platforms	**6,250**	**7,372**	**(7,338)**	**(7,303)**	**(1,088)**	**69**
External platforms	235	378	(632)	(690)	(397)	(312)
Total Australian wealth management	**6,485**	**7,750**	**(7,970)**	**(7,993)**	**(1,485)**	**(243)**

Source: AMP

Total AUM (assets under management) in the wealth management business edged up $579 million from the second quarter 2018 to $132.6 billion, buoyed by positive investment markets over that time. We note the rough start to 4Q18 seen in October makes a repeat of that unlikely.

Separately, AMP Capital external et cash inflows were $521 million in the quarter, down from net cash flows of $616 million a year earlier. AUM increased from $190.5 billion at the end of 2Q18 to $192.4 billion at the end of the third quarter. AMP Bank's loan billion book tallied $20.1 billion in 3Q18, down from $20.2 billion in 2Q18 which the company attributed to "the slowdown in credit growth, a period of conservative liquidity management and increased flows to the non-bank sector." The deposit book increased $773 million during the quarter to $13.5 billion.

Turning to the technical picture and on the daily chart, the bearish moving average crossover present since April is suggestive of momentum to favour the downside. This is when the 50-day moving average (red line) crosses below the 200-day moving average (green line). Initial support at the February low of $4.74 has also given way as has that at $3.53, $3.29. and more recently $3. Significant technical damage has now been done, and some base building will now be needed for the short-term technical outlook to improve.

With reference to the monthly chart, a downtrend has ensued since early 2015, leading to significantly softer price-action. The 127.2% Fib retracement at $2.73 has given way, with the 161.8% Fib retracement at $1.62 the next major buttress. Prices could well go below $2 in the near future.

Summary

Although a sale of the life insurance business was expected, last week's announcements resulted in a harsh reaction. We attribute this to several factors, which are the discounted price tag, the complexity of the transaction, the weak flows to the Australian wealth business for the quarter and a lower expected dividend.

The latter reflects the sold businesses discussed above being classed as discontinued operations. That means the fiscal 2018 second half earnings from those businesses won't be included when AMP is determining its dividend, which is set to be towards the lower end of its guidance range of 70% to 90% of underlying profit. When transaction proceeds are received, we believe it is likely AMP will end up buying back some shares given its strong capital position and this would partially offset the impact from lower earnings due to the discontinued businesses. Even if this were to occur though, the proceeds are only expected in 2H19.

Sentiment towards AMP was already at a low ebb prior to last week's announcements due to a poor track record and glacial pace of change in recent years. The changes have come thick and fast this year under chairman David Murray and a new externally sourced CEO is about to join. Despite this, the market reaction to last week's changes has been brutal, coming at a time when investor nerves are already frayed due to broader market volatility. The shares have since been soft in trading following the one-day bloodbath as well, suggesting no respite is in the offering.

AMP shares are now trading on approximately 7.8 times consensus earnings for FY19 and a projected dividend yield of 8.8% that year.

We expect weakness in flows to the Australian wealth business to continue until the Royal Commission wraps up and it appears even though long-awaited change has come through, investors are still unwilling to give new management a chance. With the reputation of AMP likely to take a long time to recover, even if management does a good job, we believe there are better investment alternatives and accordingly we recommend selling AMP.

We recommend Members sell AMP. The stock will be removed from the Fat Prophets portfolio.

Snapshot AMP

AMP

Latest Closing Price: $2.32

Reuters: AMP Limited (AMP) is a wealth management company operating in Australia and New Zealand. The Company has selective investment management activities in Asia. AMP has over three million customers in Australia and New Zealand. The Company has two core businesses: AMP Financial Services, which provides financial planning, investment services, superannuation, mortgage and savings products and life insurance products, and AMP Capital Investors, which provides investment management services, including private capital, infrastructure and property portfolios and socially responsible investments.

Market Capitalisation:$6.80b

	FY1	FY2
Price to Earnings	17.9	7.8
Dividend Yield (%)	5.6	8.8

Price to Book	2.1	1.0
Return on Equity (%)	-	9.6