BondAdviser

Research Report

Report Created on 16 December 2019

Issuer Name
AMP Limited

Security Name
AMP Capital Notes 2

Security Recommendation
Subscribe

Security Risk
High

Issuer Outlook

Improving | **Stable** | Deteriorating

Key Characteristics

Product Type	Capital Note	**Last Price**	$100.00
Outstanding Amount	$200,000,000.00	**Accrued**	$0.00
Par Value	$100.00	**Capital Price**	$100.00
Fixed/Floating	Floating	**Running Yield**	5.39%
Payment Frequency	Quarterly	**Yield to Maturity**	5.56%
Current Distribution	5.39%	**Trading Margin**	4.50%
Issue Margin / Coupon	4.50%	**Optional Call Date**	16 December 2025
Franking Credits Incl.	Yes	**Legal Final Maturity**	16 December 2027
ASX Listed	Yes (ASX Code: AMPPB)	**Next Ex-Date**	5 March 2020
Convertible	Yes	**Next Payment Date**	16 March 2020
GICS Sector	Insurance	**Next Cash Distribution**	$0.87

*Subject to change, expected to be $200 million, with the ability to raise more or less. **Based on issue margin range of 4.50 - 4.70% plus 90-Day BBSW of 0.8942%. ***Based on issue margin range, an interpolated swap rate to call of 1.0074% and an expected call date of 16 December 2025. All pricing as of close 22 November 2019.

Summary

On 26 November 2019 AMP Limited (AMP) launched AMP Capital Notes 2 (ASX Code: AMPPB), seeking to raise $200 million, with the ability to raise more or less. Proceeds will be used to meet general funding requirements, including to fund Additional Tier 1 Capital of one or more regulated entities within the AMP Group. AMP is the non-operating holding company (NOHC) of all companies within the AMP Group but is a subordinated creditor to its operating subsidiaries, hence AMP is arguably a higher risk issuer than its subsidiaries.

The Capital Notes are structured as perpetual, unsecured, convertible, transferable, redeemable and subordinated notes. Distributions will be discretionary, franked (generally expected to be 100%), floating rate, non-cumulative and subject to payment conditions. The interest margin is guided at 4.50 – 4.70% p.a. above 90-Day BBSW and paid on a quarterly basis in arrears. This security has no fixed maturity date but is scheduled for mandatory conversion into AMP ordinary shares on 16 December 2027, subject to conversion conditions being satisfied. AMP also has the right (but not the obligation) to convert, redeem or resell (subject to APRA approval) the Notes on the optional exchange date (16 December 2025).

As this security meets the new capital instrument eligibility criteria under Basel III it also contains loss absorbing terms and conditions known in the documentation as a Non-Viability Event. Upon the occurrence of this event, this security may be converted into ordinary shares without the protection of conversion conditions.

For the purposes of exchange calculation, the maximum conversion number is set based on Issue Date VWAP (TBC). If conversion cannot occur for any reason the notes will be written off and all holders rights terminated.

Figure 1: Capital Structure[1]

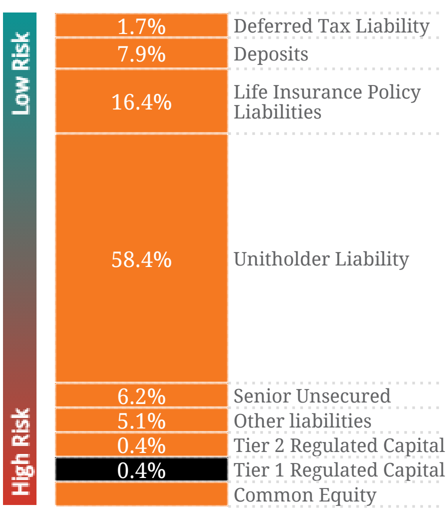
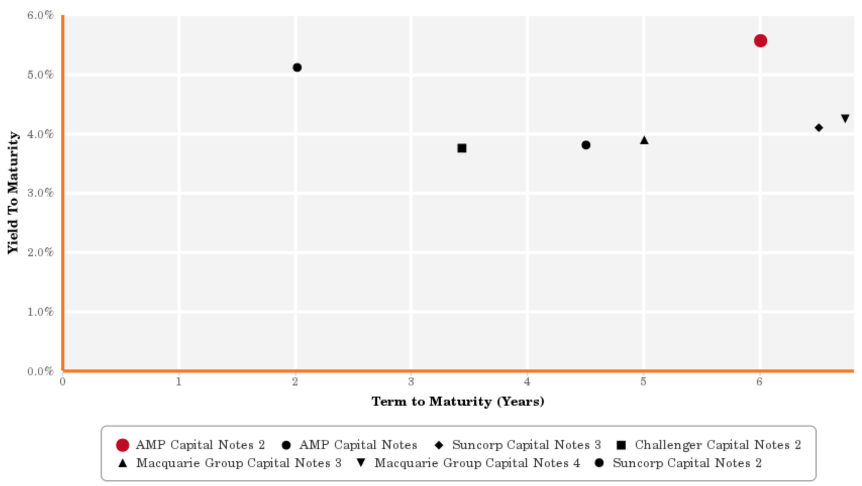


Figure 2: Relative Value



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Security Recommendation - Subscribe *as at 25 November 2019*

BondAdviser recommends investors **Subscribe** to this security

AMP has had a varied few years prior to the launch of AMPPB in November 2019. Its previous debt and hybrid securities had performed well up to early 2018. However, following market selloffs coupled with increasingly poor news throughout 2018 and 2019 of the Group's 'fee-for-no-advice' and regulatory misrepresentations, margins on its AMPPA instrument sold off to levels of 4.50%, retraced, and then went higher still to 5.00% at the end of 2018 and briefly approached the same in August 2019.

We viewed the above as being predominantly headline selling. In February 2019, after the release of the Royal Commission and calmer markets, spreads have rallied reasonably well on AMPPA.

The August Half Year results in 2019 (1H19) showed a new path to the sale of AMP Life and also a large capital raising. Although the sale is probably neutral overall, we view the capital raising positively and particularly so given it will be progressively expended transforming the bank. This is important for credit investors since equity capital has been raised significantly and will not be spent immediately – i.e. cash outflows can be curtailed or ceased.

We believe that material risks to the Group are now in sight and either fully provisioned for or managed well. There is a high degree of execution risk to AMP's turnaround plans but on a tenor basis, we believe that these securities offer very good risk-adjusted returns to certain investors. This conclusion is especially relevant given the significant spread compression that has occurred to major bank hybrids post the election.

Risk of events such as a non-viability event triggering conversion (or write off) are common across 'new style' Tier 1 securities, but we consider the probability of such an event for AMP to be remote given its high asset quality and deposit base in the current macroeconomic environment. Investors should note these terms make the return profile asymmetric (potential for total loss of capital but limited upside), as a result in all likelihood its performance will have a higher correlation to equities than a traditional fixed income instrument during a period of stress. The most likely scenario leading to a breach of these triggers would be either (or a combination of) a significant and sharp deterioration in the asset quality of residential mortgages (which would affect all banks), pervasive outflows from its Wealth Management or AMP Capital arms or a failure of risk management within an institution that would lead to significant losses. On top of these, there remains the risk of unforeseen 'shocks' caused by legal, compliance, regulatory or litigation risks. If a Non-Viability Event is triggered, it is likely to cause a significant capital loss on the security.

Our valuation assumptions for this security are based on it being redeemed (in full) on the first optional call date (16 December 2025 or ~6.0 years) and all interest payments being made in a timely manner. If this security is not called on this date (extension risk), the price of the security may drop significantly. We recognise the risks of a Non-Viability Event triggering conversion (or write-off), but we consider the probability of such an event to be remote.

We additionally note the presence of a contractual risk within these securities which requires Shareholder Approval for possible future conversion into AMP Shares. This applies at the Optional Exchange Date and on the Mandatory Conversion Date (16 December 2027), but we currently do not believe it will make a practical difference to the above assumption of redemption on 16 December 2025.

We had previously and recently recommended both the listed AMPPA securities and AMP's Wholesale Capital Notes to investors and both have performed well.

Overall, we believe AMP will evolve into a stronger business over the longer term and the offered margin current valuations tilt us to recommend investors **Subscribe** to this security.

Positive / Negative Risk Factors

What factors would change the Recommendation UP

- Despite short-term obstacles ahead, in the long-term, AMP should benefit from the changing demographics and significant forecasted growth within the superannuation sector.
- Its investments into China Life AMP Asset Management Company and China Life Pension Company are performing well and generating high Asset Under Management (AUM) growth and associated fee growth. Provided China's economy continues without significant setbacks, this provides AMP with valuable diversifying revenue streams.
- The Productivity Commission's report regarding competition in the Australian financial system may provide tailwinds to smaller banks, including the Group's banking subsidiary.
- The Group exhibits robust capitalisation levels which will provide a backstop to elevated compliance costs and any short-term adverse fluctuations in earnings.
- AMP's sale of its Wealth Protection and Mature businesses in late 2018 was mildly positive for credit since it frees up capital from intensive units but does of course remove diversifying revenue streams. We note that these businesses contribution to Group profits are low and often contained unexpected shocks.
- Management has recently undertaken several capital management initiatives that we view as creditor friendly, including a fully underwritten $650 million equity capital raising, $134 million share purchase plan and a temporary halt in dividend payments with the Group holding $1.7 billion in surplus capital above minimum regulatory requirements. We view management's commitment to maintaining an unquestionably strong financial position as a credit positive.

What factors would change the Recommendation DOWN

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- From a structural perspective, obligations of AMP Limited (including AMP Capital Notes) rank behind obligations of its subsidiaries (i.e. AMP Life [noting its planned divestment], AMP Bank & National Mutual) and APRA has the ability to prevent the upstreaming of capital from the regulated entities to the Non-Operating Holding Company (NOHC). This effectively means AMP must rely on APRA-approved dividends (or capital distributions) from its operating subsidiaries in order to service its obligations (including AMP Capital Notes). Therefore, the primary risk to these notes is AMP's ability to manage its capital, liquidity and operating risks over and above the minimum requirements set out by APRA across its regulated subsidiaries. Our view on each subsidiary is different but the capital intensity of the Life subsidiaries drives the viability of AMP Limited.

- Distributions on this security are discretionary, non-cumulative and subject to Payment Conditions. The primary risk here is that the minimum prescribed capital amount (PCA) required by APRA is likely to increase with changes to regulation. This means that if AMP is unable to maintain the PCA ratio above the minimum requirements, distribution payments may not be able to be made.

- Following the damning revelations of the Royal Commission, AMP has had its brand tarnished with regulators now closely monitoring the Group's every move. The final report of the Commission (February 2019) was not as adverse as could have been possible and stopped short of damaging structural changes. It is almost inevitable that AMP will face elevated compliance costs in the near to medium term as it continues to repair itself. Although there are many distractions on the horizon, ultimately, we believe AMP will re-emerge as a much stronger business in the long-term, buoyed by strong industry fundamentals.

- The reversion of the Future of Financial Advice (FOFA) rules will have a negative impact on AMP due to an increased administration burden on existing advisers, which may decrease the number of advisors available to generate revenues.

- ASIC has increased its surveillance of the advice sector and new advisers must be appropriately qualified. AMP has implemented a policy where new advisers must complete a minimum industry standard qualification within five years of joining an AMP Group licensee while existing advisers have up to 31 December 2019 to do so. This affects approximately 65% of its advisers who currently do not meet planned educational standards. Should these advisers not meet new standards or retire, a valuable revenue stream for AMP will likely be lost.

- The pending sale of AMP's prudentially regulated life business, AMP Life, will have a detrimental impact on the Group's financial and credit profile's as it loses a stable, recurring and diversifying stream of revenue that comprised a significant portion of AMP's earnings. This will be partially offset by the 20% interest retained by AMP upon successful completion of the sale. AMP will have the right, but not the obligation, to subscribe for additional capital in the future to maintain this holding, which we view reasonably favourably from a credit perspective.

- Conditional on a successful divestment of AMP Life, AMP Capital is exposed to a significant loss of funds under management (FUM) that it currently manages through separate investment management agreements with AMP Life and AMP's superannuation trustees. There is a risk that either or both entities partially or fully withdraw FUM or revise these agreements on less favourable terms following the divestment, which may adversely impact AMP Group's performance and/or financial position.

- AMP is commencing (late 2019) a comprehensive business turnaround strategy. Given AMP's variable history of attempted turnarounds, the Group is subject to a substantial level of execution risk, which, if not successful, may quickly lead to a loss of support from internal and external stakeholders, diminishing the Group's ability to access capital markets.

Issuer Outlook - Stable *as at 25 November 2019*

Earnings

Extending beyond a very tumultuous 2018 (FY18), AMP reported a 'challenging' first half for 2019 (1H19) which was headlined by a total of $2.35 billion (post-tax) of impairments for the Group. A statutory loss of $2.3 billion contrasted with an underlying profit of $309 million. This was an improvement on 2H18's profit of $185 million, but which included a $102 million loss for AMP Life. Compared to the cleaner 1H18 result of $495 million, this was a reduction of 38%.

Barely a couple of weeks ago, AMP announced that it had aborted the sale of AMP Life to Resolution Life after New Zealand regulatory hurdles could not be overcome. On results day, the Group proudly announced that this will now proceed at a higher price and via an Australian domiciled Non-Operating Holding Company controlled by Resolution Life and which AMP will hold a 20% equity stake. AMP will receive $2.5 billion in cash with the equity value implied at $500 million. The agreed sale has had some mild negative outcomes for most divisions as earnings from 1 July 2018 will be transferred.

Positively, the client remediation program remains in line with the earlier estimate of $778 million and increases to provisions were minimal in this half. We are comforted that ASIC have agreed the program's scope and remediation policies and also that it is subject to external audit review every six months. AMP expects the program to scale and accelerate its spend against the provision through to completion in 2021.

The bulk of the $2.35 billion impairments relate to goodwill write-downs in Australian Wealth Management ($1.5 billion) and AMP Life ($459 million) to reflect the overall reduction in value of wealth management from significant industry disruption and AMP's actions to reshape its advice network. The AMP Life impairment is a direct consequence of the Protecting Your Super legislation on its mature book. Additional impairments were recorded against prior capitalised project costs ($211 million) and advice related assets ($173 million).

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Cost control was poor for the twelve-month period since 1H18 with a controllable cost base of $427 million increasing to $501 million and which was dominated by increased regulatory, compliance and insurance costs.

AMP had earlier announced that it has scrapped the 1H19 dividend and will maintain a consistent approach to capital management until the AMP Life sale is completed.

On a divisional basis:

- Australian Wealth Management saw a 50% decline in operating earnings to $103 million with a six basis point margin compression caused by MySuper fee reductions, some AMP Life earnings transfers and higher controllable costs incurred. Assets Under Management (AUM) ended 8% points higher and was due to higher investment markets as large net cash outflows continued ($3.1 billion at 1H19) but which in some positive, were stable on the prior period. AMP expects a subdued performance for the wealth management segment for the next three years.

- New Zealand Wealth Management was also down, albeit by a lesser proportion (21%) and which added just $22 million to the Group's earnings. Excluding AMP Life transfers, the result was steady, and we further note that the NZ arm is not experiencing outflows in such a magnitude as the Australian unit, but they are occurring ($250 million).

- AMP Capital was the only division to record operating earnings growth with $120 million reported for the first half – a gain of 28%. This though included a few one-off profits from REIT sales in the period. Positively, the unit received net cash inflows of $818 million and it retains $5.1 billion of funds raised but not committed whilst its committed transactions stand at $2.0 billion. Controllable costs were also up 10% but it is continuing to target a cost to income ratio of 60 to 65% amid ongoing growth.

- AMP Bank's earnings declined by a relatively small 9% to $71 million in the period and which was impacted by higher regulatory and compliance costs. The bank did grow its loan book and strongly grew its deposit book (9%) as it continues to progress to being a more deposit-funded bank. AMP Bank remains very well capitalised with a CET1 ratio of 11.1% and it is peer leading from a cost to income perspective (35%). Net interest margins improved to 1.70% (+3 basis points) but are still a little behind levels a year ago.

- AMP Life was understandably the worst performer with operating earnings of $31 million being 69% down on 1H18. This was mostly due to the impact from Protecting Your Super legislation as well as higher income protection and TPD claims.

Capital Management

Fundamentally, AMP remains well capitalised with a Level 3 excess capital above minimum regulatory requirements (MRR) of $1.7 billion as at 30 June 2019. This was up from $1.65 billion at the end of FY18 and remains in line with the board's target surplus requirements.

Post the sale of AMP Life in conjunction with the capital raising announcement, the pro forma MRR is expected to be $2.6 billion with a large reduction once AMP Life is no longer a part of the Group.

The capital raise includes a fully underwritten $650 million Institutional Placement together with a non-underwritten Share Purchase Plan, which we assume will be moderately taken up.

Current plans for this excess capital are that it will be used to fund the delivery of the new AMP strategy. Further to this, AMP will assess all options for capital management with a stated intent of returning excess to shareholders. We are comfortable with this position from a credit perspective because it should mean a slow decline in the excess capital position as the transformation progresses. This retention of capital means that should materially adverse conditions occur, it is still within the Group to act as a loss-absorber, should this be required (not a base case).

As noted, AMP has scrapped its 1H19 dividend which is perfectly fine from a credit perspective. The Board intends to target a 40-60% net profit (not underlying) dividend payout ratio, which similarly is sound from a credit investors' perspective.

Funding and Liquidity

AMP has traditionally operated with a low gearing target even relative to the credit ratings agency thresholds. Nonetheless, corporate gearing ticked up by an additional 6% to 23% having increased from 17% at the year-end and 13% a year ago. Again, this was mostly due to core equity declines rather than debt levels, which remained stable over the prior six months.

Interest coverage ratios also declined during 1H19 and which ended at 8.0x on an underlying basis versus 11.0x at FY18. Previous on an actual basis, coverage levels were 1.4x, but are not applicable given the magnitude of the statutory loss.

There has been no significant Tier 1 or Tier 2 treasury actions from AMP in this half but we note that its MTN programme has, whilst retaining around $3 billion of debt, substantially shifted this to Group debt as opposed to Bank debt. We assume this is because of the tilting towards a higher deposit mix for the Bank.

AMP maintains ample liquidity, comprised of $307 million in cash and undrawn facilities of $1 billion. It repaid a syndicated loan ($500 million) during the period. AMP's debt maturity profile should present no problems in refinancing either with

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$500 million due in less than a year and nothing after this until at least two years hence.

Although AMP does not disclose the overall asset allocation mix of AMP shareholder funds ($3.8 billion and stable from FY18), only around 5% was invested in equities. It is likely the remainder is primarily invested in fixed interest investments and for which AMP discloses this specific allocation to be 25% invested in government exposures and 75% in corporate exposures. This split has been very static over recent periods and it is again reassuring to see that the Group is not increasing risky exposures to boost returns.

Outlook

We had described 2018 as being 'transformative' for AMP with a new Chairman and CEO appointed to navigate the problems experienced. 2019 and beyond are arguably shaping up to be even more transformative to the Group.

The 'surprise' agreed sale of AMP Life is in our view and on balance, a credit neutral. The Group is losing some earnings diversification and which ratings agencies are primed to downgrade on once it completes. Countering this is the announced capital raise, which we assume will deliver north of $800 million to the Group to preferentially fund its planned transformation.

The new CEO has outlaid his vision, which is Board-endorsed and that is essentially fourfold:

- Divest AMP Life
- Reinvent wealth management in Australia
- Grow AMP Capital
- Transform AMP to be client-led, entrepreneurial and accountable

These are lofty aims and we additionally note the future of New Zealand wealth management will be evaluated with an exit, in our view, likely more than not.

The strategy will incur a 'focused and disciplined' $1.0 - $1.3 billion program investing in growth, cost improvement and to tackle legacy issues by de-risking the business.

A fair proportion of the 1H19 analyst call was spent going over the plan and we were impressed with the CEO's presentation, commitment and drive for it to succeed. However, there are significant and multiple hurdles to achieve this over the stated timeframe which presents a very high execution risk. This risk will be borne by equity holders more than credit investors and we reiterate that we view it as a positive that cash will be expended progressively – if the plan is clearly not working, it is reasonable to conclude that it will cease or be curtailed – positive for credit.

Lastly, we fundamentally believe that AMP has put its worst behind it and can proceed with its ambitions without fear of significantly larger, externally-induced shocks, which was not the case for the past two periods.

Subsequent Events:

- AMP swiftly concluded the institutional element of its capital raise by announcing on 9 August 2019 that it had raised $650.0 million via the Placement. It followed this on 10 September by confirming that $134.1 million had been raised under the Share Purchase Plan. A negative from the latter is that only 2.1% of over 710,000 eligible shareholders submitted valid applications with an average application worth $10,000. This indicates to us that the vast majority of the available pool of equity shareholders were not willing to further invest significant amounts of capital into AMP given its travails at the time. An extension to this is that should there be any further adverse impacts to AMP, which requires additional external capital, then this reaction can reasonably be expected to reoccur or even worsen. This may become a problem for AMP's credit investors but we do note that the larger institutional shareholder base has been, and is in general, much more supportive to management and equity capital raisings.
- On 27 August 2019, following the revised sale agreement for AMP Life, announced as part of the 1H20 results, Standard & Poors lowered its ratings of AMP Limited and AMP Bank Limited by one notch to BBB+. This was not unexpected given prior comments and expectations. Should the sale not be completed however, there may not be an automatic re-rating upwards.
- On 10 October 2019 AMP announced it was merging its banking and wealth management units, to be called AMP Australia. This presents another (albeit lower), execution risk to AMP.
- On 24 October 2019, AMP announced another poor quarterly Assets Under Management (AUM) and cashflows update. Australian Wealth Management saw additional cash outflows and which for 3Q19 were a net $1.9 billion. The unit's AUM increased marginally to $133.2 billion, we assume mostly on high investment returns. Positively, the well-respected AMP Capital unit increased its AUM to $202.2 billion and signalled further strong growth in 4Q19.

Next Event: AMP Limited Full Year results (2019) to be published in February 2020.

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Figure 3: Credit Curve (Comparable Securities)

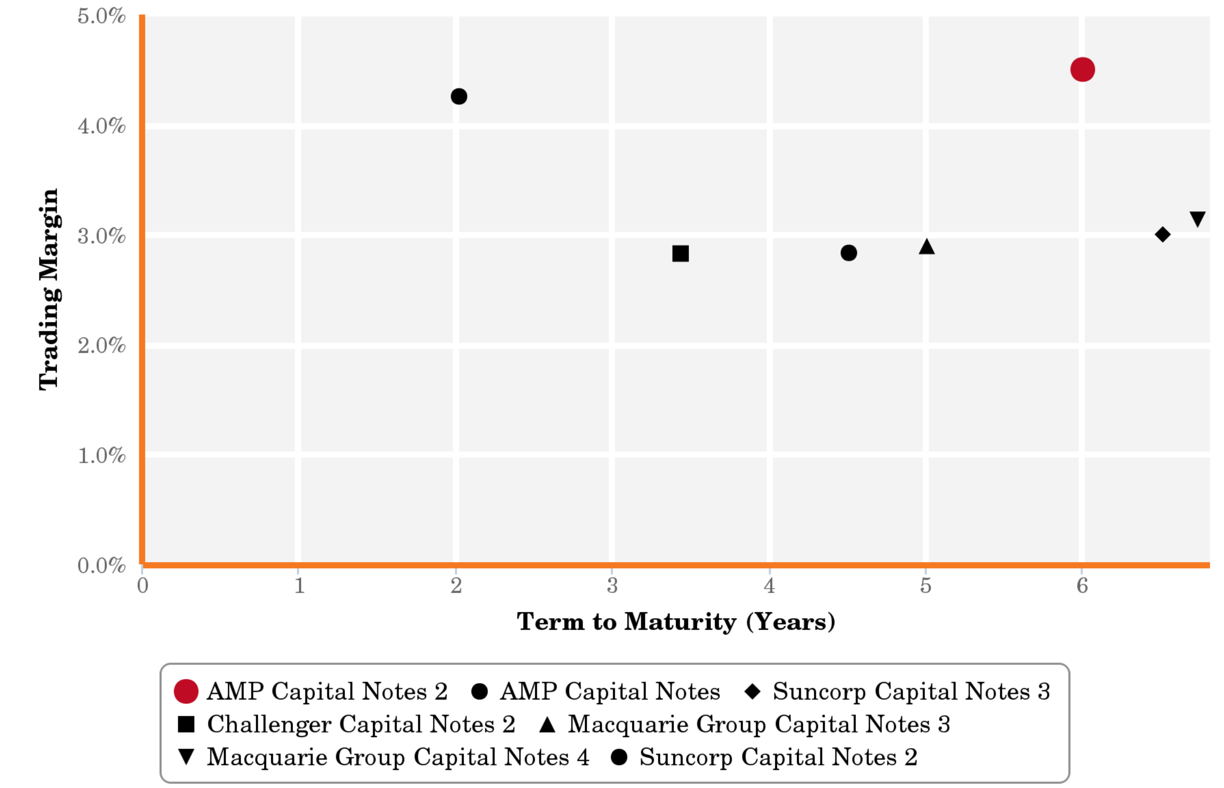
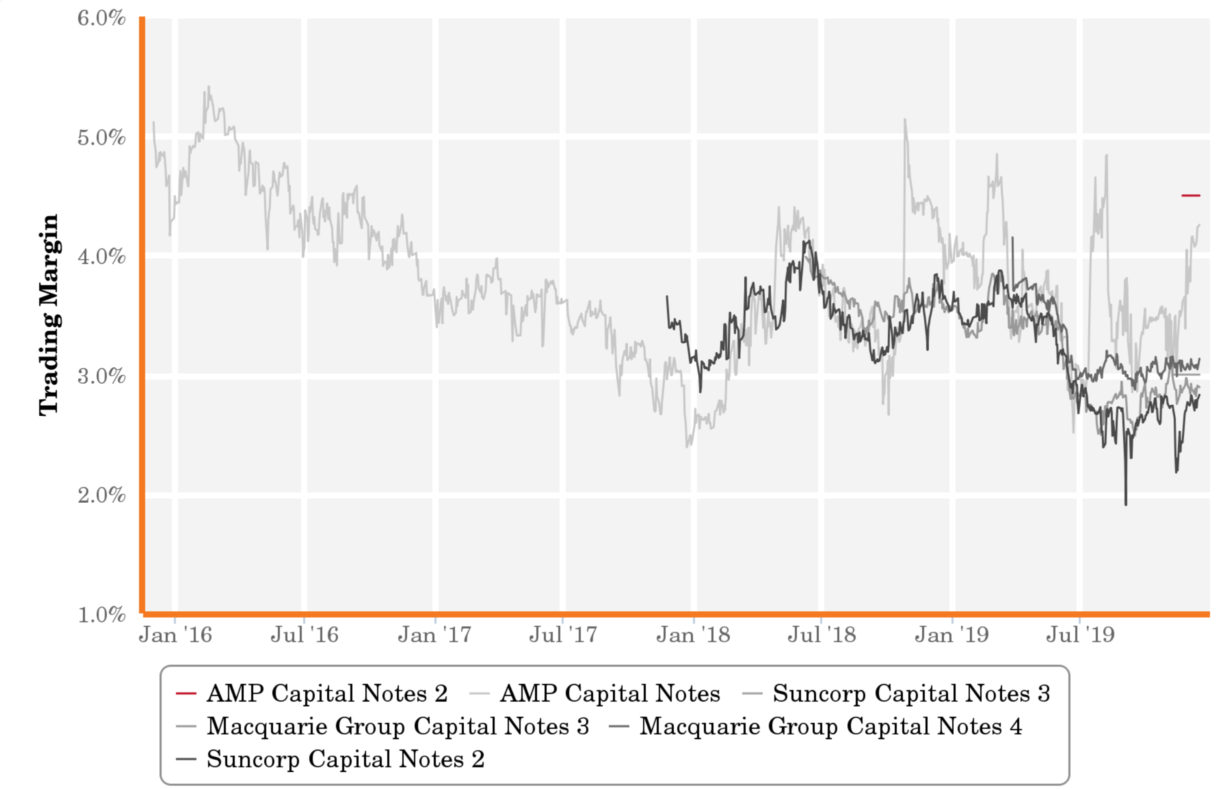


Figure 4: Historical Trading Margins of Comparable Securities



[1] The balance sheet structure diagram represents a measure of liabilities and capital in order of seniority of the overall cash balance sheet.

Source: BondAdviser

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Hybrid Commentary

Since 2014, non-major banks have significantly increased their hybrid issuance in line with the regulatory framework that governs the Australia banking system (Figure 5). Excluding this proposed issue (ASX Code: AMPPB), AMP has only issued a single ASX-listed tier one security, AMP Capital Notes (ASX: AMPPA) in 2015, which raised almost $270 million. In the same year, AMP also issued $275 million of Capital Notes to wholesale investors but for a shorter tenor (5 years), and which we assume the issuance of AMPPB will, in part, prefund the redemption of in March 2020.

Absent any major changes in the regulatory environment or Group strategy, following the issuance of AMPPB, we expect AMP to next return to the market in early 2021 for a similarly sized issuance ahead of the likely redemption of AMPPA. However, given the wholesale changes made by the Group in the wake of the royal commission, including drastically reducing its financial advice base and divesting the majority of its stake in AMP life, this is by no means certain.

Given limited past issuance in the AT1 market, AMP currently boasts a reasonably well-spaced maturity profile with AMP Wholesale Capital Notes due to maturity in March 2020, followed by AMPPA in December 2021. Accordingly, we expect flows to partially stem from wholesale investors as well as new entrants from the listed retail market. An attractive margin (assumed 4.50%) should present substantial investor support and as AMP progresses its transformation, a narrowing of this trading margin through time.

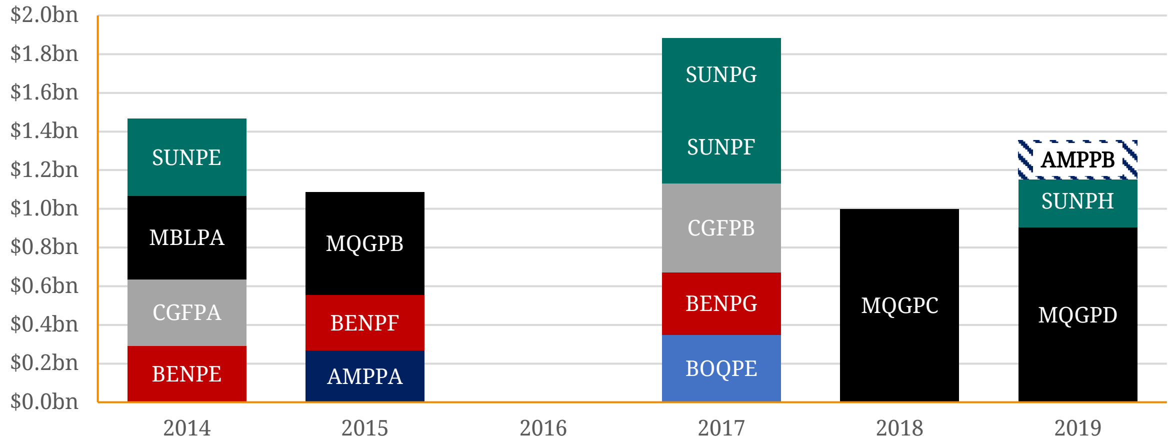
Furthermore, recent hybrid deals (Macquarie Group's Capital Notes 4 (MQGPD), CBA's PERLS XII (CBAPI) and Suncorp Capital Notes 3 (SUNPH)) received a very high level of demand, seeing the intended offer size reached quickly. We additionally note that these were non-refinancing deals – reinforcing the demand element to current pricing levels. We expect spreads to be further aided in the near- to medium-term by low global and local interest rate settings which are predicted to remain subdued and could even trend lower. There also remains the possibility of some form of quantitative easing being initiated by the Reserve Bank of Australia (RBA).

In late October 2019, Standard & Poor's upgrade of major bank hybrids to an investment-grade rating (BBB-) should also have a positive, ongoing, second-order effect on non-major hybrid spreads, in sympathy.

Lastly, APRA's Loss Absorbing Capital (LAC) proposals of mid-2019 should strongly aid all credit instruments within Australia, including AT1 issues of entities not yet directly affected by the likely changes.

However, we do note potential risks of a widening in spreads from an issuance surge in non-refinancing motivated, new-money trades following an encouraging investor response to the latest deal (PERLS XII). Whilst we cannot opine on other issuer's capital intentions, we believe this risk to be lower than that of the major banks with ~$1 billion in upcoming refinancing maturities from non-major banks in 2020 and 2021 (Figure 6). We do not believe this completely eliminates this risk however, and caution investors to be wary of major banks opportunistically increasing their capital buffers through the issuance of long-dated deals which would qualify for APRA's 2024 LAC start date. We note also Westpac's decision in November 2019 to raise up to $2.5 billion of ordinary equity (CET1), which reduces the risk somewhat of this bank specifically taking additional actions to increase its Additional Tier 1 (AT1) capital as well in the near future.

Figure 5. Non-Major Bank ASX-Listed Hybrid Issuance



Source: BondAdviser

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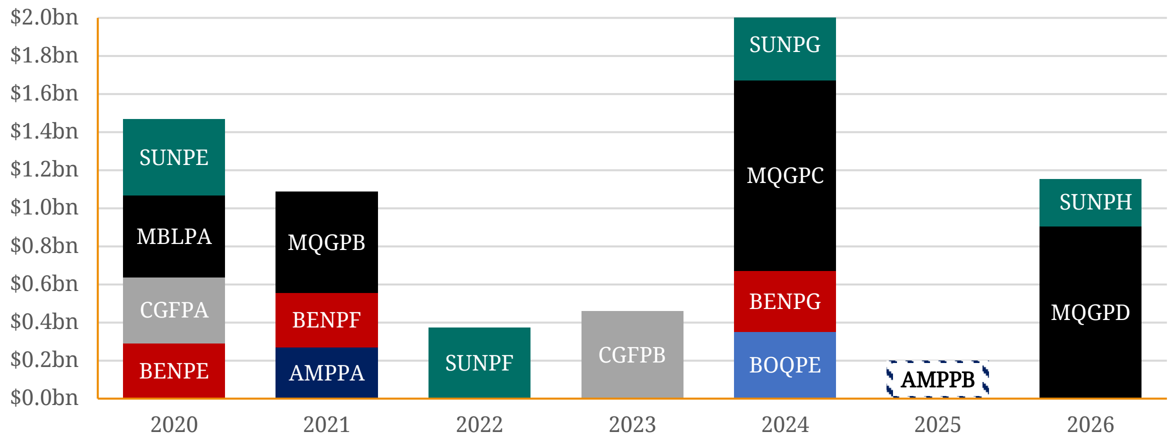
Figure 6. Non-Major Bank ASX-Listed Hybrid Maturity Profile



Source: BondAdviser

Contrastingly, given APRA's ongoing focus on the merits of CET1 capital, we reasonably expect a degree of all peers' capital accumulation to come from retained earnings together with new net issuance of Tier 2 and AT1 capital instruments. This may be to the eventual detriment of ordinary shareholders (lower dividends perhaps) but should be very supportive to issuer credit profiles, and hence, trading margins.

Whether the Tier 2 marketplace (local and global) has been sated is an interesting point related to APRA's LAC proposals – if it has, then expect more AT1 issuance, if not (our base case), then expect more Tier 2 issuance and perhaps even a return of this instrument to the local listed (retail) market. Either way, it is quite clear that Australian banks will have to undertake large issuances to fill the APRA requirement by 2024 (and which could go higher still). Thus, we expect all banks (both regional and majors) to regularly issue longer-dated Tier 2 paper into local and global institutional marketplaces through to 2024 (and beyond) but would not discount the possibility of additional local retail AT1 or Tier 2 issuances in the near-to medium-term, increasing supply.

Prior to the Royal Commission hearings in mid-2018, AMP's AT1 securities (retail and wholesale) delivered robust yield compression (~200bps over two years). Sharp widening occurred in April 2018 when it was first revealed that AMP had charged clients for unprovided financial advice and misled ASIC on numerous occasions. Following the federal election in May 2019, AMP's margins have broadly tightened. This was driven by (i) the certainty provided to the accessibility of franking credits post-elections, (ii) a weaker than expected fallout post Royal Commission and (iii) three rate cuts from the RBA – compressing the 3m BBSW reference rate.

Figure 7. AMP AT1 Hybrids' Historical Weighted Average Yield to Expected Maturity*

*Source: BondAdviser, *Weighted Average based on market capitalisation.*

Following this rally, trading margins are currently close to historic lows (Figure 8 overleaf and Appendix 1) and consequently, there is some risk of a retracement over the next few months (evident in November 2019 see Appendix 1). In our opinion, this would most likely occur on sentiment/market sell-off grounds (as seen in 2016) or more topically relevant, should there be a large increase in unexpected supply. It also has become evident in 2019 that heightened credit risk has seen AMP structurally diverge from peers, with respect to trading margin. Whereas previously, AMPPA would trade in line with non-major bank peers, AMPPA now trades ~50bps higher.

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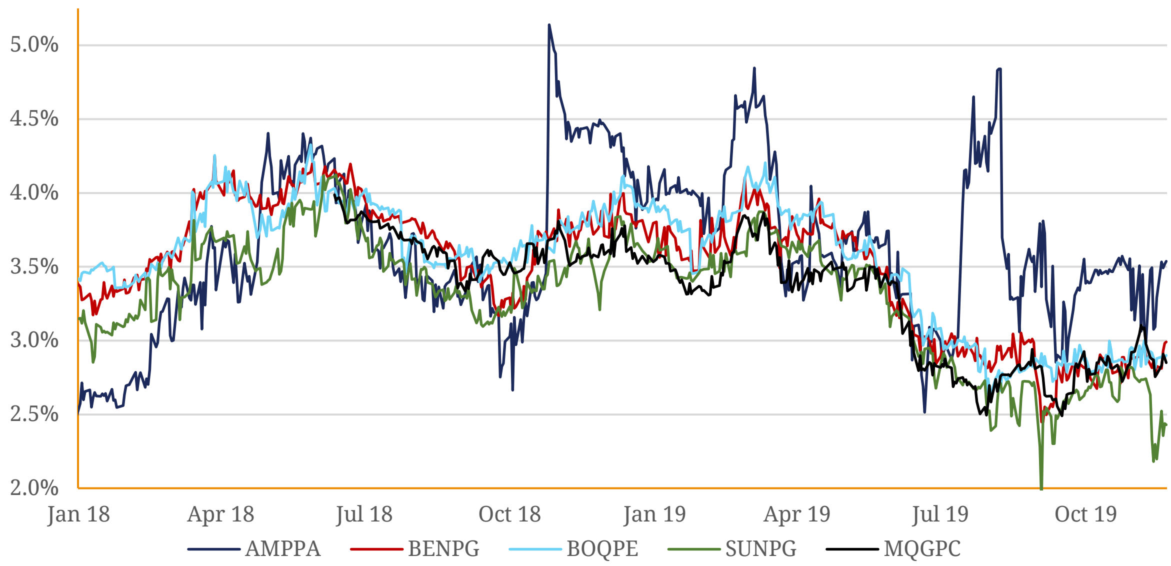
Figure 8. Recent Non-Major Bank Hybrid AT1 Historical Trading Margins



Source: BondAdviser

Broadly, AMP's outstanding AT1 issuance has displayed material volatility over the past few years and this has been driven by concerns over the Group's business model and regulatory / litigation risks. We note that AMP Wholesale Capital Notes are not ASX-listed and exhibit far lower traded volumes and volatility.

More recently, as demonstrated in Figure 9 below, trading margins have stabilised as the Group executes on its transformation strategy. We note the recent emergence of a consistent spread between AMPPA and AMP Wholesale Capital Notes, diverging from the closer spreads and correlation seen through 2017 to mid-2018.

Figure 9. Trading Margin Histories of Recent AMP AT1 Trading Margins

Source: BondAdviser

The AT1 market has been characterised by strong-supply dynamics recently, with minimal new issuance premiums offered over the AT1 curve on SUNPH and CBAPI, which both issued at the lower end of their respective margin guidance's at 3.00% each (Figure 10 overleaf).

Our relative value analysis suggests a fair value of around ~3.00% for a 6.0-year tenor prior to any offered new issuance premium, which would be consistent with pricing of recent issuances (SUNPH, CBAPI).

We further note that both MQGPC and MQGPD have quickly rallied from wider pricing levels (at time of issue) and are now more closely aligned with the major bank curve.

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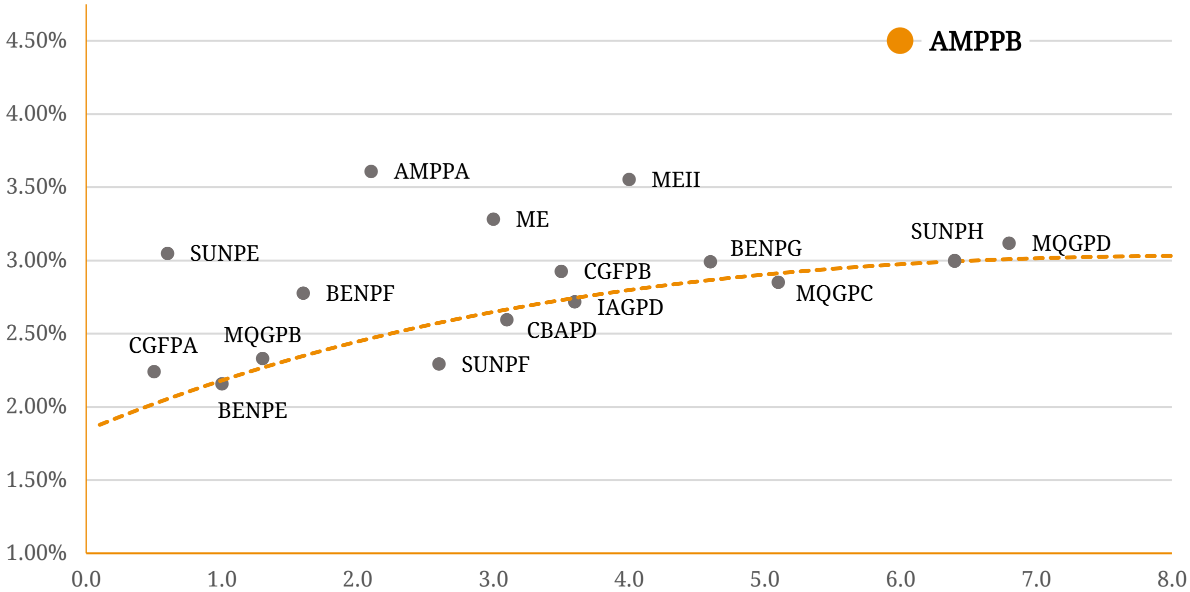
The sale of AMP Life to Resolution Life has been complicated, revised and remains to be completed (expected 1H20). Should it occur, AMP will no longer possess a prudentially regulated life business, which is viewed negatively from a credit perspective (fewer stable cashflows) but more favourably with an equity lens.

Thus, AMP will essentially become a diversified financial services company with sizeable financial advice and funds management (AMP Capital) businesses together with a small, APRA-regulated bank. These will still act as solid diversifiers of earnings, but we note that a lot of the flows into AMP Capital depend on the success of its adviser network, which is shrinking. There is a clear risk that future deterioration in both could well be linked and concurrent, which would present serious risks to the Group and investors. There also remains outstanding regulatory and litigation risks to be solved with substantially higher remediation and costs still possible.

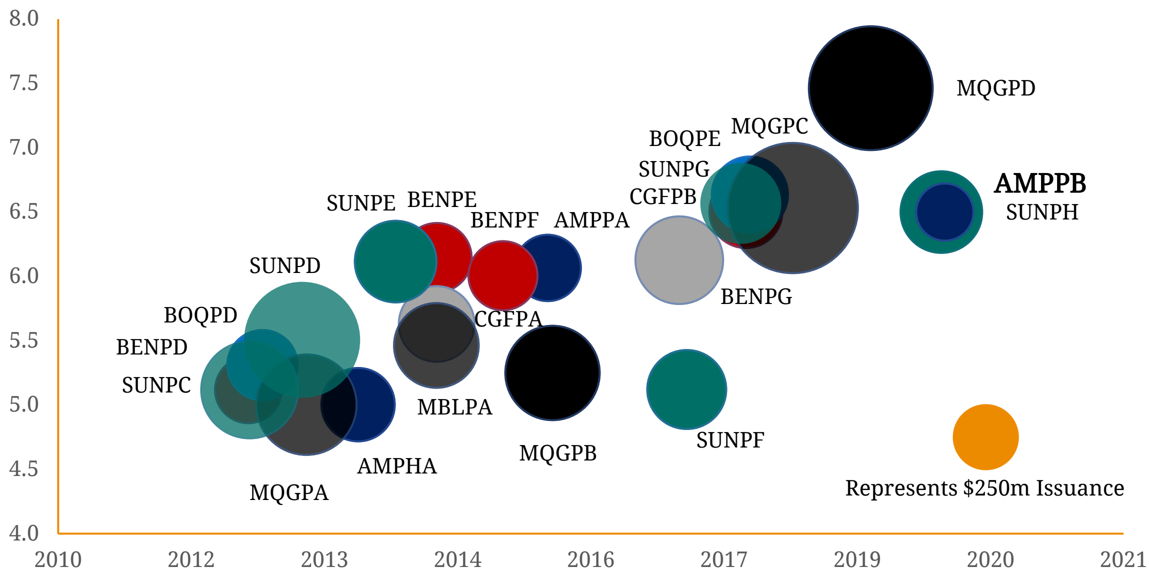
Considering the above factors, an assumed 4.50% margin offers a significant premium above peer's fair value and acknowledges the Group's recent struggles. Given it also sold its life business in 2019 and with banking now serving as its core business outside general insurance, Suncorp serves as the closest comparable to AMP, with SUNPH's 3.00% margin offering a pick-up of 1.25% for AMPPB, but reflects Suncorp's stronger business and capital positions at this time.

Figure 10. Non-Major Bank Hybrid AT1 Current Trading Margins (to Call)



Source: BondAdviser

Figure 11. Non-Major Bank Hybrid AT1 Tenor (to Call) by Issuance Year



Source: BondAdviser

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As Figure 11 above shows, there had been a reasonably consistent evolution in the non-major bank hybrid market, with most deal sizes landing between $250-$500 million. MQG has recently bucked this trend with its last two issuances reaching issue sizes of $1 billion and $905 million for MQGPC and MQGPD respectively. With SUNPH serving primarily as an opportunistic refinancing issuance, we expect AMPPB to see reasonably high flows, but which may potentially see a below average deals size of ~$200-300 million, reverting more towards the past means.

Early issuances (around 2012 and 2013) were largely concentrated at the five-year point, which lengthened through 2014 to the 5.5-6.0-year mark. This was primarily due to a supportive issuance environment, with market spreads similar to current conditions.

Market spreads began to widen in 2015, which resulted in non-major issuers refraining from hybrid markets, with zero issuances in 2016. As spreads lowered from the elevated levels seen early in 2017, issuers began to revisit the marketplace, with BEN, BOQ, SUN (SUNPG) and MQG completing deals with longer tenors of ~6.5 years.

Spreads then rallied strongly into the start of 2018 following a flurry of issuances in the back half of 2017. Despite this, MQG was the only non-major issuer to capitalise on favourable market conditions, however, it did so in a resounding way, raising $1 billion at a (then) tight 4.00% with a 6.5 year-tenor, making the issue the largest in the non-major market by a sizeable margin. Following a quiet 2019 for the non-major's following Macquarie's MQGPD issuance in early 2019, Suncorp launched an opportunistic financing in SUNPH earlier this month in which it intends to raise ~$250 million, following the success of CBA's PERLS XII (CBAPI) in October 2019.

As noted earlier, there are many positive tailwinds to current hybrid valuation levels. Locally, most credit-supportive factors are well understood, but for the final details (increased regulation, higher equity, and overall capital levels). There is also importantly a now stable local housing market. This last point could become a credit negative should excessively strong house-price growth reassert, but we are not certain it will to the extent seen prior to the 2018/2019 correction. Indeed, the slowly softening housing market has been a broad positive to bank credit profiles.

When comparing AMP to the most recent issues of SUNPH at 3.00% and MQGPD at the beginning of the year, which is now trading at a 3.10% trading margin, on a comparable and relative value basis the proposed issue margin appears to attractive given it is positioned well above the curve, and given AMP's track record, perhaps rightfully so.

Investors should be reminded that AMP is in the middle of a large organisational restructure and business reshaping with many senior executives and Board members with a high degree of operating knowledge now departed. There is also material litigation, regulatory and reputational risks still present.

Although we expect AMPPB to be redeemed at its Optional Exchange Date (December 2025), there is a new contractual risk specified in the Product Disclosure Statement concerning Shareholder Approval being required for conversion into AMP Shares. This applies at the Optional Exchange Date and on the Mandatory Conversion Date (December 2027) but we currently do not believe it will make a practical difference since our assumption, and the long-standing practice of the local hybrid market, is for redemption at the Optional Exchange Date. This risk is incorporated into the offered margin and probably adds around 25 basis points (0.25%) to the guided launch margin range (4.50 – 4.70%).

Should AMP progress its transition well, the Suncorp Capital Notes 2 will perform well. Should it not, there will likely be a margin retracement which could see levels of 5.00% (or higher) quickly breached. The same will likely occur on any other regulatory, legal or litigation 'shocks', but we feel the Group is past the worst of these.

BondAdviser has for a long-time post the Royal Commission, recommended the AMP Wholesale Capital Notes and more variably, AMPPA to investors.

There are some mild supply-side risk present due to upcoming maturities as noted earlier. We would also advise investors to be aware of other options currently available in the marketplace (transaction costs excepted) with several sitting at or around fair value as can be seen in Figure 10. The local AT1 curve is currently well constructed although generally it is low and flat at the time of writing and expected to remain so for the foreseeable future. Investors should therefore be comfortable with the credit risks inherent in the AMP Group.

With consideration to the points outlined above to form the basis of our opinion, we recommend investors **Subscribe** to this security, most strongly on allocation certainty from wholesale investors currently holding AMP Wholesale Capital Notes as well as new retail entrants attracted by the high absolute and relative returns available but which are comfortable with the visible risks to the AMP Group.

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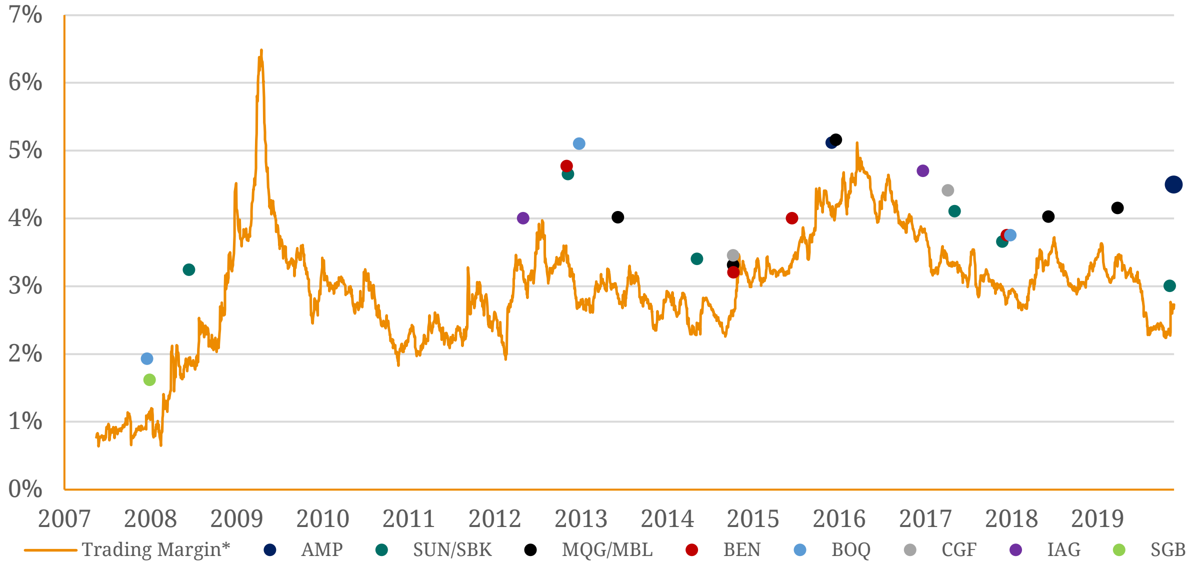
Appendix 1. Historical Comparison

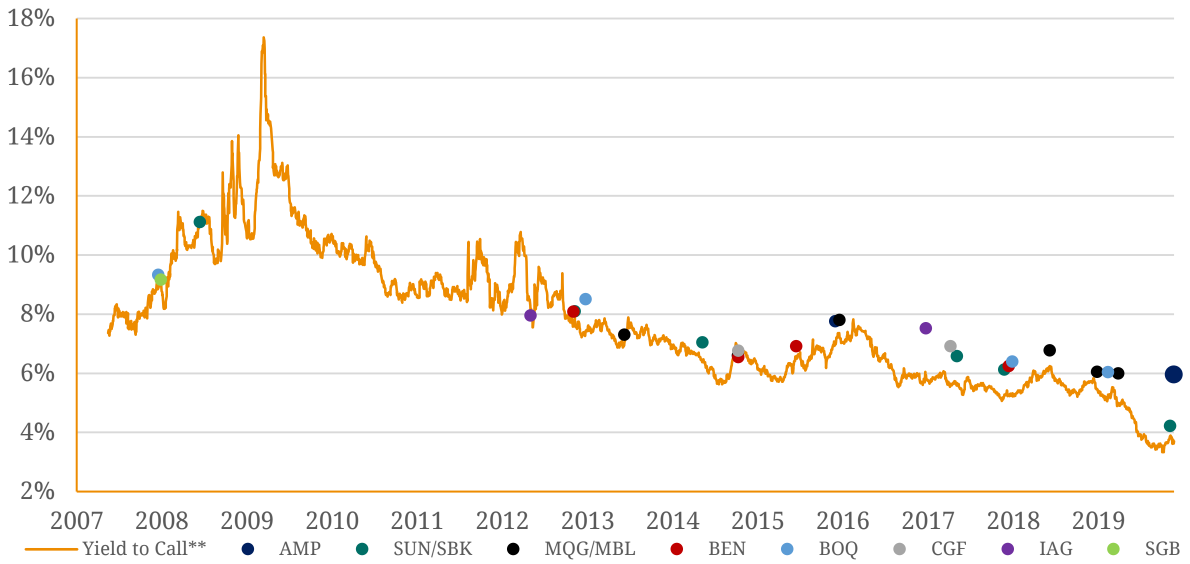
Figure 1. Non-Major AT1 Primary & Weighted Average Secondary Trading Margin*



	Last	1m	3m	YTD	1y	3y	5y	Inception^
Trading Margin	2.73%	2.63%	2.71%	3.17%	3.31%	3.71%	3.30%	0.89%
%Δ		3.80%	0.74%	-13.88%	-17.52%	-26.42%	-17.27%	207%

Source: BondAdviser Index Platform: BANMAT1DFTR
** Weighted average based on market capitalisation. BANMAT1DFTR is a franked, total return index that is rebalanced on a daily basis.*
^Inception of BANMAT1DFTR is 16/5/2007.

Figure 2. Non-Major AT1 Primary & Weighted Average Secondary Yield to Call**



	Last	1m	3m	YTD	1y	3y	5y	Inception^
Yield to Call	3.70%	3.67%	3.59%	5.36%	5.72%	5.94%	6.42%	7.36%
%Δ		0.82%	3.06%	-30.97%	-35.31%	-37.71%	-42.37%	-50%

Source: BondAdviser Index Platform: BANMAT1DFTR
*** Weighted average based on market capitalisation. BANMAT1DFTR is a franked, total return index that is rebalanced on a daily basis. Yield to call based on BondAdviser estimates.*
^Inception of BANMAT1DFTR is 16/5/2007.

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AMP Limited: Financial Summary

AMP Limited: Financial Summary

Recommendation Summary **Subscribe**

16 December 2019

Group Profit or Loss	2018	2017	2016	2015
Life Insurance Premiums ($m)	3,140.0	3,231.0	3,033.0	2,465.0
Fee Revenue ($m)	3,083.0	3,125.0	3,031.0	2,941.0
Other Revenue ($m)	167.0	88.0	140.0	133.0
Investment Gains/Losses ($m)	1,854.0	11,888.0	8,567.0	8,529.0
Equity Accounted Inv. ($m)	42.0	29.0	28.0	27.0
Life Insurance claims/expenses	-3,243.0	-2,681.0	-2,281.0	-2,164.0
Operating Expenses ($m)	-4,724.0	-3,751.0	-4,551.0	-3,691.0
Finance Costs ($m)	-611.0	-585.0	-551.0	-732.0
Movement in external liabilities	-208.0	-1,481.0	-979.0	-855.0
Change in policyholder liabilities	134.0	-8,227.0	-6,079.0	-4,614.0
Taxation ($m)	417.0	-763.0	-166.0	-280.0
Net Profit ($m, AMP Shareholders)	28.0	848.0	-344.0	972.0
Non-Controlling Interest ($m)	23.0	25.0	536.0	741.0

Group Credit Metrics	2018	2017	2016	2015
Dividend Payout Ratio (%)	60.0	81.0	85.0	74.0
Common Equity Tier 1 ($m)	2,430.0	3,529.0	4,154.0	3,161.0
Total Regulatory Capital ($m)	2,611.0	3,331.0	3,375.0	3,844.0
Reported Gearing (%)	17.00	9.00	9.00	10.00
Reported Interest Cover (x)	11.00	20.60	9.20	20.00

Divisional Profit	2018	2017	2016	2015
Australian Wealth Mang. ($m)	363.0	391.0	401.0	410.0
AMP Capital ($m)	167.0	156.0	144.0	138.0
Australian Wealth Protect. ($m)	-176.0	110.0	-415.0	185.0
AMP Bank ($m)	148.0	140.0	120.0	104.0
NZ Financial Services ($m)	92.0	125.0	126.0	120.0
Australian Mature ($m)	134.0	150.0	151.0	158.0
Group Office Costs ($m)	-76.0	-74.0	-104.0	-61.0
Total Operational Earnings ($m)	652.0	998.0	423.0	1,054.0

Bank Ratios	2018	2017	2016	2015
Note: GLA - Gross Loans & Advances				
CET1 Ratio (%)	10.90	9.70	8.30	7.90
Capital Adequacy Ratio (%)	16.30	15.20	12.60	12.80
Net Interest Margin (%)	1.70	1.70	1.67	1.59
Deposit to Loan Ratio (%)	66.00	64.00	67.00	63.00
Impairment/GLA (%)	0.06	0.02	0.04	0.04
Total Provisions/GLA (%)	0.19	0.08	0.08	0.06
90+ days in Arrears (%)	0.47	0.36	0.43	0.40

Group Balance Sheet ($m)	2018	2017	2016	2015
Cash & Liquids ($m)	3,932.0	3,602.0	3,476.0	3,955.0
Receivables ($m)	2,608.0	2,151.0	1,975.0	2,067.0
Financial Asset Investments	132,103.0	136,675.0	129,419.0	127,221.0
Intangibles ($m)	3,208.0	3,218.0	3,199.0	3,983.0
Property, Plant & Equipment	95.0	75.0	66.0	423.0
Other ($m)	3,332.0	2,364.0	1,925.0	2,059.0
Total Assets ($m)	145,278.0	148,085.0	140,060.0	139,708.0
Payables ($m)	2,032.0	1,752.0	1,952.0	2,031.0
Borrowings ($m)	21,650.0	21,009.0	17,218.0	17,452.0
Investment Contract Liabilities	68,742.0	75,235.0	71,579.0	69,848.0
Insurance Contract Liabilities	23,257.0	23,683.0	24,225.0	23,871.0
Subordinated Debt ($m)	0.0	0.0	0.0	0.0
Other ($m)	22,806.0	19,123.0	17,545.0	17,611.0
Total Liabilities ($m)	138,487.0	140,802.0	132,519.0	130,813.0
Net Assets ($m)	6,791.0	7,283.0	7,541.0	8,895.0

Insurance Capital Adequacy	2018	2017	2016	2015
Common Equity Tier 1 ($m)	2,430.0	3,529.0	1,956.0	1,667.0
Additional Tier 1 ($m)	305.0	305.0	205.0	205.0
Tier 2 ($m)	250.0	300.0	215.0	215.0
Total Capital Base ($m)	2,611.0	3,331.0	2,376.0	2,087.0
Prescribed Capital Amount ($m)	1,190.0	1,228.0	825.0	860.0
Capital Adequacy Multiple (x)	2.2	2.7	2.9	2.4

NMLA Capital Adequacy	2018	2017	2016	2015
National Mutual Life Association				
Common Equity Tier 1 ($m)			814.0	737.0
Additional Tier 1 ($m)			100.0	100.0
Tier 2 Capital ($m)			85.0	85.0
Total Capital Base ($m)			999.0	922.0
Prescribed Capital Amount ($m)			498.0	424.0
Capital Adequacy Multiple (x)	2.26	2.18	2.01	2.17

AMP Capital AUM	2018	2017	2016	2015
Australian Equities ($m)	26,800.0	31,263.0	28,414.0	29,774.0
International Equities ($m)	37,995.0	41,568.0	35,381.0	34,495.0
Fixed Interest ($m)	68,068.0	69,296.0	62,708.0	61,518.0
Infrastructure ($m)	20,315.0	14,842.0	12,261.0	10,335.0
Direct Investments ($m)	1,168.0	976.0	979.0	840.0
Property ($m)	29,335.0	26,093.0	22,741.0	20,753.0
Alternative Assets ($m)	3,567.0	3,686.0	2,916.0	2,170.0
AMP Capital Total ($m)	187,248.0	187,724.0	165,400.0	159,855.0

Source: Company data, BondAdviser estimates.

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