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corporatefile.com.au - Open Briefing by AMP's CEO Andrew Mohl

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Lodgement of Open Briefing

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AMP Limited reported profit after income tax before other items of $412 million for the first half ended June 2004, compared with $239 million for the previous corresponding period. What were the highlights of the results and what guidance can you give regarding the outlook for full-year earnings?

CEO Andrew Mohl
The highlight was that we're delivering much improved performance on our key metrics. We've seen a further reduction in costs, and the cost-to-income ratio fell 5 percentage points to a low of 42 percent. We've seen a significant improvement in our cash flow. In AMP Financial Service (AFS), cash inflows were up 21 percent and net cash flows improved by around $1.1 billion. In AMP Capital Investors, we've seen an improvement of around $2.3 billion in net cash flows.

Our investment performance improved, with 81 percent of our funds outperforming benchmarks, and we added substantial value relative to benchmark in the AMP Life No. 1 fund. Finally, we saw a reduction of around $2.8 billion in our debt levels and effectively, a halving of our gearing ratio over the period. We've achieved our target gearing levels around six months earlier than expected.

All of this contributed to a 21 percent improvement in the underlying contribution, and adjusting for the additional interest expense on the debt transferred from the UK, the improvement would've been higher. There's strong momentum in the business going forward.

In terms of the full-year outlook, we've reaffirmed that in AFS we expect strong growth in embedded value (EV) and value of new business (VNB). The full-year result will reflect both seasonally higher sales in the second half and the benefit of adjustments for unit costs in 2005 across the full-year sales achieved in 2004. In AMP Capital, we've lifted the guidance from broadly steady margins to a slightly higher result in 2004, which reflects the good underlying result in the first half.

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Total business unit operating margins improved to $261 million, up 11.5 percent compared with the previous first half. To what extent is this attributable to the improvement in general market conditions and to what extent does it reflect company specific factors such as market share gains, cost reduction and improved product mix?

CEO Andrew Mohl
In AFS there was an improvement of around $51 million in margins half on half. Around $24 million of that reflected improved markets. In AMP Capital, while margins were $35 million versus $34 million previously, if you adjust for the listed property trusts and the abnormally low staff incentives in the previous year, the comparison is $35 million versus $21 million. Of that $14 million improvement, around $6 million reflected improved markets. So in both cases less than half of the improvement was due to markets and over half was due to management influences.

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You've previously flagged your intention to return excess capital to shareholders. What will be the key determinants of the quantum and timing of any capital return initiatives and can shareholders expect such an initiative in the current year?

CEO Andrew Mohl
The first thing to say is that shareholders are already receiving some of the benefits through the decision to increase our dividend payout policy from 60 percent to 75 percent of underlying contribution, with franking of 75 percent. This is sustainable over the medium term.

As we've highlighted, there's around $484 million of excess capital in AMP Life, which subject to the Life board's approval, we'd expect to be transferred to the group. Our stake in HHG was valued at around $324 million at the end of June. This isn't a long-term holding but it remains a part of our portfolio because we see upside value for our shareholders at current market levels.

In terms of our priorities, we continue to target an 'A' rating for AMP Group holdings, to reinvest for profitable growth in our core businesses and to return excess capital to shareholders. Our approach to capital return, including the precise quantum and timing, is something the board will be focusing on over the next few months and we've signalled that an initiative is likely no later than mid 2005.

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You announced a 75 percent franked interim dividend of 13 cents per share. What was behind the decision to increase the payout ratio to 75 percent and why did you cap the DRP participation to 10,000 shares?

CEO Andrew Mohl
It's worth saying that the 75 percent is based on the underlying contribution, which normalises investment returns. Our businesses are in a position to fund their growth organically so we're confident AMP can sustain a 75 percent payout ratio. We certainly recognise our shareholders have had a difficult few years and one of the best ways of signalling to them that times are better is by paying a higher dividend. The franking level will fall back 10 points to around 75 percent, but this is only as a result of increasing the payout ratio.

The rationale behind capping the participation in the DRP is simply that the group has excess capital and therefore raising further capital through the DRP isn't desirable. We've effectively kept the DRP in place for smaller shareholders, but capped the participation of larger shareholders. Our analysis highlights that 99.5 percent of shareholders by number are unaffected.

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What guidance can you give regarding the outlook for the final dividend and what are your expectations for franking going forward?

CEO Andrew Mohl
Given AMP's policy to pay out 75 percent of underlying earnings, we'd expect future dividend growth to be a function of EPS growth. We'd expect the franking level to remain at 75 percent in the next couple of years.

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You've stated the traditional EV of AFS at the end of June at $5,747 million after transfers, using a risk discount margin of 3 percent. What were the drivers of the $0.5 billion EV growth during the half?

CEO Andrew Mohl
Around $222 million of that was simply the roll forward of the expected return. Around $125 million reflected the value of new business written in the period, $203 million reflected changes in markets, and an additional $70 million was due to a range of factors such as improving mortality experience and other assumptions. There was also a negative impact of $91 million due to the effect of the pricing reductions we're initiating on our contemporary retirement savings products. In aggregate, these produced a 9.3 percent return in the half year; a strong return.

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What's the likely impact of the pricing reductions on AFS's profit and value going forward?

CEO Andrew Mohl
Let me say at the outset, the re-pricing is a clear signal of AMP's market leadership. We've fundamentally changed the rules of the game for platform managers and asset managers. We're leveraging our low-cost product manufacturing position to deliver tangible benefits to our planners and customers. Finally, we're reinforcing to both sides of the political fence that this is a vibrant market where customer value is being enhanced by the forces of competition. This is good for AMP and the industry.

The effect of the pricing reductions, other things being equal, on operating margins will be around $15 million in 2005, or a bit over 3 percent of AFS's current operating margins. EV and VNB already include the pricing effect of the fee reductions although we'd expect there to be positive persistency and volume effects in the future.

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In addition to the re-pricing initiatives, operating margins will be impacted by the loss of about $20 million annually in transitional tax relief from 2005. Your guidance suggests these negatives will be more than offset by growth in cash flows and AUM. How will they change AMP's profit growth profile moving forward?

CEO Andrew Mohl
If you look at the sensitivities we've provided in our Investor Report on page 8, AFS only needs to increase AUM by 5 percent, and group costs need to reduce by 3 percent in order to fully offset the negative impact from both the loss of transitional tax relief and the re-pricing initiatives.

In terms of our future growth profile, I'd make the following comments. The loss of transitional tax relief is an industry issue that affects all life companies. Secondly, in terms of the re-pricing initiatives, AFS is clearly the market leader and it's now going on the front foot to strengthen its advice based distribution, attract funds in price sensitive segments, retain existing business and more broadly, give back to its customers part of its efficiency gains and pricing power with suppliers. Longer term, this can only enhance shareholder value.

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AFS's VNB was $125 million for the first half, up 25 percent from $100 million in the previous first half. What have been the main drivers of the growth and is it sustainable?

CEO Andrew Mohl
The first half of last year was a difficult period, and before the effect of the product re-pricing, the increase in VNB was closer to 39 percent. The principal driver was cost savings, which contributed around $18 million, generating further gains in unit costs. The effect of sales growth and mix changes was $12 million, which is less than might have been anticipated, reflecting the fact that sales were skewed towards lower margin products. There was a negative effect of around $4 million from bond yields, and the net effect of pricing changes was negative $7 million, with the impact of the re-pricing of retirement savings products offset primarily by better pricing on annuities.

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AMP Capital Investors' operating margin was impacted by your exit last year from the listed property trust business, increasing slightly to $35 million in the first half. What's the outlook for AMP Capital for the full year in terms of key performance measures such as investment performance, cost to income ratio and return on invested capital?

CEO Andrew Mohl
If we achieve slightly higher operating margins as expected, there'll be a slight improvement in the cost-to-income ratio and the return on invested capital relative to the first half. In terms of investment performance, our goal is for over 75 percent of funds to outperform their benchmarks. That's a challenging goal, and the result of 81 percent of funds outperforming their benchmarks in the half-year was very strong. We'll certainly be seeking to sustain that.

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Since the demerger, AMP has suffered a number of departures from its funds management team. How would you rate the current health of the AMP Capital franchise and what strategies do you have in place to build the brand?

CEO Andrew Mohl
It's true we've had some departures from our Australian equity teams, but it's also the case that we've been able to hire very good people to replace them, and our competitive position is as strong as, if not stronger than, it was at the start of the period. The business has performed extremely well; its underlying earnings growth was high and 81 percent of funds outperformed benchmarks.

Since we re-branded the business as AMP Capital Investors late last year, it's broadened its business development to include the external retail market in Australia as well as Asia. It had significant success in Japan during the half with over $1.2 billion raised in that market.

We're confident of AMP Capital's position as a major player in the marketplace. In relative terms it has a strong financial position, strong investment performance and a talented and stable investment team.

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Under the new APRA guidelines, the Cobalt/Gordian general insurance run-off business is required to hold additional capital to meet the 99.5 percent confidence interval. How far away is Cobalt/Gordian from achieving this capital requirement and when will it be in a position to begin to release capital?

CEO Andrew Mohl
There are two drivers. As the Cobalt/Gordian book runs down, its minimum capital requirement and its 99.5 percent capital requirement are also reducing, and at the same time we're effectively recapitalising the business by retaining earnings, so its capital strength is improving progressively. On our modelling, it will probably exceed the 99.5 percent confidence interval by the end of next year and then be in a position to transfer capital to the parent, with transfers increasing

progressively thereafter. It should be noted that part of the difference between Cobalt/Gordian's minimum capital requirement and its actual capital level is being lent back to the parent, so in that sense cash is already flowing back to us. At this point around $215 million has been lent to the parent. That's a loan as opposed to a capital transfer.

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As of June 30, 2004, AMP's debt was $1.55 billion and debt-to-equity stood at 29 percent, down from $4.3 billion and 55 percent six months earlier. This is close to the "optimal" level identified in last year's explanatory memorandum for the demerger. Can you comment on the current structure of the debt portfolio and your targets for debt levels going forward?

CEO Andrew Mohl
The structure of the debt portfolio is still largely the outcome of what we've assumed from the UK. We've paid down debt where we had the greatest capacity to achieve reductions, hence the redemption of the RPS, the repayment of income securities and the $747 million repayment of offshore bonds. So I don't think our debt structure today is optimal and that's something we'll work on over time.

We're comfortable with the debt level itself given gearing is down to 29 percent, and lower on the S&P basis. But in the event that we reduce equity through capital initiatives in the future, we'd pursue further modest reductions in our debt levels to ensure our gearing ratio remained at or around current levels. At current levels we believe gearing is consistent with an A-rating and we'd be keen to ensure that's maintained.

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Group controllable costs were $396 million in the first half compared with $400 million previously. To what extent is the recent round of cost reductions complete and what are your expectations for cost reductions going forward?

CEO Andrew Mohl
You're never finished in terms of cost management, it's an ongoing challenge. We continue to have success, although as we've indicated previously, the rate of improvement is slowing. We expect to see significant improvement in unit costs in AFS in particular, as volumes are likely to continue to grow strongly, and we'll continue to press ahead on absolute cost reductions but recognise there's a limit, particularly given the improvement in the market environment and the focus on business development.

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What are the risks of continuing to cut costs from these levels?

CEO Andrew Mohl
Industry margins generally are under pressure and cost excellence isn't an option, it's mandatory for a major player. We've moved from being relatively poor in this area to being strong today so it's something that will never slip off our radar screen.

I don't believe we've impeded our ability to grow by reducing costs. The improvement in processes, the automation, the new technology, and the streamlining of the corporate office have made us more service oriented, more agile, faster to market. One reason we've been able to launch the re-pricing initiatives for example, is that we manage all of that business, in effect over $20 billion of business, on one platform. A couple of years ago a re-pricing would have involved changes to three platforms, it would have been much more difficult and costly.

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Under the terms of last year's demerger, AMP becomes able to sell half of its 10 percent stake in HHG following HHG's first-half result announcement on August 25. AMP also becomes able to sell the whole stake provided it gets permission from HHG and HHG's investment banks. What are your intentions regarding the HHG stake?

CEO Andrew Mohl
It's purely about value realisation. HHG's a non-core asset on our balance sheet and part of our shareholders' funds. The investment performed strongly in the first half and has continued to rise in value so far in the second. We'll look to hold the stake, like most investments, until such time as we believe shareholders will get appropriate value for it.

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Are you able to provide any preliminary insight into the potential impact on AMP of the introduction of international financial reporting standards from 2006?

CEO Andrew Mohl
At this stage our view is that the impact of IAS won't be material in terms of business unit margins, although our future profitability is likely to be more volatile as a result of the new standards. Equity at the start of the period will be reduced by the loss of part of the deferred acquisition costs that are currently on our balance sheet and the excess of market value over net assets (EMOVA). Reflecting that adjustment, return on equity is likely to be higher going forward. But we need to do more work to be in a position to give a more precise outline of the financial impact. We'll certainly be in a position to do that with our full-year results.

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Your stated strategic intent is "to run AMP better than it's ever been run before." How do you define running AMP better and how will you achieve this goal?

CEO Andrew Mohl
This is about leveraging the assets of AMP – the brand, the franchise, the scale, the technology, and the people – such that the business performs at a peak level. In my seven years at AMP, the recent first half was the first period in which the senior management team and the whole thrust of energy within AMP has been focused on the core business. That's one of the reasons we've seen such significant improvement. We believe we're only in the first phase and that we

need concentrated application and effort over an extended period to achieve the full potential of AMP.

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Thank you Andrew.

For more information about AMP, visit www.ampgroup.com or call Mark O'Brien on (+61 2) 9257 7053, Howard Marks on (+61 2) 9257 7109 or Rosalie Duff on (+61 2) 9257 9557

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