Company

20 July 2010 | 24 pages

AMP Ltd (AMP.AX)

Equity

Margin squeeze revisited for MySuper; conclusions unchanged

- **5% to 6% margin squeeze** — Our analysis last September led us to include 5% to 6% revenue margin squeeze in our Contemporary Wealth Management ("CWM") numbers for the next few years. In this report, we update our revenue analysis for CWM taking into account the scenario set out in the final Cooper report. The results suggest that CWM's revenue margin could fall from 149bps now to 125bps post MySuper and 105bps longer term. Our current 2H12E estimate is 124bps.
- **AMP's guidance too optimistic** — We still believe that if the Cooper review's MySuper proposals are implemented then AMP's 3%pa revenue margin squeeze guidance in CWM will be too optimistic for the next few years. Nonetheless, we still see margin squeeze as negative but not earth shattering and retain our Buy/Medium Risk (1M) rating and A$6.50 target price.
- **Default estimate critical to our analysis** — Cooper's main focus for MySuper is those people in the default option of default funds. It is therefore key to estimate the proportion of AMP's customers currently invested in such options. As APRA data shows, this can vary considerably from fund to fund. Using Plan for Life data, we believe our estimate of this has solid foundations, and details are inside.
- **Margin by product key too** — AMP has a number of superannuation and post retirement products, many of which have different margins. Estimating margins by product has also therefore been key to our analysis. In total our estimates of current margins are consistent with CWM's revenue and margin disclosures.
- **What proportion of MySuper margin squeeze will AMP suffer?** — Our estimates for super assume AMP will suffer 15% of the short term and 7% of the long term industry savings as estimated by the Treasury. We think this is logical for reasons we set out inside. Unlike the Treasury estimates, we have also assumed margin compression on both post retirement and Choice products.

AMP.AU (Y/E Dec)	2009A	2010E	2011E	2012E
Reported Profit (A$m)	739.0	812.8	879.2	940.7
Core Net Profit (A$m)	762.8	812.8	879.2	940.7
Core EPS (A¢)	37.7	39.2	42.3	45.2
Core EPS Growth (%)	65.1	4.0	7.9	7.0
PE Ratio (x)	14.1	13.6	12.6	11.7
DPS (A¢)	30.0	34.0	36.0	38.0
Dividend Yield (%)	5.6	6.4	6.8	7.2
Franking Rate (%)	50.0	70.0	70.0	75.0
P/NTA (x)	6.7	6.2	5.7	5.2
ROE (%)	33.1	30.7	31.4	31.7

Source: Company Reports and dataCentral, CIRA.

Buy/Medium Risk	1M
Price (20 Jul 10)	A$5.31
Target price	A$6.50
Expected share price return	22.4%
Expected dividend yield	6.4%
Expected total return	**28.8%**
Market Cap	A$11,002M US$9,555M

Price Performance (RIC: AMP.AX, BB: AMP AU)

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Fiscal year end 31-Dec	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	23.3	14.1	13.6	12.6	11.7
P/E reported (x)	17.4	14.6	13.6	12.6	11.7
P/BV (x)	5.2	4.2	4.0	3.8	3.6
P/NTA (x)	9.6	6.7	6.2	5.7	5.2
Dividend yield (%)	7.5	5.6	6.4	6.8	7.2
Per Share Data (A¢)					
EPS adjusted	22.8	37.7	39.2	42.3	45.2
EPS reported	30.5	36.5	39.2	42.3	45.2
BVPS	102.2	125.5	131.5	138.9	147.3
NTAPS	55.1	79.3	85.8	93.3	101.7
DPS	40.0	30.0	34.0	36.0	38.0
Profit & Loss (A$M)					
Adjusted earnings	**433**	**763**	**813**	**879**	**941**
Extraord./Min.Int./Pref.div.	147	-24	0	0	0
Reported net income	**580**	**739**	**813**	**879**	**941**
Growth Rates (%)					
EPS adjusted	-55.9	65.1	4.0	7.9	7.0
EPS reported	-42.4	19.4	7.4	7.9	7.0
Dividend	-13.0	-25.0	13.3	5.9	5.6
Balance Sheet (A$M)					
Total assets	**86,750**	**89,830**	**93,904**	**96,354**	**98,894**
Investments	80,641	84,171	88,189	90,603	93,104
Net goodwill & intangibles	939	946	946	946	946
Other assets	5,170	4,713	4,770	4,806	4,843
Total liabilities	**84,633**	**87,196**	**91,117**	**93,413**	**95,778**
Life policy reserves	68,012	71,740	75,288	77,563	79,907
Non-life policy reserves	0	0	0	0	0
Total debt	12,376	12,350	12,350	12,350	12,350
Other liabilities	4,245	3,106	3,479	3,500	3,520
Shareholders' funds	**2,117**	**2,634**	**2,788**	**2,942**	**3,116**
Growth Rates (%)					
BVPS	-0.6	22.8	4.8	5.7	6.0
Profitability/Solvency Ratios (%)					
ROE adjusted	21.8	33.1	30.7	31.4	31.7
ROA adjusted	0.5	0.9	0.9	0.9	1.0
Total debt to capital	85.4	82.4	81.6	80.8	79.9
Total debt to equity	584.6	468.9	443.0	419.8	396.4

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The simple story

What does Cooper mean for AMP's margin squeeze?

The release of the final Cooper report has reawakened the debate about margin squeeze for AMP. Clearly, if the review's findings are implemented, this will bring industry margin squeeze for AMP and many others. This should, however, come as no surprise as it has long been anticipated. Indeed, we have had significant margin squeeze – about 5% to 6% per annum over the next few years – for AMP Contemporary Wealth Management ("CWM") in our estimates since last September. These, we acknowledge, were calculated using slightly different (albeit similar) assumptions to the scenario Cooper seems to envisage. In this report, we update our analysis from last September to take into account the details contained in the final Cooper report.

3% pa too optimistic if margin squeeze impacts post retirement products

We remind that alongside the announcement on 20 May 2010 of its recent new product launch, AMP guided the market to 3% per annum revenue squeeze for CWM cross cycle. However, as we highlighted in our AMP note last week: *"AMP: Cooper margin squeeze may be more than AMP expected*" dated 12 July 2010, AMP does not appear to have allowed for any margin squeeze on post retirement products in its calculations. Instead it only allows for margin squeeze on superannuation (i.e. accumulation phase) products. Our read of the Cooper review is that Cooper intends his reforms to cover both the superannuation and post retirement segments. For example, we note the report's comments that the Cooper panel expresses:

"*doubts whether … higher fees for allocated pensions are justifiable*" and "*considers there is scope for these fees to be reduced substantially*".

We also note that Cooper envisages MySuper as a whole of life product, presumably also assuming that the low fees stay in the post retirement phase. Consequently, we believe if the Cooper review is adopted by the Government in full, which is a strong possibility but not certain, then short term margin squeeze for AMP CWM is likely to be higher than AMP's cross cycle estimates and more in line with our original forecasts published for the first time in our note *"AMP: Margin squeeze - negative but unlikely to be earth shattering*" dated 18 September 2009.

We perform analysis in this report that supports our view

In this report, we perform analysis to support this point. Critical to our analysis is our estimate of the proportion of FuM and FuM balances of AMP customers currently invested in the default option of default funds as this is the area targeted by the Cooper review and, so, it is here that AMP is likely to suffer the most margin squeeze. Consequently, we have applied a degree of science to our work in this area to ensure that our analysis is supported by realistic assumptions.

Further contraction in margins once MySuper reaches critical mass

In the short term Cooper envisages MySuper will be priced at 85bps. Longer term, he envisages MySuper products will be priced at 66bps including intrafund advice. He does not propose mandating these fees, he merely suggests that this is where competition will take the product. In the short term he suggests cannibalisation from Choice products to MySuper is likely to be around 5% of FuM balances while in the longer term he suggests this will be as high as 15%. We note that the achievement of a 66bps fee is only expected to happen once MySuper products reach a critical mass of around A$20bn in FuM, a level which even AMP's MySuper product, which is likely to be one of the largest in the market, is unlikely to be anywhere close to in its initial phase. Clearly AMP is unlikely to price its MySuper product at 66bps unless its competitors do so, a situation that should only occur when its nearest competitors also reach critical mass.

CWM's revenue margin could fall to 125bps once MySuper comes in

In short, we believe that under the assumptions underpinning our analysis and set out in depth in this report, AMP CWM could envisage margin pressure such that at the start of MySuper, which Cooper envisages as taking place no sooner than two years time, its average revenue margin across all products could fall to 125bps from its existing 149bps excluding planner fees. This is broadly consistent with our existing forecasts that incorporate a revenue margin of 124bps in 2H12E. Longer term, if Cooper is right that MySuper is priced at 66bps, then allowing for some margin squeeze on Choice products as well we derive an average revenue margin of 105bps. However, we again emphasise that even Cooper believes this scenario will only occur once MySuper has critical mass of at least A$20bn of FuM. In the analysis that follows, we have estimated that it takes at least a further four years post the introduction of MySuper for the 66bps target to be reached.

But impact on profit can be mitigated by lower costs

We note too that our analysis only covers revenue margins. In reality MySuper products will be cheaper to produce and there are likely to be some cost of manufacture savings alongside the fall in revenue. Our forecasts already incorporate some allowance for this, though this is of course a matter of judgment as it is currently hard to estimate precisely how much cheaper these products will be and also what quantum of savings there will be available for AMP from such initiatives as Cooper's SuperStream proposals. We do not envisage AMP will benefit from SuperStream as much as some other industry players that are currently less efficient than it, but there are likely to be some benefits for AMP as well (Cooper suggests SuperStream will save the industry as a whole about A$1.0bn in the both the short and long term).

The super world as envisaged by Cooper

We begin our analysis by examining how the Cooper report and the Treasury forecasts contained therein view the new world. We have already discussed this to some extent, in our report "*Wealth Management/Risk Insights: Plenty of Cooper's "libertarian paternalism*" dated 5 July 2010, but as it is crucial to our detailed analysis on AMP and we also want to emphasise how we have incorporated additional assumptions to those used by the Treasury, we revisit it here.

The assumptions underlying the Treasury analysis are summarised in Figure 1. As this clearly illustrates, Treasury has assumed:

- MySuper products will initially be priced at around 0.85%, compared to the existing default fund default investment option at 0.97%;
- Initially, about 5% of members currently in Choice or DIY funds paying an average fee of 1.28% will switch to MySuper products;
- Longer term MySuper products will be priced at 0.66% (including intrafund advice) once MySuper products reach large scale (assets of A$20bn+); and
- Longer term, about 15% of members currently in Choice or DIY funds will switch to MySuper products. This increased switching rate reflects the fact that under these assumptions the differential between fees for Choice and fees for MySuper products would be greater providing greater incentive to switch (although note in our analysis we also assume, we think realistically, that the price of Choice products comes down as well). The report also suggests that switching would be supported by the new financial advice rules which require planners to put members' interests above their own. In addition, companies such as AMP and BT are already marketing lower cost MySuper-style products.

Figure 1. Highlighting the assumptions underlying Treasury's calculation of MySuper savings

	Now	After MySuper	Difference
Short term savings			
Super assets currently in default investment option (A$m)	340,000	340,000	
Average fee (%)	0.97%	0.85%	
Total fees (A$m)	3,298	2,890	408
Super assets in the accumulation phase in SMSFs and Choice	725,000	725,000	
Percentage assumed to switch into MySuper (%)	4.8%	4.8%	
Assets assumed switched to MySuper (A$m)	35,000	35,000	
Average fee (%)	1.28%	0.85%	
Total fees (A$m)	448	298	151
Total short term savings (A$m)			**559**
Long term savings			
Super assets currently in default investment option (A$m)	340,000	340,000	
Average fee (%)	0.97%	0.66%	
Total fees (A$m)	3,298	2,244	1,054
Super assets in the accumulation phase in SMSFs and Choice	725,000	725,000	
Percentage assumed to switch into MySuper (%)	15.2%	15.2%	
Assets assumed switched to MySuper (A$m)	110,200	110,200	
Average fee (%)	1.28%	0.66%	
Total fees (A$m)	1,411	727	683
Total long term savings (A$m)			**1,737**

Source: Cooper Review final report, CIRA

These Treasury estimates assume:

- no fall in choice product fees. However, in our analysis of AMP's margin squeeze below we have assumed that fees also come down on choice products. Although lower fees for choice products could lower the switching rate between choice and MySuper, we have nonetheless still assumed the 5% and 15% switching rates proposed by the Treasury in the short and long term respectively;

- no growth in assets from March 2010 levels with the long-run impact still being computed on existing assets; and
- no impact on fees for post retirement products. Our analysis of AMP's margin squeeze below does, however, apply the margin squeeze to post retirement assets.

The Treasury estimates also ignore ongoing or transition costs of funds meeting the MySuper requirements.

What margin is AMP currently receiving?

Figure 2. Estimate of AMP CWM (ex Bank) revenues by major product category

	AuM 31 Dec 2	Citi fee estimate	Planner fee	Fee net of planner fee
AMP AuM mix per Plan for Life		**bps**	**bps**	**Ps**
Flexible Lifetime Super (Retail)	20,042	225	45	180
SuperLeader (SMEs)	2,815	210	30	180
CustomSuper (Mid sized companies)	5,996	180	30	150
Signature Super (Large corporate plans)	6,146	75	0	75
Total super	**34,999**	**190**	**33**	**156**
Other retail AuM:				
Retirement income	7,229	210	40	170
Discretionary investments	2,200	220	40	180
External Platforms	7,000	120	40	80
CWM AuM	**51,428**	**184**	**35**	**149**

Source: Company Reports, Plan for Life and CIRA Estimates

In Figure 2, we estimate AMP's revenue margins for each of its super and post retirement products. In an overall sense, this ties into what AMP CWM reports as its total revenue margin of 184bps including planner fee in 2H09. AMP moved to separate product and advice fees at 1 July 2010 but its reported revenue margins to this date have included planner fees. For ease of analysis and explanation of this we have therefore shown both in Figure 2.

What proportion of FuM will be in MySuper?

As at March 2010, Treasury estimates that there were approximately A$560bn of assets in default funds, with around A$340bn of that amount in the default investment option. It is the A$340bn (equating to roughly 32% of overall superannuation FuM) which the Treasury estimates envisage will initially transfer to MySuper. Further, as we outlined above, it also believes that 5% of the A$725bn currently invested in:

- default funds, but effectively in the choice sector as they are not in the default investment option;
- other parts of the choice sector; and
- DIY funds;

will move across to MySuper in the short term due to the fee differential.

In applying this proposed new world to AMP it is critical to identify how many of its customers are currently in the default option as this can vary considerably between types of funds. For as APRA suggests in its Annual Superannuation Bulletin for June 2009, issued on 10 February 2009:

"Of the total assets held by entities with more than four members at June 2009, 45.5% of assets (A$320.1bn) were held in the default investment strategy. Industry funds held 69.1% of assets in the default investment strategy, followed by public sector funds with 60.0%, corporate with 47.4% and retail funds with 23.0%"

This is a critical piece of information to take into account when attempting to work out the relative amount of industry margin squeeze likely to be experienced by each entity.

One way to work out AMP's proportion of default customers would have been to apply these percentages to its FuM balances in each category of fund. However, we have identified an alternative method which should provide a more accurate estimate, albeit one that produces results that are broadly consistent with the percentages quoted by APRA in its June 2009 report.

Using Plan for Life data, we have analysed the investment options within each of AMP's main superannuation and post retirement product categories and discovered that for each product there is one fund that captures a significant part of the FuM. For the most part these are balanced fund type options consistent with what we would expect the nature of a default fund to look like. The funds we have so chosen are shown in Figure 3. We also include the two "core" funds in AMP's new flexible super product, which were formerly the Super Easy product which are effectively designed to be a My-Super style product.

Figure 3. Estimated AMP funds in default options by product

Product Detail	Mar-10 A$m
Flexible Lifetime Super - Super Easy - Cash	12.0
Flexible Lifetime Super - Super Easy - Balanced	31.7
Flexible Lifetime Super - Balanced Growth	4,178.6
Flexible Lifetime Super - Total	**4,222.2**
CustomSuper - Balanced Growth	1,629.7
Signature Super - Future Directions Balanced	3,453.3
SuperLeader Plan - Safe & Secure	2,336.8
Flexible Lifetime Alloc Pension - AMP - Future Directions Balanced	960.6

Source: Plan for Life and CIRA Estimates

The resulting proportions of default funds across each of AMP's products are shown in Figure 4.

Figure 4. Calculated proportion of default and choice by AMP product

Product	Choice	Default	Total
CustomSuper	73.2%	26.8%	100.0%
Flexible Lifetime Super	79.2%	20.8%	100.0%
Signature Super	45.8%	54.2%	100.0%
SuperLeader Plan	19.3%	80.7%	100.0%
Total	**67.4%**	**32.6%**	**100.0%**

Source: Citi Investment Research and Analysis

Refreshingly, these proportions appear broadly consistent with the APRA analysis referred to above.

Summary of other assumptions

We have assumed that the funds currently in default options move into Super at MySuper rates, consistent with the Treasury analysis, of 85bps in the "Post MySuper" (i.e. short term) analysis and 66bps in the Long Term MySuper analysis. For Choice funds we have assumed:

- 3% margin squeeze per annum for two years in the Post MySuper analysis; and
- 3% margin squeeze per annum for six years in the Long Term MySuper analysis.

We assume the same rate of margin squeeze for superannuation, retirement income, discretionary investments and external platforms.

Consistent with the Treasury analysis, we make no allowance for growth in FuM, but given our analysis largely focuses on revenue margins, this should not impact the analysis too much. In reality, the underpinning assumption is that the proportion of FuM in each AMP product remains broadly the same apart from the allowance for transfer from Choice to MySuper consistent with the Treasury's assumptions. Unlike the Treasury analysis, however, we have allowed for squeeze across both superannuation and post retirement products.

Interpreting the results

Fall in margins and revenues

The results of our analysis are shown in Figure 5 for the short term impact and Figure 6 for the long term impact. In summary this shows:

- In the short term if all Cooper's proposals are implemented, AMP could expect to see its average CWM revenue margins reduce from 149bps currently (i.e. in 2H09) to 125bps post the introduction of MySuper.
- In the long term, once AMP's MySuper product and those of its nearest competitors reach critical mass of at least A$20bn in AuM and assuming further margin squeeze on Choice products, AMP's average revenue margin on CWM can be expected to fall to 105bps providing the assumptions of our analysis hold true.
- This is equivalent to a fall in revenue of 16% to A$642m in the short term (in effect across three years from 2H09 to 2H12, so equivalent to a rate of about 5% per annum) and a 29% fall to A$541m in the long term (in effect this equates to decline of 3% per annum from 2H12 to 2H16, though this timing is uncertain). These percentage declines are both calculated relative to the assumed current A$767m, excluding revenues (and expenses) associated with planner payments and commissions. This compares to AMP's 2H09 reported A$447m of investment related reported revenue, including planner fees. As planners also receive fees from other revenue (primarily commissions from CWP and Mature) and potentially also from bank related revenues, we believe this analysis is consistent with AMP's disclosures.

Sense check: proportion of industry savings

As a sense check, we have calculated the proportion of the Treasury's estimated industry savings of around A$550m in the short term and A$1.7bn in the long term, that our above analysis suggests will be available from the implementation of MySuper in superannuation, that AMP could be expected to bear. First, we estimate AMP's current market share of retail superannuation FuM at about 17% and its equivalent share of combined retail and industry super at a little under 10%. Our analysis in Figure 5 and Figure 6 effectively calculates that it has, for superannuation products only (i.e. excluding post retirement products) A$11.6bn or 3.4% of the industry's A$340bn in default options in default funds and 4.0% of the remaining A$725bn in choice and DIY funds.

Our analysis in Figure 5 and Figure 6 effectively assumes that it loses superannuation (i.e. excluding post retirement products) revenue of A$83m in the short term from the two effects included in the Treasury estimates (i.e. defaults to 85bps and 5% shift from Choice to MySuper) and A$119m in the long term which is 15% and 7% of the short and long term industry savings respectively. AMP's relatively large share of the initial savings can be explained by its relatively high fees now (our analysis in Figure 5 suggests its average default fund fee is 145bps, well ahead of the industry average calculated by Treasury of 97bps) whereas its smaller share of the longer term savings can be explained by its relatively small share of default funds.

Short term

Figure 5. Estimated impact of MySuper and Choice architecture on AMP short term

Superannuation and retirement income				**Revenue margins excluding planner fees**		**Revenue**	
				Current	**Post MySuper**	**Current**	**Post MySuper**
Category	**Product**	**Type**	**Total**	**bps**	**bps**	**A$m**	**A$m**
Retail	Flexible Lifetime Super	Choice	15,893	180	169	286	269
		Default	4,149	180	85	75	35
	Flexible Lifetime Super Total		**20,042**	**180**	**152**	**361**	**304**
SMEs	SuperLeader Plan	Choice	526	180	169	9	9
		Default	2,289	180	85	41	19
	SuperLeader Plan Total		**2,815**	**180**	**101**	**51**	**28**
Middle market	CustomSuper	Choice	4,380	150	140	66	61
		Default	1,615	150	85	24	14
	CustomSuper Total		**5,996**	**150**	**125**	**90**	**75**
Large corporate	Signature Super	Choice	2,812	75	75	21	21
		Default	3,334	75	75	25	25
	Signature Super Total		**6,146**	**75**	**75**	**46**	**46**
Allocated pensions	Flexible Lifetime Alloc Pension	Choice	5,034	170	160	86	81
		MySuper	945	170	85	16	8
	Flexible Lifetime Alloc Pension Total		**5,979**	**170**	**148**	**102**	**89**
Other pension products		**Choice**	**1,250**	**180**	**169**	**23**	**21**
	Grand Total		**42,228**	**159**	**133**	**672**	**563**
							5% switch
Impact of Choice shifting to MySuper (default)			**Total**	**bps**	**bps**	**A$m**	**A$m**
	Flexible Lifetime Super	Choice	15,893	0	-84	0	-7
	SuperLeader Plan	Choice	526	0	-84	0	0
	CustomSuper	Choice	4,380	0	-55	0	-1
	Signature Super	Choice	2,812	0	0	0	0
	Flexible Lifetime Alloc Pension	Choice	5,034	0	-75	0	-2
	Other retirement income products	Choice	1,250	0	-84	0	-1
	Total	Choice	**23,612**	**0**	**-4**	**0**	**-11**
Total impact			**42,228**	**159**	**131**	**672**	**553**
Other categories of FuM		**Type**	**Total**	**bps**	**bps**	**A$m**	**A$m**
Investments		All	2,200	180	169	40	37
External platforms		All	7,000	80	75	56	53
Total			**9,200**	**104**	**98**	**96**	**90**
Total CWM			**51,428**	**149**	**125**	**767**	**642**

Source: Company Reports, Citi Investment Research and Analysis

Note: revenue broadly ties in to what AMP describes as revenue less planner payments plus a bit of other revenue e.g. in 2H09 A$447m minus A$80m times two equals A$734m, allowing for A$33m of other revenue to reach A$767m

Long term

Figure 6. Estimated impact of MySuper and Choice architecture on AMP long term

Superannuation and retirement income				**Revenue margins excluding planner fees**		**Revenue**	
				Current	**Long-term MySuper**	**Current**	**Long-term MySuper**
Category	**Product**	**Type**	**Total**	**bps**	**bps**	**A$m**	**A$m**
Retail	Flexible Lifetime Super	Choice	15,893	180	150	286	238
		Default	4,149	180	66	75	27
	Flexible Lifetime Super Total		**20,042**	**180**	**133**	**361**	**266**
SMEs	SuperLeader Plan	Choice	526	180	150	9	8
		Default	2,289	180	66	41	15
	SuperLeader Plan Total		**2,815**	**180**	**82**	**51**	**23**
Middle market	CustomSuper	Choice	4,380	150	125	66	55
		Default	1,615	150	66	24	11
	CustomSuper Total		**5,996**	**150**	**109**	**90**	**65**
Large corporate	Signature Super	Choice	2,812	75	75	21	21
		Default	3,334	75	66	25	22
	Signature Super Total		**6,146**	**75**	**70**	**46**	**43**
Allocated pensions	Flexible Lifetime Alloc Pension	Choice	5,034	170	142	86	71
		MySuper	945	170	66	16	6
	Flexible Lifetime Alloc Pension Total		**5,979**	**170**	**130**	**102**	**78**
Other pension products		**Choice**	**1,250**	**180**	**150**	**23**	**19**
	Grand Total		**42,228**	**159**	**117**	**672**	**494**
							15% switch
Impact of Choice shifting to MySuper (default)			**Total**	**bps**	**bps**	**A$m**	**A$m**
	Flexible Lifetime Super	Choice	15,893	0	-84	0	-20
	SuperLeader Plan	Choice	526	0	-84	0	-1
	CustomSuper	Choice	4,380	0	-59	0	-4
	Signature Super	Choice	2,812	0	-9	0	0
	Flexible Lifetime Alloc Pension	Choice	5,034	0	-76	0	-6
	Other retirement income products	Choice	1,250	0	-84	0	-2
	Total	Choice	**23,612**	**0**	**-14**	**0**	**-32**
Total impact			**42,228**	**159**	**109**	**672**	**461**
Other categories of FuM		**Type**	**Total**	**bps**	**bps**	**A$m**	**A$m**
Investments		All	2,200	180	150	40	33
External platforms		All	7,000	80	67	56	47
Total			**9,200**	**104**	**87**	**96**	**80**
Total CWM			**51,428**	**149**	**105**	**767**	**541**

Source: Company Reports and CIRA Estimates

Conclusions for AMP CWM's revenue margins

Given Cooper envisages at least two years for MySuper to be implemented, the findings of our work above appear consistent with the 124bps revenue margin we have in our CWM estimates from 2H12E (refer Figure 7) and well within the bounds of error of such analysis. We therefore see no reason to change our forecasts currently, although we do continue to highlight that our forecasts are more conservative than AMP's guidance.

Figure 7. Citi's current CWM revenue margin estimates including our anticipated margin squeeze

	1H10E	2H10E	1H11E	2H11E	1H12E	2H12E
AuM related revenue to AuM	1.79%	1.40%	1.35%	1.32%	1.27%	1.24%

Source: Citi Investment Research and Analysis

In Figure 8 we show what our revenue margins would look like were we to only assume AMP's 3%pa margin guidance over the next few years.

Figure 8. Margins if we were to assume only 3% margin squeeze

Period	1H10E	2H10E	1H11E	2H11E	1H12E	2H12E
AuM related revenue to AuM	1.79%	1.40%	1.38%	1.36%	1.34%	1.32%

Source: Citi Investment Research and Analysis

To put this in the context of the overall group we also show in Figure 9 the impact on our overall EPS forecasts of making these changes. These changes do not allow for any changes in costs.

Figure 9. Impact on EPS of moving from our forecasts for revenue margin squeeze to AMP's

	FY10E			FY11E			FY12E		
	Old	New	Change	Old	New	Change	Old	New	Change
EPS (cents)	39.2	39.2	0.0%	42.3	42.9	1.6%	45.2	46.9	3.6%

Source: Citi Investment Research and Analysis

So the analysis in this report is broadly consistent with the conclusions of our report of last September where we highlighted that with our revenue squeeze estimates, AMP become a 7% EPS growth stock in normalised markets rather than the one capable of double digit EPS growth prior to Cooper. We also continue to highlight that for this analysis to hold true requires the Government to fully embrace the Cooper's MySuper recommendations, which is possible but not certain. So we continue to see the margin squeeze coming out of Cooper for AMP's CWM business as potentially negative but not earth shattering for AMP.

Clearly there could be implications for AMP from other Cooper review recommendations. Some of these are negative e.g. volumes of risk product sales could be affected by Cooper's decision to ban planner commissions on risk product sold within super (though curiously not on risk product sold outside super which, if implemented, would appear to open the door to an unwelcome conflict of interests for planners). It is also possible that AMPCI will suffer margin squeeze from a greater skew towards passive products, although AMP should be able to lower the fees it pays to other fund managers as well if more of its FuM becomes passive not active. However, there are also possible positives including the potential for lower risk of leakage of customers on retirement due to MySuper being a whole of life product and the potential for an opening up of access to default funds for award employees, which is an area currently controlled by industry funds and one which AMP has fought hard to access. Given these proposals are surrounded by uncertainty, their precise impact is difficult to estimate at present. However, for a discussion of these and other aspects of the Cooper review relevant to AMP, see our note *AMP: Cooper margin squeeze may be more than AMP expected*" dated 12 July 2010 and our report *Wealth Management/Risk Insights: Plenty of Cooper's "libertarian paternalism*" dated 5 July 2010.

Summary and recommendation

The AMP share price has been suffering of late and we expect it is being hurt by factors that include:

- Uncertainty surrounding the Cooper review – as we have outlined above, we do not see the Cooper review as all bad for AMP. Clearly it will mean margin squeeze for AMP's Contemporary Wealth Management ("CWM") business but this is no surprise and has been factored into our forecasts since September 2009. As our renewed analysis in this report shows, we do not think the final Cooper review report envisages a scenario that will result in CWM revenue margin squeeze materially worse than we have currently allowed for, although we are continuing to forecast greater margin squeeze than AMP's guidance of 3%pa margin squeeze cross-cycle for the next three years (although we are consistent with this thereafter on the assumption that MySuper takes a further four year post implementation to reach the target 66bps). We understand AMP's guidance did not contain any allowance for significant margin squeeze on post retirement products whereas in reality this looks a likely outcome if the Cooper proposals are implemented in full. However, the potential opportunity to break down the apparent closed shop for award defaults, potentially greater stickiness between pre- and post- retirement phases and the fact that AMP has already changed its modus operandi to cover much of what is being proposed by Cooper should leave it in relatively good stead to deal with the Cooper review's recommendations. While the release of the final report ends some uncertainty, there is still more ongoing with the Government response to the report expected within two months.

- Uncertainty regarding AXA – we continue to argue that AMP cannot afford to pay what it previously offered for AXA with its share price where it currently is. A successful transaction for AMP would appear to require the ACCC to continue to reject a revised bid from NAB and AMP's share price to rise to at least A$6. If this does not occur then the success of the deal for AMP may be reliant on either AXA AP being willing to accept a lower price – this seems unlikely, although given AMP would then be the only bidder perhaps not completely impossible – or AXA SA being prepared to contribute a greater portion of the total purchase price.

- Uncertainty over the future direction of the equity market – AMP is still a beta driven stock, and will normally find it hard to outperform against a falling equity market backdrop. Our buy call is clearly predicated on our house view of a market rally.

At some stage, these issues should resolve themselves and allow the stock to trade higher and, potentially too, catch up some of its lost ground relative to the broader market. Once it reaches our target price, there then remains the question of whether its growth profile post Cooper will be sufficient to allow it to outperform from thereon. In our view this will require clear evidence that AMP's new growth initiatives, planner productivity etc, are bearing fruit. However, with the catch-up still to occur, and AMP's value attractions, we retain our Buy/Medium Risk (1M) rating and A$6.50ps target price.

Detailed financial summary

Financial Summary - AMP

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Year ended 31 December									
Segmental earnings (A$m)	**FY08A**	**1H09A**	**2H09A**	**FY09A**	**1H10E**	**2H10E**	**FY10E**	**FY11E**	**FY12E**
Business unit operating margins									
AMP Financial Services									
Contemporary wealth management	266	129	149	278	155	156	311	325	343
Contemporary wealth protection	154	83	81	164	85	92	178	195	212
Australian contemporary	**420**	**212**	**230**	**442**	**240**	**249**	**489**	**521**	**554**
Australian mature	161	72	79	151	73	67	140	129	124
New Zealand	56	23	31	54	28	29	57	60	62
AMP Financial Services - total	**637**	**307**	**340**	**647**	**341**	**344**	**686**	**710**	**741**
AMP Capital Investors	136	43	48	91	47	57	104	117	133
Total business unit op margins	**773**	**350**	**388**	**738**	**389**	**401**	**790**	**827**	**873**
Corp. & other expenses	(36)	(18)	(19)	(37)	(19)	(19)	(38)	(38)	(38)
Total operating margins	**737**	**332**	**369**	**701**	**370**	**382**	**752**	**789**	**835**
Interest expense on debt	(82)	(37)	(34)	(71)	(33)	(33)	(66)	(66)	(66)
Tax loss recognition	15	8	8	16	8	9	17	19	21
Cobalt/Gordian	0	0	0	0	0	0	0	0	0
Total operating profit	**670**	**303**	**343**	**646**	**345**	**358**	**703**	**742**	**790**
Underlying investment earnings	140	64	62	126	67	70	136	149	163
Underlying profit	**810**	**367**	**405**	**772**	**412**	**428**	**839**	**891**	**954**
Investment income mkt adjustment	(377)	(51)	44	(7)	(21)	(5)	(26)	(12)	(13)
Core earnings	**433**	**316**	**449**	**765**	**391**	**422**	**813**	**879**	**941**
Other items									
Employee defined benefit schemes	3	0	0	0	0	0			
Fair value of debt and derivatives	(41)	(4)	(1)	(5)	0	0			
Other	70	53	(43)	10	0	0			
Seed fund writedown	(42)	(35)	5	(30)	0	0			
Total other items (after tax)	**(10)**	**14**	**(39)**	**(25)**	**0**	**0**	**0**	**0**	**0**
Reported net profit pre mismatch items	**423**	**330**	**410**	**740**	**391**	**422**	**813**	**879**	**941**
Mismatch items	157	32	(33)	(1)	0	0			
Reported profit	**580**	**362**	**377**	**739**	**391**	**422**	**813**	**879**	**941**
Normalised reported profit pre mismatch	**800**	**381**	**366**	**747**	**412**	**428**	**839**	**891**	**954**
Normalised core profit	**810**	**367**	**405**	**772**	**412**	**428**	**839**	**891**	**954**
Growth in normalised core profit	***-15.6%***			***-4.7%***			***8.7%***	***6.2%***	***7.0%***
Overall performance measures	**FY08A**	**1H09A**	**2H09A**	**FY09A**	**1H10E**	**2H10E**	**FY10E**	**FY11E**	**FY12E**
RoE - operating margins	33.8%	30.8%	32.0%	28.0%	28.6%	27.5%	26.5%	26.5%	26.6%
RoE - investment earnings	-12.0%	1.3%	9.2%	5.2%	3.7%	4.9%	4.2%	4.9%	5.1%
RoE core - total	**21.8%**	**32.1%**	**41.2%**	**33.2%**	**32.4%**	**32.4%**	**30.7%**	**31.4%**	**31.7%**
RoA - operating margins	0.8%	0.8%	0.8%	0.8%	0.8%	0.8%	0.8%	0.8%	0.9%
RoA - investment earnings	-0.2%	0.0%	0.2%	0.1%	0.1%	0.1%	0.1%	0.1%	0.2%
RoA - total	**0.5%**	**0.8%**	**1.1%**	**0.9%**	**0.9%**	**1.0%**	**0.9%**	**1.0%**	**1.0%**

B/sheet (A$m) (AIFRS basis)	**FY08A**	**1H09A**	**2H09A**	**FY09A**	**1H10E**	**2H10E**	**FY10E**	**FY11E**	**FY12E**
Investment assets	80,641	77,738	84,171	84,171	86,271	88,189	88,189	90,603	93,104
Intangibles	180	162	216	216	216	216	216	216	216
Goodwill	759	759	730	730	730	730	730	730	730
Receivables & other assets	5,170	5,964	4,713	4,713	4,741	4,770	4,770	4,806	4,843
Total assets	**86,750**	**84,623**	**89,830**	**89,830**	**91,957**	**93,904**	**93,904**	**96,354**	**98,894**
Borrowings	12,376	12,136	12,350	12,350	12,350	12,350	12,350	12,350	12,350
Policyholder liabilities	68,012	66,702	71,740	71,740	73,473	75,288	75,288	77,563	79,907
Other liabilities & provisions	4,245	3,478	3,106	3,106	3,438	3,479	3,479	3,500	3,520
Total liabilities	**84,633**	**82,316**	**87,196**	**87,196**	**89,261**	**91,117**	**91,117**	**93,413**	**95,778**
Net assets	**2,117**	**2,307**	**2,634**	**2,634**	**2,697**	**2,788**	**2,788**	**2,942**	**3,116**
Share capital	4,481	4,618	4,814	4,814	4,814	4,814	4,814	4,814	4,814
Reserves	(2,598)	(2,584)	(2,563)	(2,563)	(2,563)	(2,563)	(2,563)	(2,563)	(2,563)
Retained earnings	154	214	320	320	383	474	474	628	802
OEI	80	59	63	63	63	63	63	63	63
Total shareholders' funds	**2,117**	**2,307**	**2,634**	**2,634**	**2,697**	**2,788**	**2,788**	**2,942**	**3,116**
Net tangible assets	**1,098**	**1,327**	**1,625**	**1,625**	**1,688**	**1,779**	**1,779**	**1,933**	**2,107**
AuM (A$bn)	**FY08A**	**1H09A**	**2H09A**	**FY09A**	**1H10E**	**2H10E**	**FY10E**	**FY11E**	**FY12E**
By Asset Class									
Equities	36.6	38.6	43.7	43.7	39.2	41.1	41.1	45.3	46.7
Fixed Income	31.6	39.6	31.3	31.3	33.6	35.3	35.3	38.8	40.1
Property	18.1	16.5	15.7	15.7	15.9	16.6	16.6	18.3	18.9
Private Capital	5.6	5.3	6.3	6.3	4.7	4.9	4.9	5.4	5.6
Total	**91.8**	**99.9**	**96.9**	**96.9**	**93.3**	**97.9**	**97.9**	**107.9**	**111.3**
By line of business									
Internal funds	56.5	55.7	62.1	62.1	69.2	77.1	77.1	95.7	118.8
Institutional	35.3	34.2	34.8	34.8	24.1	20.8	20.8	12.2	-7.5
Total	**91.8**	**89.9**	**96.9**	**96.9**	**93.3**	**97.9**	**97.9**	**107.9**	**111.3**

Current valuation summary (A$m)	**Embedded value**	**A$ per share**	**Other/New business**	**Total value**	**A$ per share**
Australian Financial Services	7,702	3.76	4,439	12,141	5.93
AMP Limited Tax Loss Recognition	90	0.04	0	90	0.04
AMP Capital Investors	1,693	0.83	0	1,693	0.83
Corporate capital	712	0.35	0	712	0.35
Holding company costs	(342)	(0.17)	0	(342)	(0.17)
Group debt	(1,189)	(0.58)	0	(1,189)	(0.58)
Total valuation	**8,665**	**4.23**	**4,439**	**13,105**	**6.40**

EV and AV summary (A$m)	**FY08A**	**1H09A**	**2H09A**	**FY09A**	**1H10E**	**2H10E**	**FY10E**	**FY11E**	**FY12E**
EV per share (A$)	4.15	4.30	4.46	4.46	4.51	4.77	4.77	5.06	5.28
AV per share (A$)	6.37	6.21	6.62	6.62	6.72	7.07	7.07	7.52	7.91
Price:EV	1.3	1.2	1.2	1.2	1.2	1.1	1.1	1.0	1.0
Price:AV	0.8	0.9	0.8	0.8	0.8	0.8	0.8	0.7	0.7

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Financial Summary - AMP : continued

Stock information			
Recommendation			Buy / Medium risk
Diluted market cap. (A$m)			10,879
Diluted market cap. (US$m)	USD:AUD	0.877	9,541
Current price (A$ per share)			5.31
Average daily volume (m shares)			8.6
Valuation data			
Citi spot valuation per share			6.40
Price: FY09A NTA at valuation			8.1

Valuation parameters	FY08A	1H09A	2H09A	FY09A	1H10E	2H10E	FY10E	FY11E	FY12E
Based on reported profit after tax									
Basic EPS (¢)	22.4	16.4	20.3	36.7	19.0	20.4	39.3	42.4	45.4
PER (x)	28.6	38.9	31.6	17.4	33.7	31.4	16.3	15.1	14.1
Based on core earnings after tax									
Basic EPS (¢)	22.9	15.7	22.2	37.9	19.0	20.4	39.3	42.4	45.4
PER (x)	23.2	16.9	12.0	14.0	28.0	26.1	13.5	12.5	11.7
Fully diluted EPS (¢)	**22.8**	**15.7**	**22.1**	**37.8**	**18.9**	**20.3**	**39.2**	**42.3**	**45.2**
PER (x)	23.3	17.0	12.0	14.1	28.1	26.2	13.6	12.6	11.7
PE Rel (All Ords.) (x)	1.6	1.2	0.8	1.0	1.9	1.8	0.9	0.9	0.8
EPS growth (%)	-55.9%	7.7%	165.8%	65.6%	20.5%	-8.1%	3.7%	7.9%	7.0%
Dividend data									
DPS (¢)	40.0	14.0	16.0	30.0	16.0	18.0	34.0	36.0	38.0
DPS growth (%)	-13.0%	-41.7%	0.0%	-25.0%	14.3%	12.5%	13.3%	5.9%	5.6%
Yield (%)	7.5%	3.0%	2.6%	5.6%	3.0%	3.0%	6.4%	6.8%	7.2%
Payout ratio (%)	175.4%	89.4%	72.4%	79.4%	84.8%	88.7%	86.8%	85.2%	84.0%
Underlying payout ratio (%)	98.4%	76.8%	80.9%	79.6%	80.6%	87.2%	84.0%	83.7%	82.6%
Franking (%)	85.0%	50.0%	50.0%	50.0%	60.0%	70.0%	65.3%	70.0%	75.0%
Capital return paid May/June (¢ps)									
Book value/NTA									
Book value per share (A$)	1.02	1.12	1.25	1.25	1.27	1.31	1.31	1.39	1.47
NTA per share (A$)	0.55	0.66	0.79	0.79	0.81	0.86	0.86	0.93	1.02
Price to book/NTA									
Price to book (x)	5.2	4.8	4.2	4.2	4.2	4.0	4.0	3.8	3.6
Price to NTA (x)	9.6	8.1	6.7	6.7	6.5	6.2	6.2	5.7	5.2
Price to diluted NTA (x)	9.6	8.1	6.7	6.7	6.5	6.2	6.2	5.7	5.2

Index weightings		Credit ratings (S&P)
All Ordinaries	0.9%	AMP Group A
S&P/ASX 200	1.0%	AMP Life AA-
Insurance	20.7%	AMP Bank A (guaranteed by AMP group)

Shareholder information as at 20 May 2010	
Capital Group Companies	6.8%
Commonwealth Bank Group	5.7%

Source: Company reports and Citi estimates

Capital structure	FY08A	1H09A	2H09A	FY09A	1H10E	2H10E	FY10E	FY11E	FY12E
No. shares on issue (m)									
B/f no. of shares	**1874.9**	**1992.9**	**2013.7**	**1992.9**	**2048.7**	**2072.0**	**2048.7**	**2072.0**	**2072.0**
- issues under DRP	18.3	20.8	34.9	55.8	23.3	14.7	38.0	29.9	28.7
- other	99.7	0.0	0.0	0.0	0.0	-14.7	-14.7	-29.9	-28.7
C/f no. of shares	**1992.9**	**2013.7**	**2048.7**	**2048.7**	**2072.0**	**2072.0**	**2072.0**	**2072.0**	**2072.0**
Options	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Diluted shares on issue	**1992.9**	**2013.7**	**2048.7**	**2048.7**	**2072.0**	**2072.0**	**2072.0**	**2072.0**	**2072.0**
Weighted ave. basic	1,890	2,008	2,024	2,016	2,060	2,072	2,066	2,072	2,072
Weighted ave. diluted	1,899	2,018	2,033	2,025	2,069	2,081	2,075	2,081	2,081

Net inflows	FY08A	1H09A	2H09A	FY09A
Australia				
Retail (A$m)	1,202	737	746	1483
Growth in retail (%)	-65%	70%	1%	23%
Corporate Super (A$m)	1,134	616	528	1144
Growth in corporate (%)	30%	-9%	-14%	1%
Mature	-1,036	-576	-625	-1201
Growth in mature (%)	-28%	-60%	9%	16%
New Zealand net (A$m)	126	88	147	235
Growth in net NZ	152%	29%	67%	87%
Value of new business				
AMPFS VNB (A$m) - 4%dm	318	124	168	292
Growth in AMPFS NBV (%)	-9%	-26%	35%	-8%

Persistency	FY08A	1H09A	2H09A	FY09A
AMP Financial Services	90.3%	90.3%	90.1%	90.1%

Investments	FY08A	1H09A	2H09A	FY09A	1H10E	2H10E	FY10E	FY11E	FY12E
Allocation of investments backing tangible shareholder capital									
Australia & NZ									
- income	65.0%	72.9%	71.5%	71.5%	71.5%	71.5%	71.5%	71.5%	71.5%
- growth	18.6%	15.5%	17.1%	17.1%	17.1%	17.1%	17.1%	17.1%	17.1%
- other	16.3%	11.7%	11.4%	11.4%	11.4%	11.4%	11.4%	11.4%	11.4%
TOTAL	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Corporate Gearing (ex op debt)	FY08A	1H09A	2H09A	FY09A	1H10E	2H10E	FY10E	FY11E	FY12E
Debt/ equity	74%	62%	46%	46%	45%	44%	44%	41%	39%
Debt/(debt+equity)	42%	38%	32%	32%	31%	30%	30%	29%	28%

Source: Company Reports and Citi Investment Research and Analysis.

AMP Ltd

Company description

AMP consists of AMP Financial Services (AFS), AMP Capital Investors (AMPCI) and its Group Office. AFS manufacturers and distributes wealth management products in Australia and New Zealand, primarily through self-employed financial planners and advisers. AMPCI is AMP's investment and property manager.

Investment strategy

We rate AMP Buy/Medium Risk (1M). AMP offers many attractions including a hard to replicate business model and desirable brand, a low-cost producer in an industry with a favourable long-term growth profile and high RoE. Despite uncertain market conditions and elevated regulatory risks, at current levels we believe the stock represents attractive value. If the takeover of AXA's Australia and New Zealand businesses is successful without a significant increase in the offer price, further upside is possible.

Valuation

We set our 12-month A$6.50 target price for the stock slightly above our adjusted FY09 cross-cycle valuation of A$6.40 as we allow for some rollforward of our spot valuation. Our cross-cycle valuation includes AMP's Australian business, AFS, at a traditional appraisal value, which we have adjusted to reflect current regulatory risks. This uses 14.8x the value of one year's new business. We value AMP Capital Investors at a multiple of 14x prospective earnings. We PV the Cobalt/Gordian tax benefits to 2015 at 11.5% and deduct 9x recurring head office costs and debt at face value and add corporate capital adjusted for market movements to date. We have also used a P/E methodology to review our target price valuation.

Risks

We rate AMP Medium Risk referencing a number of quantitative and fundamental factors.

We see the main upside risk to our target price as a strong rally in the equity market, AMP generating improvements in net flows and possible takeover interest in the stock, plus favourable benefits from changes to regulations in excess of our estimates.

Downside risks to our target price exist from adverse regulatory changes, falls in the equity market, disappointment against market expectations for dividends, future sales, outlook statements, valuation growth, planner departures, higher lapse rates; or sales increases, cost reductions or lapse rate reductions being less than the assumptions underlying our target price and pandemic outbreaks. Possible regulatory changes restricting the fees AMP charges could be an outcome resulting from the government adopting certain recommendations from recent regulatory reviews.

Notes

Notes

Appendix A-1

Analyst Certification

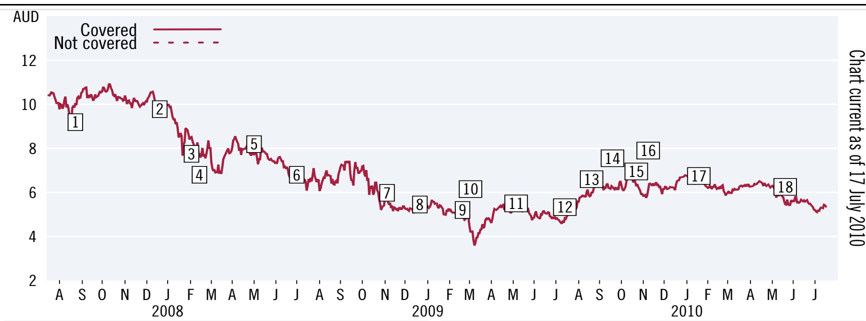
The research analyst(s) primarily responsible for the preparation and content of all or any identified portion of this research report hereby certifies that, with respect to each issuer or security or any identified portion of the report with respect to an issuer or security that the research analyst covers in this research report, all of the views expressed in this research report accurately reflect their personal views about those issuer(s) or securities. The research analyst(s) also certify that no part of their compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this research report.

IMPORTANT DISCLOSURES

AMP Ltd (AMP.AX)

Ratings and Target Price History
Fundamental Research

Analyst: Nigel Pittaway



	Date	Rating	Target Price	Closing Price
1	23-Aug-07	2M	*10.80	10.05
2	20-Dec-07	2M	*10.50	9.79
3	4-Feb-08	2M	*8.40	8.52
4	14-Feb-08	2M	*7.50	7.75
5	1-May-08	*3M	*7.00	7.69
6	1-Jul-08	3M	*6.00	6.51
7	5-Nov-08	*2M	6.00	5.89
8	22-Dec-08	2M	*5.50	5.37
9	19-Feb-09	2M	*5.30	5.05
10	3-Mar-09	2M	*4.40	4.19
11	6-May-09	*3M	*4.90	5.49
12	14-Jul-09	*2M	*4.80	4.83
13	20-Aug-09	2M	*6.20	6.02
14	18-Sep-09	2M	*6.60	6.25
15	22-Oct-09	2M	*6.75	6.28
16	9-Nov-09	*1M	6.75	6.12
17	19-Jan-10	*2M	*7.00	6.50
18	20-May-10	*1M	*6.50	5.46

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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