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Divestments & Shareholder Rights

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We review all divestments since the year 2000 by top 100 listed companies in Australia and the manner in which they were implemented. We observe that:

- ***Divestments are usually well received*** by the market with average outperformance of +2% on the day of announcement;
- ***Larger divestments are particularly well received*** by the market with average outperformance of +5% on the day of announcement;
- ***Non-financially distressed sellers are able to deliver better outcomes*** with average outperformance of +4% on the day of announcement;
- ***Directors generally seek shareholder approval for large divestments*** with approval sought for the vast majority of deals exceeding 20% of the sellers' enterprise value.

Divestments usually work out well for shareholders…

Our findings are good news for shareholders: generally boards are able to extract higher prices for divestments than reflected in market expectations. Further, boards typically take a conservative approach to seeking shareholder approvals.

AMP – A Highly Unusual Situation

However, ***the recent AMP announcement is unique*** in at least the following respects:

- ***AMP experienced the worst share price reaction*** of all top 100 company divestment announcements since the year 2000, and by a significant margin;
- Never before has a top 100 company sought to ***divest so much of its operations without shareholder approval***;
- ***AMP appears to have misled the ASX*** by providing data justifying its decision not to seek shareholder approval and prevent the ASX from doing so; *and,*
- ***The AMP board has 3 unelected directors*** (including the Chairman).

… but the AMP divestments did not and set a grim precedent for governance practices amongst listed Australian companies…

AMP's approach to divesting assets sets a grim precedent in relation to the enforceability of ASX listing rules and governance practices amongst listed Australian companies.

We are deeply disappointed with AMP's divestment of its Australian and New Zealand wealth protection and mature businesses (a question of ***value***). We are equally disappointed with the manner in which it has been handled by the company and the board of directors (a question of ***governance***).

We simply cannot understand how proposing to divest such a large component of a company's enterprise value without shareholder approval or an independent expert's opinion can be considered appropriate or acceptable by any investor in Australian shares under any circumstances.

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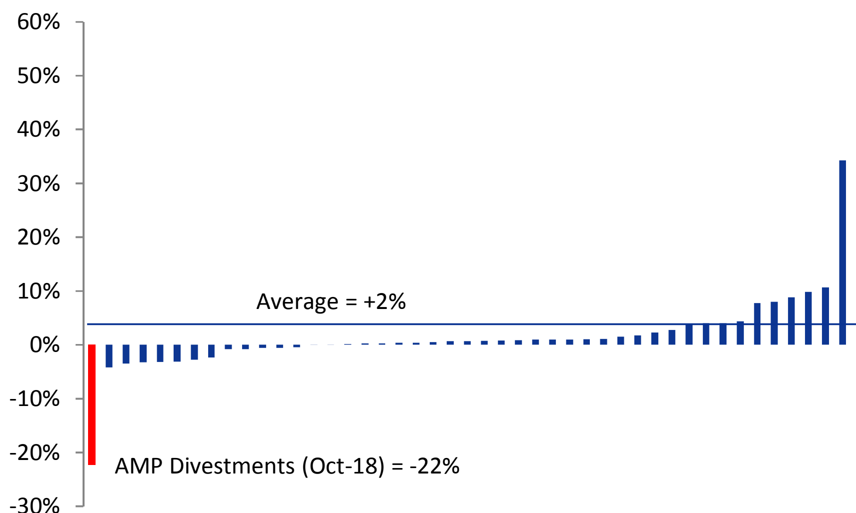
Divestments in Australia

On average, divestments are well received by investors…

We analysed all divestment announcements of ASX100 companies since the year 2000. Of approximately 1,200 announcements, there were 46 cases where the sale proceeds exceeded 10% of the sellers' enterprise value. On average, share prices responded positively to divestment announcements.

Figure 1: Share Price Reaction on Day of Divestment Announcement (ASX100 Companies, 2000 to Today, Proceeds > 10% of Enterprise Value)



Source: Bloomberg, share price reaction relative to all ordinaries accumulation index

The market reaction to the AMP divestment announcement was the worst on record…

This overall finding is consistent with overseas academic research dating back to the 1980s that showed gains to shareholders around the announcement of divestments.

The market reaction to the recent AMP announcement is a clear outlier within the context of the 46 cases where the sale proceeds exceeded 10% of the sellers' enterprise value. In fact, the market reaction is the most negative of approximately 1,200 divestments analysed.

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Size and Financial Distress

Larger divestments usually generate more value…

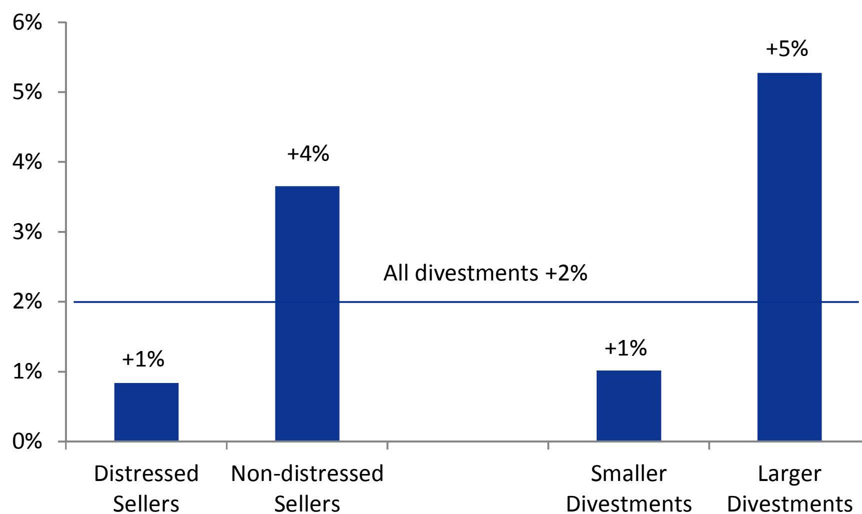
Overseas research also highlighted that the magnitude of gains are greater where:

- the divestment is a larger proportion of the parent[1]; *and*
- the seller is not financially distressed[2].

To test the relevance of these findings within an Australian context, we split the 46 deals into proportionately large / small divestments, and into financially distressed / non-destressed sellers. Our findings are consistent with the offshore experience.

…and non-distressed sellers tend to do better deals…

Figure 2: Share Price Reaction on Day of Divestment Announcement (ASX100 Companies, 2000 to Today, Proceeds > 10% of Enterprise Value)



Source: Bloomberg, share price reaction relative to all ordinaries accumulation index, distressed sellers = sellers with debt > 30% of enterprise value, smaller divestments = <20% of enterprise value

…which makes AMP's situation highly unusual

The market's reaction to the recent AMP announcement is again particularly unusual against this backdrop because AMP was not financially distressed and the series of transactions represented a very large proportion of its operations.

[1] See Zaima and Hearth, 1985; Klein, 1986
[2] See Zaima and Hearth, 1985

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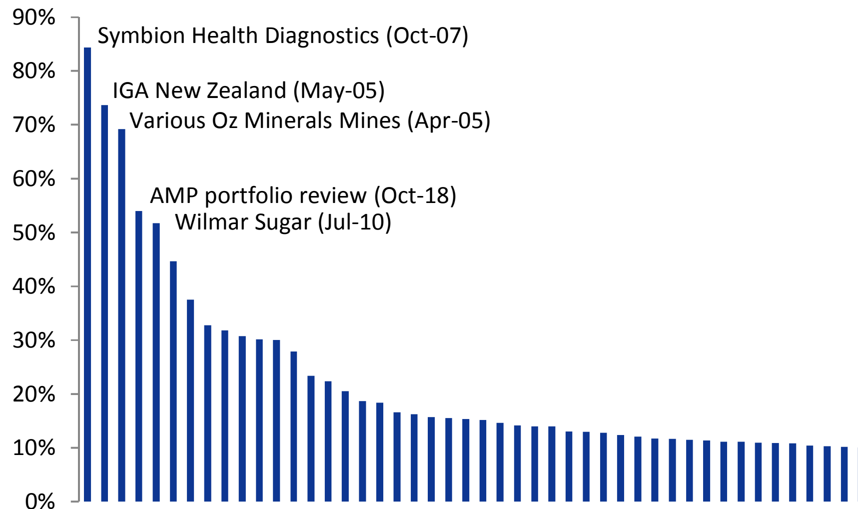
Only 5 Australian divestments have represented more than half of firm value…

Divestments Exceeding One Half of Enterprise Value

There were just five cases amongst ASX listed companies where the proceeds of divestments exceeded half the sellers' enterprise value. The size of these transactions – or series of transactions – compared with other transactions is illustrated in the chart below.

Figure 3: Divestment Proceeds as a Percentage of Enterprise Value (ASX100 Companies, 2000 to Today, Proceeds > 10% of Enterprise Value)



Source: Bloomberg, Enterprise Value = Market Capitalisation plus (minus) net debt (cash), AMP portfolio review percentage applies $600m value to New Zealand IPO (15x $40m annual earnings)

In four of these five cases directors sought or had shareholder approval to complete the transactions. Transactions with shareholder approval mechanisms were better received by the market than was the case with AMP's recent announcement.

Typically, companies seek shareholder approval for large transactions…

Figure 4: Divestments Where Sale Proceeds Exceeded 50% of Enterprise Value ("EV") (ASX100 Companies, 2000 to Today)

Date	Seller	Assets	% of Enterprise Value	Shareholder Vote	Share Price Reaction
8-Oct-07	Symbion	Diagnostics Businesses	84%	Yes	+1%
25-May-05	Foodland	IGA New Zealand	74%	Yes	+2%
1-Apr-09	Oz Minerals	Various Mines	69%	Yes	-3%
25-Oct-18	AMP Limited	Various Businesses	54%	No	-22%
5-Jul-10	CSR Limited	Wilmar Sugar	52%	Yes	+4%

Source: Bloomberg, company announcements, Enterprise Value = Market Capitalisation plus (minus) net debt (cash), share price reaction relative to all ordinaries accumulation index, AMP percentage of enterprise value applies $600m value to New Zealand IPO (15x $40m annual earnings)

Divestments Exceeding One Fifth of Enterprise Value

Using hand collected data from company announcements we were able to further observe that for 16 transactions representing more than 20% of enterprise value, 14 had either explicit shareholder approval mechanisms, independent expert reports or had been implicitly approved through annual general meetings that specifically indicated the intent to sell the assets.

Divestments greater than 20% of firm value have typically gone to shareholder vote…

…or in the very least been accompanied by expert opinions

Figure 5: Divestments Where Sale Proceeds Exceeded 20% of Enterprise Value ("EV") (ASX100 Companies, 2000 to Today)

Shareholder Protection	Count	Proportion	Share Price Reaction
Explicit vote	11	69%	+5% (average)
Specifically Flagged at AGM	2	13%	Pac Dunlop sale of Pac Brands: +1% Pac Dunlop sale of GNB: +11%
Independent Expert	1	6%	Origin sale of CSG stake: +9%
No Approval	2	13%	Bluescope sale of ASEAN stake: +34% AMP "Portfolio review": -22%

Source: Bloomberg, company announcements, Enterprise Value = Market Capitalisation plus (minus) net debt (cash), share price reaction relative to all ordinaries accumulation index

The findings in the table above highlight that generally directors of companies making divestments adopt a conservative position with the vast majority seeking shareholder approval for transactions that exceed 20% of enterprise value.

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There were only two instances where no approval or independent expert opinion was sought: the recent AMP "portfolio review" and Bluescope's 2012 sale of 50% of their ASEAN & US Coated Products business to Nippon Steel. The Blusecope deal was well received by investors with the stock outperforming 34% on the day of announcement.

AMP had not flagged the imminent divestment of these businesses at its most recent Annual General Meeting in May 2018. In fact, the company specifically stated at the time *"We continue to progress the portfolio review, however we are currently prioritising the performance of the business, board renewal and the appointment of a new CEO."*

At the May 2018 AGM, AMP suggested the portfolio review was being de-prioritised…

If anything, this statement would suggest the portfolio review was being de-prioritised. It wasn't until an announcement on 27 July 2018 that AMP stated in a release that "*the portfolio review of the manage for value businesses has been reprioritised."* AMP subsequently reported in August an updated financial valuation of the assets in question of around $5 billion. Regardless of the specific language, it is difficult to argue that the board had a mandate from shareholders to complete the portfolio review, particularly at such a significant discount to the most recently signed off valuations.

ASX Listing Rules Intended to Protect Shareholder Rights

Under ASX Listing Rule 11.1, a listed company is required to notify and consult with ASX if it proposes to make a 'significant change' to the 'nature or scale' of its activities. ASX has discretion under ASX Listing Rule 11.1.2 to require a listed entity to seek shareholder approval for a significant change. In addition, an entity is required under ASX Listing Rule 11.2 to seek shareholder approval where the entity is proposing to dispose of its 'main undertaking'.

The ASX has guidelines and rules to protect shareholders' right to vote on large transactions…

In assessing whether a transaction, or series of transactions, constitutes a disposal of a main undertaking, ASX applies a 50% 'rule of thumb' against four key measures:

(a) consolidated to total assets;
(b) consolidated annual revenue;
(c) consolidated Earnings Before Interest, Taxes, Depreciation and Amortisation (EBITDA); *and*
(d) consolidated annual profit before tax.

…and boards have historically taken a conservative view of these rules in seeking shareholder approval…

If a business accounts for more than 50% of all four of the above measures, then the business is likely to be the main undertaking. If the business accounts for one or more of the measures, but not all of them, ASX will assess the circumstances as a whole.

Even if, after taking into account all of the above factors, ASX considers divestments do not technically constitute an entity's 'main undertaking', it has the ability to exercise its power under listing rule 11.1.2 to require a *"disposal, or series of disposals to be subject to security holder approval, regardless of whether Listing Rule 11.2 technically applies."*

Chapter 11 of the ASX Listing Rules, at its core, empowers the ASX with the means to protect shareholders and give shareholders an opportunity to approve or reject significant transactions.

As our preceding analysis shows, generally speaking, boards take an appropriately conservative view of Listing Rules as well as their broader responsibilities and in the vast majority of cases have sought shareholder approval – or at least independent advice – for transactions representing more than 20% of an entity's value.

AMP – A Highly Unusual Situation

Within the context of the analysis above, the recent AMP announcement stands out in a number of respects:

AMP's recent board behaviour is unprecedented and highly unusual…

- AMP experienced the worst share price reaction of all top 100 company divestment announcements since the year 2000, and by a significant margin;
- AMP is the first top 100 company seeking to divest more than half of its enterprise value without shareholder approval;
- If the series of transactions complete, AMP will become one of only two top 100 companies to have ever divested more than 20% of enterprise value without shareholder approval or an independent expert's opinion; *and,*
- Three of AMP's board members, including the Chairman, have not yet faced election at a shareholders' meeting.

When asked why AMP hadn't sought shareholder approval, David Murray – the AMP Chairman – in a television interview responded *"because we didn't have to"* and that "*shareholders appoint the board to make those decisions*".

Was the ASX Misled?

At 5:47pm last Friday night AMP disclosed to the market the four "rule of thumb" metrics discussed above that it had provided to the ASX in relation to its portfolio review. Of note, AMP acknowledged to a number of sell-side analysts that:

AMP appears to have provided out-of-date, inaccurate and non-public information to the ASX…

- The metrics provided to the ASX were 10 months out of date;
- Only one of the four metrics provided ("Segment profit after income tax") can be traced back to publicly released disclosures;
- The one metric that can be traced back to publically released disclosures ("Segment profit after income tax") excludes up to $184 million of earnings to be divested;
- The one metric that can be traced back to publically released disclosures ("Segment profit after income tax") is based on "Underlying profit" rather than audited statutory profits.

There is no basis for AMP ignoring Royal Commission impacts on the retained advice business…

There is no commercial basis for using outdated accounts, especially given the adverse impact of the Royal Commission is only evident more recently and this impact is largely confined to the retained financial advice business.

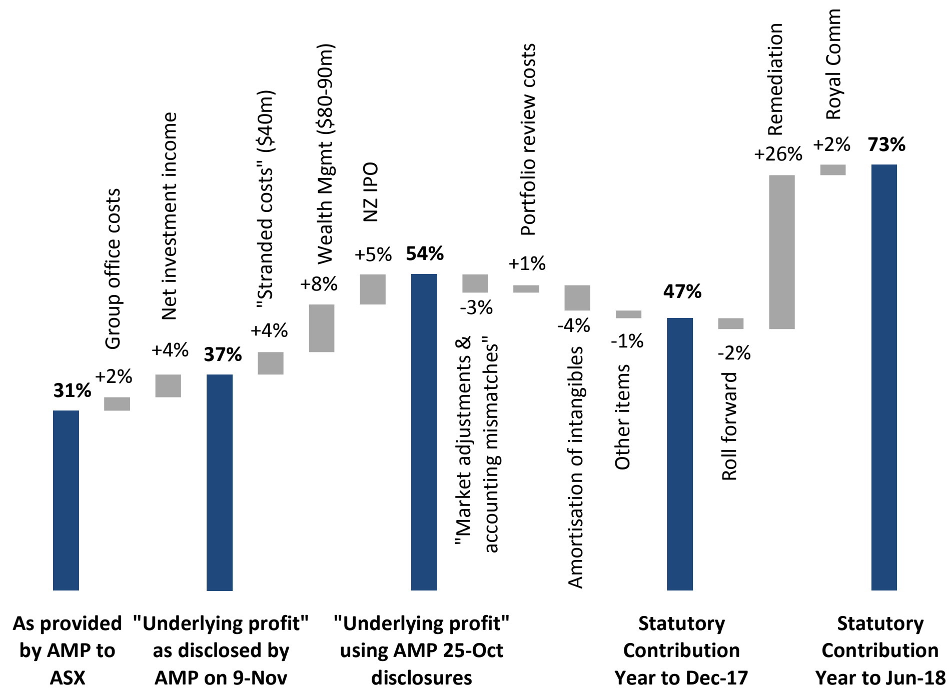
The ASX earnings 'rule of thumb' measure relates to audited statutory earnings presumably because any management generated "underlying earnings" adjustments are inherently subjective and open to manipulation. As an example, AMP's "underlying earnings" contribution provided to the ASX appears to include some arguably "one-off" costs for the divested businesses (e.g. capitalised and experience losses) but excludes some arguably recurring "one-off" costs for the retained businesses (e.g. Royal Commission and remediation costs). This is despite the fact AMP has stated in ASX announcements that it expects the trend of lower profitability in the retained financial advice business to continue (e.g. announced investment platform fee reductions to impact the next set of results).

Nevertheless, we are able to precisely replicate AMP's "underlying earnings" calculation for "Segment profit after income tax". This allows us to bridge AMP's calculations as represented to the ASX with statutory disclosures.

AMP's announced series of divestments represent 73% of statutory earnings and 54% of more subjective "underlying earnings"…

…well above the ASX "rule of thumb" for shareholders to have a say

Figure 6: Divested Businesses Profit After Tax Percentage of AMP



Source: Company announcements. Note 73% figure reduces to 62% of AMP net profit after tax in comments made by a third party in the Australian Financial Review (4 November 2018) if NZ IPO contribution is excluded. A full reconciliation of the above figures to publically available information is included in the Appendix to this report.

This analysis indicates AMP may have materially understated the proportion of earnings related to the series of transactions in the information it provided to the ASX. This applies to

both statutory earnings (avoids eliminating "one-off" costs) and "underlying earnings" (attempts to exclude "one-off" costs).

It is difficult to precisely comment on the other metrics provided to the ASX as these cannot be reconciled to publicly released disclosures. However, some ways AMP may have materially understated the metrics provided to the ASX are detailed in the table below.

AMP may have also materially understated the revenue, EBITDA and asset contributions of its planned divestments to the ASX…

Figure 7: AMP Metrics Provided to the ASX Irreconcilable to Public Information

Metric	Figure Provided to ASX	Possible Inaccuracies
Consolidated Revenue	34%	• AMP most likely included policyholder investment gains in the revenues for businesses to be retained. • Policyholder investment gains are equally offset by changes in policyholder liabilities. That is, on a net basis there are no revenues. • A condition precedent for the transaction is for AMP to transfer "contemporary wealth management business out of AMP Life". • Following the abovementioned transfer, policyholder investment gains and offsetting changes in policyholder liabilities will no longer be recognised. • For the above reasons, policyholder investment gains should be excluded from revenues to be retained. • The Merlon estimate for divested revenue submitted to the ASX is 86%.
Consolidated EBITDA	32%	• AMP have never reported EBITDA for its segments or the consolidated group. • AMP most likely excluded up to $184m in after tax earnings from the EBITDA for the businesses to be divested. • AMP most likely included some "one-off" costs for the divested businesses but excluded "one-off" costs for the retained businesses.
Consolidated total assets	25%	• AMP most likely included policyholder investments in the assets for businesses to be retained. • Policyholder investments are equally offset by policyholder liabilities. That is, on a net basis there are no assets. • AMP themselves acknowledge in their annual report that "*Asset segment information has not been disclosed because the balances are not provided to the CEO… …for the purposes of evaluating segment performance, or in allocating resources to segments*." • A condition precedent for the transaction is for AMP to transfer "contemporary wealth management business out of AMP Life". • Following the abovementioned transfer, policyholder investments and offsetting policyholder liabilities will no longer be recognised. • For the above reasons, policyholder investments should be excluded from assets to be retained.

Source: Company announcements, Merlon Capital Partners

Our legal advisers have written to the ASX on at least two occasions to query the basis upon which AMP has sought to avoid taking the outcomes of its portfolio review to

shareholder vote. No response has been provided except insofar as the ASX requested permission to provide AMP with our estimates which we granted.

Concluding Remarks

As we commented in our initial correspondence with the AMP Board of Directors, *"Over the years we have unfortunately seen many boards allocate capital poorly, but we cannot recall a transaction as inept as this one."* This research confirms that the AMP transaction is outside the bounds of anything remotely normal and, unfortunately, was not a scenario that we contemplated in formulating our investment thesis.

When put to David Murray – the AMP Chairman – in a television interview he indicated he "*could think of a few much worse*" transactions. The preceding analysis would suggest that – if there was a worse divestment – it must have been prior to the year 2000 or outside the top 100 companies.

The largest ever value lost on announcement of a divestment proves there is a major problem…

During the same television interview, when asked why AMP hadn't sought shareholder approval, Mr Murray responded *"because we didn't have to"*. In making this statement Mr Murray may have been relying on highly misleading information provided to the ASX and may not have been aware that the vast majority of divestments by top 100 companies exceeding 20% of enterprise value have historically been taken to shareholders.

Mr Murray went on to comment that "*shareholders appoint the board to make those decisions*". In making this statement Mr Murray may have overlooked the point that he and two other directors have not yet been elected at a shareholders meeting.

…in terms of value and governance…

The ASX also has a role to be more open and transparent with respect to its listings rules, specifically Chapter 11, and the protections offered to minority shareholders. In particular, it would be reasonable to expect the ASX to clarify its position on:

- The use of non-public financial information to justify waiving shareholder rights;
- The use of non-statutory financial information to justify waiving shareholder rights;
- The use of out-of-date financial information to justify waving shareholder rights.

We are deeply disappointed with AMP's divestment of its Australian and New Zealand wealth protection and mature businesses (a question of ***value***). We are equally disappointed with the manner in which it has been handled by the company and the board of directors (a question of ***governance***).

…which should lead to change

The fact that investors assessed this divestment as the worst in decades, in terms of single day firm value lost, makes it unarguable that there is a major problem with both the value and governance aspects of the transaction.

This is not just an issue relevant to AMP's 751,459 shareholders. The ***governance*** issues raised apply to all investors and have ramifications well beyond this transaction.

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Appendix: Impact of AMP Divestments on Earnings

Financial Summary	Year to Jun-18				Year to Dec-17			
A$m	To be Retained	To be Divested	Group	Divested Percentage	To be Retained	To be Divested	Group	Divested Percentage
Profit and loss								
Australian wealth management	317	85	402		306	85	391	
AMP Capital	158	0	158		156	0	156	
AMP Bank	153	0	153		140	0	140	
Australian wealth protection	0	59	59		0	110	110	
New Zealand wealth management	0	55	55		0	54	54	
New Zealand wealth protection	0	61	61		0	71	71	
Australian mature	0	145	145		0	150	150	
BU operating earnings	**628**	**405**	**1,033**	**39%**	**602**	**470**	**1,072**	**44%**
Group Office costs	-110	40	-70		-114	40	-74	
Total operating earnings	**518**	**445**	**963**	**46%**	**488**	**510**	**998**	**51%**
Underlying investment income	48	49	97		41	54	95	
Interest expense on corporate debt	-58	0	-58		-53	0	-53	
Underlying profit	**508**	**494**	**1,002**	**49%**	**476**	**564**	**1,040**	**54%**
Advice remediation and related costs	-312	0	-312		0	0	0	
Royal Commission	-13	0	-13		0	0	0	
Portfolio review and related costs	-43	0	-43		-24	0	-24	
Other items	0	-53	-53		0	-21	-21	
Amortisation of AXA acquired intangible assets	0	-77	-77		0	-80	-80	
Profit before market adjustments and accounting mismatches	**140**	**364**	**504**	**72%**	**452**	**463**	**915**	**51%**
Market adjustment - investment income	0	-26	-26		0	-39	-39	
Market adjustment - annuity fair value	0	11	11		0	4	4	
Market adjustment - risk products	0	5	5		0	-18	-18	
Accounting mismatches	0	24	24		0	-14	-14	
Profit attributable to shareholders of AMP Limited	**140**	**378**	**518**	**73%**	**452**	**396**	**848**	**47%**

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