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AMG - Q1 2017 Affiliated Managers Group Inc Earnings Call

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OVERVIEW:

AMG reported 1Q17 economic net income of $183.2m, GAAP of EPS $2.13 and economic EPS of $3.21.

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CORPORATE PARTICIPANTS

Jay C. Horgen *Affiliated Managers Group, Inc. - CFO and Treasurer*

Nathaniel Dalton *Affiliated Managers Group, Inc. - President and COO*

Sean Michael Healey *Affiliated Managers Group, Inc. - Chairman and CEO*

Selene Oh

CONFERENCE CALL PARTICIPANTS

Alexander Blostein *Goldman Sachs Group Inc., Research Division - Lead Capital Markets Analyst*

Brian Bertram Bedell *Deutsche Bank AG, Research Division - Director in Equity Research*

Christopher Charles Shutler *William Blair & Company L.L.C., Research Division - Research Analyst*

Craig William Siegenthaler *Credit Suisse AG, Research Division - Global Research Product Head for the Asset Management Industry*

Daniel Thomas Fannon *Jefferies LLC, Research Division - Senior Equity Research Analyst*

M. Patrick Davitt *Autonomous Research LLP - Partner, United States Asset Managers*

Michael Roger Carrier *BofA Merrill Lynch, Research Division - Director*

Robert Lee *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

William R Katz *Citigroup Inc, Research Division - MD*

PRESENTATION

Operator

Greetings, and welcome to the AMG First Quarter 2017 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Ms. Selene Oh, Vice President, Investor Relations for AMG. Thank you. You may begin.

Selene Oh

Thank you for joining AMG to discuss our results for the first quarter of 2017. In this conference call, certain matters discussed will constitute forward-looking statements. Actual results could differ materially from those projected due to a number of factors, including, but not limited to, those referenced in the company's Form 10-K and other filings we make with the SEC from time to time. We assume no obligation to update any forward-looking statements made during the call.

AMG will provide on the Investor Relations section of its website at www.amg.com a replay of the call and a copy of our announcement of our results for the quarter as well as a reconciliation of any non-GAAP financial measures to the most directly comparable GAAP financial measures, including a reconciliation of any estimates of the company's Economic earnings per share for future periods that are announced on this call.

With us on the line to discuss the company's results for the quarter are Sean Healey, Chairman and Chief Executive Officer; Nate Dalton, President and Chief Operating Officer; and Jay Horgen, Chief Financial Officer.

With that, I'll turn the call over to Sean Healey.

Sean Michael Healey - *Affiliated Managers Group, Inc. - Chairman and CEO*

Thanks, Selene, and good morning everyone. AMG generated year-over-year growth in the first quarter across our key performance metrics, including record assets under management of $754 billion, a 17% increase over the first quarter of 2016, and Economic earnings per share of $3.21, a 10% increase from the year-ago quarter. Our results reflect the successful execution of our growth strategy, including the impact of new Affiliates and the excellent investment performance and growth of our existing Affiliates.

During the quarter, our Affiliates' alternative products generated strong positive net client cash flows, which were offset by elevated outflows from U.S. Equity strategies, resulting in modest outflows overall. Looking ahead, as Nate will describe, we see positive flow momentum across our business over the balance of the year as we continue to see global institutional and retail clients increase their allocations to truly active, value-added products, even as they may also expand their passive beta exposures. Given the quality and breadth of our Affiliates' alternative and differentiated Global Equity strategies, AMG is well-positioned to generate strong long-term organic growth.

Through our strategic focus on areas where we see secular demand trends and where boutique firms excel, AMG has built one of the largest and broadest alternative product sets in the industry, and clients seeking uncorrelated return streams recognize our Affiliates as among the best managers in the world. With over $290 billion in assets managed across relative value, systematic diversified, private equity, multi-strategy and other alternative products, our Affiliates in these areas provide true diversification, both in terms of cross-correlation as well as relative to traditional fixed income and equity markets.

In addition to growing demand for uncorrelated alternative strategies, trends favoring alpha-oriented products will also benefit high-conviction, high active share equity strategies, especially in global and emerging market equities, which account for approximately one-third of our assets under management. We believe that passive equity products will take share from poorly-performing core equity products, while differentiated, truly active strategies, especially non-U.S. equities, will continue to see growth.

Of course, in every area of asset management, the fundamental measure of success is investment performance. Contrary to the conventional narrative, there are active managers which have and will continue to generate alpha. AMG has partnered with a substantial number of these firms over the past 24 years, and we believe that the best boutique firms are positioned to outperform benchmarks and peers over the long-term.

And across an array of alpha-oriented strategies, leading independent firms are recognized by clients as among the best managers in the industry. We built AMG's business based on the fundamental belief that specialist firms have meaningful competitive advantages in generating alpha, including distinct, highly-focused operating and investment processes, alignment of interests through direct equity ownership and unique entrepreneurial cultures.

AMG's partnership approach preserves these attributes across generations of management partners, and the advantages of our structure can be seen in our Affiliates' outstanding long-term performance records. As Nate will describe further, in the first quarter, our Affiliates continued to generate excellent investment results across a diverse array of differentiated high value added strategies.

AMG's partnership approach allows individual Affiliates to retain their investment focus and alignment with clients, even as AMG itself has become one of the largest global asset managers. While consolidation is a topic of increasing interest in the asset management industry, we believe that consolidation and scale do not enhance, and often detract from, the primary mission of an active manager: alpha generation. AMG's business model allows us to leverage our global scale on behalf of our Affiliates in areas where scale is a benefit, such as marketing and compliance - but importantly, our partnership approach protects the unique operating investment culture of each individual Affiliate and the close alignment of client interests, preserving the essential advantages in alpha generation which will further extend our Affiliates' long-term track records of success.

Turning to new investments. We continue to make progress in executing on our substantial and unique opportunity to invest in outstanding new Affiliates. Given our proprietary relationships with the most highly-regarded independent firms worldwide, along with our reputation and unmatched track record as a partner to our Affiliates over the past two decades, we are confident that we will continue to generate incremental earnings growth through accretive investments and additional Affiliates.

With the scale of AMG's global business today, we are also able to maintain our commitment to prudent capital allocation, consistent capital return to shareholders and significant long-term value creation. As you know, last quarter we initiated a dividend, evidencing this commitment, and going forward, we expect to increase the dividend, while continuing to enhance shareholder returns through accretive investments in new Affiliates and share repurchases.

Finally, against a backdrop of heightened political and macroeconomic uncertainty, AMG's business is well-positioned to generate sustained long-term earnings growth. Our broad range of alternative strategies and differentiated Global Equity products is increasingly attractive to clients seeking to balance their passive beta exposures, and a more volatile market environment will provide enhanced opportunities for our Affiliates to continue to distinguish themselves through meaningful alpha generation.

Lastly, the breadth and diversity of our alternative strategies, which are uncorrelated with traditional markets and with each other, will provide stability and upside opportunity to our earnings and substantial free cash flow across market cycles.

With that, I'll turn it to Nate to discuss our Affiliates' results in more detail.

Nathaniel Dalton - *Affiliated Managers Group, Inc. - President and COO*

Thanks, and good morning, everyone. As Sean said, in the first quarter, our Affiliates, and especially our largest Affiliates, had excellent investment performance across a broad range of alternative and truly active equity products. We continue to believe that the best managers' products, that deliver excess return through market cycles, whether in traditional or alternative asset classes, will remain critical components of client portfolios as these clients need to generate returns to meet their liabilities. Our Affiliates have produced outstanding results over long periods of time, and again this quarter, many of them generated excess returns, extending those long-term track records.

I'll cover performance in more detail in a moment, but first let me provide a bit of context to our slightly negative flows for the quarter. There were several underlying themes. First, we continue to see very good demand for a large number of our alternative products across the full range of client types. Second, consistent with the broader environment, we continue to see weakness within U.S. Equities. Finally, and most impactful to the first quarter, we had two lumpy institutional outflows, one in Global Equity and one in U.S. Equity. Each of the underlying products has performed well, and we believe these redemptions were driven by specific client rebalancing decisions.In the case of the lost U.S. Equity mandate, a portion has already been reallocated to the same Affiliate in a different product in the second quarter. Looking ahead, we feel very good about the positive momentum we now have in the retail and high net worth areas, as our product set includes a large number of in-demand Alternative and Global Equity products and also as our U.S. Equity retail outflows have continued to moderate as absolute benchmark relative performance has improved in this area. We also feel very good about our institutional growth opportunities, especially as we begin to move into the primary fundraising cycles for a number of our significant illiquid strategies, and in addition, our pipeline of won but unfunded institutional mandates includes some very large pieces of business.

Now turning to the details for the quarter. As a reminder, our product categories include Alternatives; Global Equities, including both Developed and Emerging Markets; U.S. Equities; and Multi-Asset and Other strategies. In addition, we'll continue to discuss our alternative products at the subcategory level to dimension underlying return and flow dynamics that are lost at the aggregate level. As you may have seen, we have introduced our new product category disclosure in the tables of our press release, as we believe it helps further describe and contextualize our business.

Now for the specifics, and starting with our alternative strategies, which account for approximately 39% of our business by assets. Within Private Equity & Real Assets, our Affiliates, including Baring Asia, EIG and Pantheon continue to maintain and enhance their solid long-term track records across their flagship offerings. As we've said before, these historical returns will drive strong interest for the upcoming capital raising cycle. In addition, each of these firms continues to enhance and broaden their product sets, which over time will produce additional significant growth opportunities.

In the Fixed Income and Equity Relative Value area, major hedge fund indices posted positive returns in the quarter as indicated by the HFRI Relative Value Index with a 2.2% return; the HFRI Equity Hedge Index with a 3.8% return; and the HFRI Event-Driven Activist Index with a 1% return for the

period. Performance across our Affiliates was also very strong on an absolute and relative basis, as AQR, BlueMountain, Capula and ValueAct all performed well.

Within our Multi-Strategy and Other category, indices were generally positive for the quarter, as indicated by the HFRI Fund Weighted Composite return of 2.4%. Against that backdrop, most of our Affiliates' strategies generated good absolute and relative returns in the quarter. AQR and First Quadrant's largest strategy in the category, including Alternative Risk Premia and Risk Parity strategies, post solid positive returns benefiting from their broad portfolio positioning in the quarter as most underlying exposures performed well.

In our Systematic Diversified category, the SocGen Trend Index fell by about 0.9%. And against that backdrop, results among AQR, Systematica and Winton products were mixed in the quarter. But we continue to see good client demand for these strategies as they have uncorrelated return streams, and many of them have historically performed well in strongly downward-trending markets.

Turning next to flows in our alternatives category for the quarter. We had good organic growth, with $4.3 billion of net inflows, supported by both strong retail and institutional sales. It is also worth pointing out that we generated these positive flows almost entirely across our more liquid alternative subcategories. On the other hand, within our private equity and more illiquid product set, we have continued realization activity from maturing funds without the offsetting benefit of meaningful fundraising.

Now as we discussed last quarter, we have a very significant upcoming fundraising cycle for illiquids mostly weighted to the back half of this year and the first half of 2018, although we should start to see some initial activity in the second quarter of this year.

Now moving to our Global Equities category, which accounts for approximately 33% of our business by assets. Global developed markets had a strong quarter, with the MSCI World Index returning 6.5%. Our Affiliates generated excellent returns in the quarter as well, with the primary strategies from AQR; Harding Loevner; Trilogy; Tweedy, Browne; and Veritas outperforming the benchmarks. Emerging Markets provided even stronger returns, with the benchmark MSCI Emerging Markets Index up 11.5% in the quarter. Both AQR and Harding Loevner outpaced this index, but Genesis lagged for the quarter but still maintained an excellent long-term track record.

Within Global Equities, we had $1.1 billion in net outflows as growth within our retail and high net worth channels, both of which continue to see solid, positive momentum, was offset by elevated institutional redemption levels, most notably the single large institutional redemption I mentioned earlier. Across Global Equities more broadly, AMG's largest Affiliates: AQR; Artemis; Genesis; Harding Loevner; Tweedy, Browne; and Veritas, all continue to have excellent long-term track records. And we feel quite good about where we are with the category as a whole.

Now turning next to U.S. Equities, which accounts for approximately 15% of our business by assets. Market performance was mixed, with large cap and growth stocks generating strong returns. For the quarter, the S&P 500 returned 6.1%, while the Russell 2000 Index returned 2.5%. Our performance against these benchmarks was also mixed in the quarter. Our performers include Frontier, GW&K, SouthernSun, and Yacktman, but the largest strategy, TimesSquare, missed their benchmarks in the quarter.

Within U.S. Equities, we have $4.6 billion in net outflows, and that's in line with industry-wide trends in the product category. While we have a broad array of specialist strategies that we believe will continue to attract client demands over time, especially within small and mid-cap spaces, this was a particularly challenging quarter as the one large institutional redemption I mentioned, along with overall institutional demand weakness, more than offset the continued improvement in retail flows.

Turning finally to our Multi-Asset and Other category, which accounts for about 13% of our business by assets, andencompasses multi-strategy and balanced mandates in our wealth management Affiliates, as well as a number of multi-asset and specialty fixed income products, including Municipal Bonds as well as Canadian and U.K. fixed income strategies. Now on the wealth side, we saw good growth from performance across these generally customized portfolios as well as continued positive net flows. In the specialty fixed income space, performance was generally good, and we continue to see solid net flows into our muni bond and other fixed income strategies. Overall, within the category, we have roughly $200 million positive net flows.

Now looking ahead, with an excellent group of in-demand strategies across Global and Emerging Markets Equities and a wide range of liquid alternatives, coupled with an upcoming significant private equity fundraising cycle, we are well-positioned to generate long-term organic growth. We also believe that the combination of dedicated local sales and marketing efforts of our Affiliates, in partnership with the global scale and reach of AMG's complementary distribution platforms, creates an even greater opportunity to drive significant growth across the business.

And with that, let me turn to Jay to discuss our financials.

Jay C. Horgen - *Affiliated Managers Group, Inc. - CFO and Treasurer*

Thank you, Nate. As Sean discussed, our first quarter results reflect strong year-over-year growth across our key performance metrics. With assets under management of $754 billion, up 17% from a year ago, we continue to meaningfully increase the scale, diversity and earnings power of our business. As you saw in the release, we reported Economic earnings per share of $3.21 for the first quarter, which included net performance fees of $0.18. On a GAAP basis, we reported earnings per share of $2.13.

Turning to our performance metrics. For the first quarter, Aggregate revenue grew 37% to $1.4 billion from a year ago driven by significant growth in equity method revenue due to the impact of our 2016 new investments, all of which were equity method Affiliates, together with stronger markets and a higher level of performance fees.

The ratio of Aggregate revenue to average assets under management increased from a year ago, both on a management fee only basis and in total, reflecting our 2016 new investments, which added a number of high-quality alternative managers at slightly higher management fee rates, and also contributed to a higher level of performance fees in the quarter.

Adjusted EBITDA grew 13% to $243.8 million from a year ago, driven by the impact of our new investments, together with stronger markets and a higher level of performance fees, and reflected our mix between consolidated and equity method Affiliates.

Economic net income grew 15% to $183.2 million from a year ago as a result of lower interest expense as we have continued to reduce leverage. Economic earnings per share increased 10% to $3.21 from a year ago, which includes the full effect of last year's equity issuance.

Now turning to more specific modeling items. For the first quarter, the ratio of Adjusted EBITDA to average assets under management was 13.1 basis points, or 12.2 basis points excluding performance fees. We expect this ratio to be between 12.8 basis points and 13.1 basis points in the second quarter, reflecting a range of net performance fees of $0.06 to $0.12 per share.

With regard to our taxes, our effective GAAP tax rate was 32.1%, and our cash tax rate was 21.1% in the first quarter. Going forward, for modeling purposes, we expect our GAAP tax rate to be approximately 33% and our cash tax rate to be approximately 21%.

Intangible related deferred taxes for the first quarter were $19.8 million. In the second quarter, we expect this number to remain at approximately $20 million. Our share of reported amortization for the first quarter was $38.5 million, which includes $21.7 million of amortization from Affiliates accounted for under the equity method. Amortization increased as a result of our 2016 new investments, all of which were equity method Affiliates. For the second quarter, we expect our share of amortization to remain at approximately $38 million.

Our share of interest expense for the first quarter was $21.9 million. In the second quarter, we expect our share of interest expense to remain at approximately $22 million.

Other economic items for the first quarter were $2.4 million. For modeling purposes, we expect other economic items to be approximately $1 million per quarter.

Our adjusted weighted average share count for the quarter was approximately 57 million, and we expect it to be approximately 56.6 million for the second quarter, reflecting continued repurchases.

Finally, turning to our balance sheet. In the first quarter, we initiated a cash dividend of $0.20 per share, and we repurchased $80 million for approximately 0.5 million shares. We expect to repurchase an additional $120 million in the second quarter, bringing our total to $200 million in the first half of 2017.

Looking forward to the remainder of the year, we expect to maintain balance sheet flexibility to fund new investments or repurchase additional shares while also building capacity for the future by de-levering, including the expected retirement of our $200 million retail bond in the third quarter, which would be accretive to earnings given its relatively high cost. With the full-year effect of our new investments, the earnings power of our business has increased, generating run rate EBITDA of over $1.1 billion. And we are well-positioned to continue to execute on our growth strategy, while consistently returning capital to shareholders.

Now we'll be happy to answer questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Chris Shutler with William Blair.

Christopher Charles Shutler - *William Blair & Company L.L.C., Research Division - Research Analyst*

So when you say that you're seeing positive flow momentum across the business over the balance of the year, can you just break that down a little more? And would you feel that way even without the big private equity fundraises?

Nathaniel Dalton - *Affiliated Managers Group, Inc. - President and COO*

Yes. I'll start this. I think if you look at our flows overall, sort of trends over the last couple of years, we've generally been generating modest positive flows across the entire business, with a significant part coming through the institutional channel. And when we look at good momentum in the more retail sides of our business, the retail and high net worth parts our business, good, positive continued momentum there. A lot of that coming through alternatives, but also slowing outflows in places like U.S. equities, where there have been kind of drags. So feel good about that. And then we look at the institutional channel and it certainly got a component of the illiquids and private equity piece that you described. And I should also remind, as we said in our prepared remarks, there's a realization component to that, which has kind of been ongoing underneath the business. So I think we've got those realizations. We've got the pipeline kind of deferred for that. But honestly, you look at the won-unfunded mandates and the pipeline of kind of finals activity and all the rest, we feel good about this, and very large wins in there in the institutional channel. Now predicting exactly which quarter is hard and all that, but if you look at the back half of the year, really the balance of the year, which I think is how you framed the question, and yes, we feel pretty good about it. Again, any one quarter will have lumpy things, and I really feel good about it over the balance of the year. And then you add on top of that, you have the illiquid pipeline, which I think we have more, not visibility to the specific amounts, but we have pretty good visibility to the track records of the kinds of firms, Baring, EIG, Pantheon, that are going to be out raising money. And you make some conservative estimates about what those firms should be able to do, given their track record and the very strong performance they've been generating. And we feel quite good about that.

Sean Michael Healey - *Affiliated Managers Group, Inc. - Chairman and CEO*

And those are attractive flows when they come. And as Nate noted, right now, we're just getting the outs, if you will, the realizations without the accompanying flows, which over time will be more balanced, and obviously, some fantastic firms are representing us in those areas. So on an overall basis, we do feel quite optimistic.

Operator

Our next question comes from the line of Craig Siegenthaler with Credit Suisse.

Craig William Siegenthaler - *Credit Suisse AG, Research Division - Global Research Product Head for the Asset Management Industry*

I was just looking for an update on fee pressure. Can you talk about if any of your Affiliates have reduced prices on some of their larger products? And also, when they're launching newer products, are the fees today generally lower than they were 5 years ago on similar products? And then also, when you're going into a new platform or big relationship, what type of fee concessions could be offered in that? And I know there are a lot of different scenarios there, but I'm just looking for high level, general data points here.

Sean Michael Healey - *Affiliated Managers Group, Inc. - Chairman and CEO*

Jay, why don't you start by reminding everyone of the Aggregate revenue and fee measure overall? And then maybe, Nate, you can give some color?

Jay C. Horgen - *Affiliated Managers Group, Inc. - CFO and Treasurer*

At the top level, the ratio of our Aggregate revenue to average assets under management has actually increased from a year ago. It's increased on a management fee only basis as well as a total basis, as I mentioned. That's because, obviously, we've added a number of high-quality alternative managers that have higher management fee rates and also contributed to performance fee opportunity. But also, our alternative managers are growing as part of our mix of the existing Affiliates. So even when you exclude 2016's new investments, our fee rates have been stable to maybe up a bit, on both a management fee and total basis. And maybe, Nate, if you want to give a little more context on what's happening at the next level?

Nathaniel Dalton - *Affiliated Managers Group, Inc. - President and COO*

Sure. So I think when we talk about fee pressure, obviously, at a high level, you heard sort of Jay mention how it's happening across the whole business, but maybe to just focus on a couple of different dynamics here, right? So one, if you look across many of our Affiliates, they've got good track records, they are managing their capacity, either because of product capacity or just opportunity in the market at the time, and so they're managing their product set pretty carefully, and that group of firms is able to sustain competitiveness on kind of the flows and all that, while maintaining their pricing discipline. So there's a category of Affiliates that I'd sort of put in that bucket. Then the next thing I'd say is there are definitely parts of the business where there's fee pressure, whether it's certain product categories, certain geographies, certain channels. And there, I think Affiliates are having to make those kinds of choices. And you can actually see, in some ways, some of the choices they're making reflected in the fact that the fee rate for our business overall has been quite stable. One piece, and you touched on this, is we are seeing some of our Affiliates lower fees a bit in trade for sort of longer duration, some longer-lock, multi-year kinds of products. And we think that's a good trade. And again, depending on how you look at the pricing structure for those products, many of which will also include performance fee component, if you think that, that longer duration will allow an expanded investment opportunity set and, therefore, potentially a higher performance, you can actually get -- you can sort of think -- you can think about those as a little bit the trade between slightly lower management fees for slightly ultimately higher realized performance fees potentially. And then the third point, and you touched on this as well, but also while there are areas where we're seeing fee compression, that's offset in many respects by what we're seeing in product development, much of which is happening in relatively high-fee areas. So we're seeing lots of increased allocations to alternatives, for example, from retail investors and platforms. And so while there are some of the dynamics you talked about, if you compare that to much of the other such products, they're still coming online at very good effective management fee levels. So you put all these together and hopefully, that gives you a sense of the color that sits under the high level that Jay described.

Operator

Our next question comes from the line of Bill Katz with Citigroup.

William R Katz - *Citigroup Inc, Research Division - MD*

I had to join a little bit late. Unfortunately, there are some other breaking news in the industry this morning as well andcompeting calls. So I apologize if you covered this already. Could you talk a little bit about outflows in the U.S. equity side and maybe institutional? I guess you called out a couple of one-offs. So I'm just wondering if you could maybe give a little more detail behind that. And then I have a follow-up question.

Sean Michael Healey - *Affiliated Managers Group, Inc. - Chairman and CEO*

We did a version of the first question. But, Nate, why don't you reinforce that? And then, Bill, since that's only half a question, we'll let you ask your second one.

Nathaniel Dalton - *Affiliated Managers Group, Inc. - President and COO*

So in U.S. Equities, as we said in the prepared remarks, U.S. Equities had outflows of about $4.5 billion in the quarter. So gross of about $3.5 and outflows of about $8.0. And so what I said about what was driving it in U.S. Equities at a high level, a lot of that's consistent with the rest of the industry. But what's changed sort of in this quarter, I sort of pointed to a couple of different dynamics. One is we did, in our prepared remarks, talk about one lumpy, large institutional outflow. And actually, as we also mentioned in our prepared remarks that the product's performing fine, and that client was doing rebalancing and in fact has allocated back to the same Affiliate in a different product already in this quarter in a different product, as I said. And then, look, the other underlying sort of somewhat positive trend in U.S. equities is we continue to see outflows in U.S. retail for U.S. Equities. We do see that trend, the outflow trend slowing there as well.

Sean Michael Healey - *Affiliated Managers Group, Inc. - Chairman and CEO*

And on an overall basis, through the balance of the year, we feel quite optimistic about our positive flow momentum. And we called out and discussed a range of illiquid products, which are raising funds as well, and the mix of that. Go ahead. What's your second question, Bill?

William R Katz - *Citigroup Inc, Research Division - MD*

Okay. And I apologize to go back and forward on that one. In terms of capital management, because you laid out a big shift in policy last quarter with a dividend and then the buyback, and I think you mentioned about $200 million. This quarter is only about $80 million. Why? If you could sort of lay out where do we go from here and how you balance between repurchased dividend growth and maybe new investments?

Sean Michael Healey - *Affiliated Managers Group, Inc. - Chairman and CEO*

Maybe I'll have Jay answer that.

Jay C. Horgen - *Affiliated Managers Group, Inc. - CFO and Treasurer*

Yes, you might come back to the new investment piece. On the capital, I mentioned and I'll just reiterate that we do expect to repurchase $120 million in the second quarter, and that will bring our total for the first half to $200 million. And then as we look forward to the back half, we do expect to maintain balance sheet flexibility to fund new investments or repurchase additional shares. However, the one thing that is in our sight is that $200 million retail bond, which we do expect to retire in the third quarter. That will add about $0.14 on a run rate accretion basis to our

earnings. And beyond that, we'll evaluate our needs, which could include new investments, additional share repurchases or further de-levering or a combination of these things.

Operator

Our next question comes from the line of Dan Fannon with Jefferies.

Daniel Thomas Fannon - *Jefferies LLC, Research Division - Senior Equity Research Analyst*

I know you guys backed away from updating guidance on a quarterly basis. But I guess if you kind of talk to some of the inputs and where they sit relative to original expectations, obviously markets look like they're doing better. But wanted to get a little more color on maybe the performance fee outlook and also the $0.18 in performance fees this quarter, what Affiliates drove that, please?

Jay C. Horgen - *Affiliated Managers Group, Inc. - CFO and Treasurer*

Yes. Sure, Dan. So yes, you're right, I think on the last call, we said that just given the size of our business today and the sort of diversity of it, we're really likely to just do one time a year at the beginning of the year for full guidance, but happy to kind of comment on the drivers again. I think the first one is just, as you saw in the release, we start the second quarter at $754 billion in AUM, and that's reflective of the closing of all of our 2016 new investments that added an additional $35 billion in the quarter as well as market appreciation. And as you mentioned, it has been a strong quarter. Our blend in the quarter through March 31 was 4%. And then if you look at it and you bring it forward through last Friday, our blend is up another 1%, so bringing the total year to date to 5% approximately. And as you know, our model convention has been 2% per quarter or 4% for the first half. So we're experiencing slightly higher market levels early in the year relative to our model convention. The other 2 main assumptions or inputs that can impact our 2017 guidance are performance fees and capital deployment. And I'll talk about performance fees maybe over the course of the year, just on capital, which is a more simple one, as I just mentioned, we do anticipate another $120 million in repurchases, bringing our total to $200 million in the first half and we do expect our weighted average share count for the whole year to be about 56.6 million, so that's helpful for modeling. The other assumption being performance fees, the first thing I wanted to say to address your question, with the addition of the 2016 new investments, and a number of them report on a lag, we do expect performance fees throughout the year, so other than our fourth quarter, which tends to be the highest-performance-fee quarter, we do expect the first quarter to be the next highest, and then the third obviously the lowest. And so as you heard, performance fees in the first quarter were $0.18 compared to $0.09 a year ago. We expect the second quarter to be in the range of $0.06 to $0.12. That is consistent with last year's $0.10 number for the second quarter. And in the third quarter, we just don't have that many contracts that are expected to crystallize in the quarter. So our expectation is that the third quarter will be just a few pennies. Of course, the fourth quarter is where we experience the bulk of our performance fees. I know it's still early in the year. We are seeing positive performance across a range of our alternative products, consistent with our expectations.

Operator

Our next question comes from the line of Robert Lee with KBW.

Robert Lee - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

I guess I just have -- this is kind of a broader question. But given your, I guess, your Affiliates structure and each of your Affiliates kind of operating completely, well, independently. But given the increased demand on scale across the industry and understanding that you provide global distribution, that you do provide help if the Affiliates want it with compliance and other things, but do you feel like you're efficiently delivering scale across all your Affiliates as they operate independently? I mean, how do you really kind of scale, and take advantage of that on an administrative and operational basis, maybe not so much on the distribution side?

Sean Michael Healey - *Affiliated Managers Group, Inc. - Chairman and CEO*

Yes. Well, look, I think scale economies exist in parts of the industry. Distribution, compliance, maybe some administrative functions are among them. And in those areas, we absolutely offer Affiliates the advantages of being part of a global scale asset management company and we're in conversations, building relationships with the largest, most important clients and their constituents and advisers around the world. While there's, of course, always more to be done, I think we're in a very good place in terms of exploiting those economies of scale. I think the more important point, which to us seems often lost in broader discussions about the benefits of consolidation, is that in many areas of the industry, especially in alpha generation, it's not at all clear that scale is a benefit. And in fact, in many cases, you can see and imagine transactions that involve some integration disserving the operating and investment culture. And it seems to us to be, if you look across the history in the industry, quite rare that integration transactions actually result in better performance and to the contrary, most often, they result in worse performance. Of course, our model, our business strategy is predicated on preserving and protecting the independent operating and investment culture of our Affiliates and to maintain the very strong, direct alignment that direct equity ownership brings with clients. And so the elements of alpha generation, which in our view, are most important, and of course it always requires execution, but if you don't start with a focused operating and investment culture and if you don't start with direct alignment of interests, it becomes more challenging to sustain excellent results and real alpha generation. So for us, we're quite confident that the structure and approach that we have, as you look forward and think about the industry's evolution, where mediocre equity products, mediocre investment products generally are losing share to passive, as they should, but simultaneously, the clients, both global institutional and retail, are increasingly focused on and investing in outstanding alpha-oriented products, including alternative products, as a complement to that passive beta exposure. For that universe of alpha-oriented products, in our view, you need to have the right ingredients. You need to have, of course, the right product set, but you need especially to have underlying firms which are positioned as best as they can in terms of alignment and focus to sustain alpha generation. And for those, in that respect, scale is the enemy, not the friend.

Operator

Our next question comes from the line of Brian Bedell with Deutsche Bank.

Brian Bertram Bedell - *Deutsche Bank AG, Research Division - Director in Equity Research*

Can we just try to segment the private equity component of the alternative business a little better in terms of -- I don't know if we can dimension the actual realizations that you're seeing. And then when you talk about the fundraising cycle, maybe you could talk a little bit more about the products that's coming into it? And I assume you're counting that when it becomes fee-paying as opposed to just raised and not fee-paying. And are there different pricing structures, or agreements rather, that would change the sort of the fee rate that you see overall in your institutional business?

Nathaniel Dalton - *Affiliated Managers Group, Inc. - President and COO*

Yes. So I think you understand the pricing structures correctly. It is as they come on as fee-paying. So let me back up and try and help dimension the books. There's a number of different Affiliates who have products in the -- in kind of the private equity -- we're calling the private equity and real asset bucket. The sub-strategy, if you want to call that, include as sort of the primary ones, firms like Baring Asia, firms like EIG and firms like Pantheon. So these are firms that are leaders in their respective areas, Asian private equity as well as into real estate, and now increasingly credit, EIG, in the energy space in a few different ways, and Pantheon, both in private equity, primary, secondaries, co-invests and, increasingly, in infrastructure and real assets as well. And so it's a broad group. And there are other Affiliates, BlueMountain and others, who have products in this area as well. So very broad group. And as Sean said earlier, it's really just the accident of how the calendar worked out, with the pace of realizations happening -- for several of these happening to come ahead of the timing of raising new funds. And I think we talked about a bit, maybe last quarter, there were also some other things in there, like say, EIG, you can imagine being slightly slowed by energy prices, those kinds of things. So it just sort of worked out that the realizations are ahead of the fundraisings. And so when we look to the back, the way we characterized it in our prepared remarks, if you look to the back half of this year, the first half of next year, again we should start to see some things in the second quarter. It's just stacked up that sort of primary products. So these firms are all -- have your sort of primary products, and then they're also expanding their product sets into other areas. And so I don't want to imply that there's been no activity. But the primary products, as they move into those fundraising

cycles, that's just how they ended up getting weighted. And it really did just happen to come across those firms. So I wouldn't just call one or two out and describe it that way.

Operator

Our next question comes from the line of Michael Carrier with Bank of America.

Michael Roger Carrier - *BofA Merrill Lynch, Research Division - Director*

Just given the strength on the retail side, just had a question on the institutional and maybe a few clarifications, just given what you guys said in terms of the outlook. So one, I guess just on the outflows in the quarter, was any of that performance-driven? Or was it the trends that we're seeing in the industry in terms of some of the passive pressure? And then just in terms of that fund cycle, I don't know if you can somewhat size -- I know you can't usually give us what the funds that are being raised and the anticipation of the fund size, but more the funds that are currently being invested, like what the fund size is so we can kind of get a sense on what the base of that asset raise could be. And then same thing on the realizations. If you have anything, whether it's for the quarter, for the last 12 months on how significant that has been in the line where you have client cash outflows and realizations. Because a lot of people look at that a little differently in terms of outflows versus realizations being part of the Private Equity and Real Asset business. So couple questions there, but just trying to shed a little bit more light on the institutional side.

Sean Michael Healey - *Affiliated Managers Group, Inc. - Chairman and CEO*

Sure. Just at the highest level, and then I'll turn to Nate. The U.S. Equity products has, of course, exposure to the same kinds of structural pressures that the broader industry is facing, but we're actually seeing, over time, a narrowing of the outflows. And I think what we had this quarter were a couple of one-off institutional outflows that were, if you look at the underlying Affiliates, not performance-related. So if you look past that and extrapolate from the current trends and look at the performance of our underlying Affiliates, that's what gives us the confidence. Nate, do you want to add to that?

Nathaniel Dalton - *Affiliated Managers Group, Inc. - President and COO*

Sure. So yes, I think that covers the sort of the backward-looking piece a bit. And then I think looking forward, I think let me start with the Private Equity and Real Asset segment part of your question. So, what we said on the last call, just to try to help you dimension kind of the potential incremental impact of that cycle is, I think we said, probably about $10 billion net, I think, was the number that we used. So just as a way to dimension, as you say, we can't -- obviously, we can't go into sort of specifically how they're fundraising these products, but also the other thing is, as I described in an answer to an earlier question, while we do have a decent amount of visibility, these are very high-quality firms with really good track records, both investment track records as well as fundraising track records, and so we can have a high degree of confidence as they go into the fundraising cycle. And the products range, whether it's Asian private equity or real estate or credit through the energy product set into secondaries and whatnot. If you look across that product set, we have a pretty good sense of how they're thinking at least and have seen kind of the work they're doing around dimensioning the demand for those products. So while we can't know the exact sizes of them, we can have a pretty good sense directionally. And then I think, overall, you sort of think about the flows in the institutional channel sort of the short-term ahead. As Sean said, normalizing for the lumpy outflows, one of which was in Global Equities, one of which was in U.S. Equities. While we do see a little bit of softness continuing in U.S. Equities, we feel really good about the demand we're seeing. And actually, the accounts we've seen that are won but not yet funded, especially in alternatives, but also in some of the Global Equity areas. So yes, feel good about that over the longer term.

Operator

Our next question comes from the line of Patrick Davitt with Autonomous Research.

M. Patrick Davitt - *Autonomous Research LLP - Partner, United States Asset Managers*

I have a couple more around flows. First, on the U.S. Equity outflow you mentioned that has reallocated this quarter. Why wouldn't that just be a straight transfer? Was there just a longer decision process between what they actually wanted to put it in? And the second one, if you could, would be to qualify the commentary around the pipeline relative to last quarter and year-over-year, even if as general as "better".

Nathaniel Dalton - *Affiliated Managers Group, Inc. - President and COO*

Okay. On the first, this is my memory, but on the first, I believe it really is as funny as the accident of literally quarter timing. I think it was right at the end of one quarter and then the first day of the next month on the other quarter, just literally the way the quarter worked out. So I think it's literally just that.

Sean Michael Healey - *Affiliated Managers Group, Inc. - Chairman and CEO*

Surprisingly, the client was indifferent to our quarterly reporting flows.

Nathaniel Dalton - *Affiliated Managers Group, Inc. - President and COO*

Yes, exactly. So I think that was that one. But then on qualifying, looking forward, so I think ?we feel really good, as I said earlier, about the kind of won but not funded, and some of those will take some time to fund, the won but not funded contracts and all that. And then I'd say the kind of the alt piece and finals and activity levels, I think, are good and consistent with -- we talked about the elevated -- we have talked about the elevated activity last quarter in sort of finals. And I think the overall activity level remains great.

Operator

Our next question is a follow-up from the line of Robert Lee with KBW.

Robert Lee - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

I just had a question on flows. I mean, obviously, we're all focusing on the gross inflow -- the outflow, the $1.3 billion. But maybe economically, is the $1.3 billion outflow, is that a good indication of kind of the EBIT contribution of flows if we were to think of it in that context? Or given the mix of Affiliates and asset classes, was there a positive EBIT contribution despite having the headline asset outflow?

Jay C. Horgen - *Affiliated Managers Group, Inc. - CFO and Treasurer*

So, yes, I appreciate that question because there's a lot of questions on flows and when you look at our AUM table, you'll note that flows are the smallest number on the page net. And surely, the $35 billion of new investments or the $30 billion of market swamps that number, so does FX even, this quarter. And the impact of those flows are proportionate to our business. So I think the flows as a percentage were like 0.3% down, and that's about what it impacted our earnings.

Sean Michael Healey - *Affiliated Managers Group, Inc. - Chairman and CEO*

And said differently, I think our additional disclosure around

Aggregate revenue and ratios to assets so that you're getting a sense of what the stability of the fee level is over time is important. I think we and Nate had a good answer to this earlier, so I'll refer you to that rather than restating it. But we feel good about how our overall business is positioned and how Affiliates are responding to challenges in the broader environment. And while there are some challenges, I think we're pleased that our

business and our Affiliates are holding up very well. And what you're seeing in contrast to others in the industry, what you're seeing at AMG is real stability in the fee levels.

Operator

Our next question comes from the line of Alex Blostein with Goldman Sachs.

Alexander Blostein - *Goldman Sachs Group Inc., Research Division - Lead Capital Markets Analyst*

Just another one around some of the channel dynamics in the quarter. I wanted to hit on the high net worth channel. It looks like the flows there are a bit softer than what we've seen in the past in the beginning of the year. So I was wondering if you could just give us a little more color on what's kind of happening underneath and, again, more importantly, the forward backdrop.

Nathaniel Dalton - *Affiliated Managers Group, Inc. - President and COO*

Got it. So focusing on the high net worth channel, so just to dimension for a second. So as we said in the prepared remarks, right, another positive quarter. I do think if you look, I think, kind of up quarter-over-quarter and down a bit from the very beginning of last year, especially that second quarter, which was a very strong gross sale quarter and low net outflow quarter. So in this quarter, we had about $4 billion of gross sales, $3.5 billion of redemptions and 13 positive quarters in a row. So we feel really good about kind of the stable, steady contribution that we're getting from the high net worth business. In terms of dimensioning the pieces underneath it, I think in the prepared remarks, we broke it into the two categories. And if you think about the wealth management Affiliates, which had positive flows, but we're also seeing pretty strong and sustained flows into the SMA businesses. And the biggest contributors for us there are strong Global Equity flows and also municipal bonds, including, in both cases, ones that are sold through our AMG Funds U.S. platform. So feel good about that. And we are seeing some good momentum -- and I think consistent with some of the underlying industry dynamics on the SMA side. So sort of longer term, maybe to finish off that, answer that question, I do think that the separately managed account market has a lot of potential interaction, and we have strong products there. And some of this, as I said, is responding to the way platforms are moving as they anticipated the deal overall. So feel good about the momentum there.

Operator

Our next question comes from the line of Brian Bedell with Deutsche Bank.

Brian Bertram Bedell - *Deutsche Bank AG, Research Division - Director in Equity Research*

Appreciate the asset class disclosure that you've got. Maybe if you can talk a little bit about the quantitative strategy contribution, and we can see AQR was a little over $3 billion on the mutual fund side, positive flows in the quarter. And maybe not getting firm-specific, but if you can talk about what you would view as the overall contribution of flows from quantitative strategies and is that all in alternatives? Or would you characterize some of that in multi-asset as well?

Nathaniel Dalton - *Affiliated Managers Group, Inc. - President and COO*

So maybe just to step back for a second, when we think about the firms that are, maybe I'll say, more quantitative because I think most of our Affiliates have some quantitative element to their strategies. But we think about what would be broadly put into that sort of quantitative bucket. So one, as you know, very strong franchise in the alternative space across a number of Affiliates. You think about firms like AQR, Winton, Systematica, First Quadrant, BlueMountain, Capula, I would even put many of their products into those kinds of buckets when you think about their strategies. So I think we have a very strong franchise across a number of Affiliates and alternatives. I do think it includes sort of equities franchises as well, again, across several Affiliates. And I think you could put into that both the more traditional quant equity kinds of products and strategies. You

might also put into that the factor, so-called factor in smart beta, which lots of people are talking about now. You could put that there as well, and I think a couple of our Affiliates, in that case, most notably AQR, have quite strong -- have really been pioneers and have quite strong franchises there. So yes, I think it is definitely broader than just in the alternatives category. And I do think it also -- and you've alluded to this in your comment, you also see it coming as a strong franchise across different channels for us as well.

Sean Michael Healey - *Affiliated Managers Group, Inc. - Chairman and CEO*

Yes, maybe just to add to that. I think there, as we all know, has been an increasing level of discussion around the role of technology and especially technology as it relates to investment processes and products. And I think it's a broad topic, but it's important to underscore the degree to which the leaders in the industry include a handful of specialist firms. And we're very pleased that, that group includes a number of AMG Affiliates: AQR, Winton, Systematica, First Quadrant. We have firms which are leading the development of advanced machine learning, artificial intelligence applications, which over time, I think will play an increasingly important role. And each in their own way, these firms are innovating and developing products all at really, at the highest level of the industry. So as you think about that broad trend unfolding over time, we feel very good about how AMG is positioned to benefit from it.

Operator

Thank you. Ladies and gentlemen, thank you. We have come to the end of our time allowed for questions. I'll now turn the floor back to Mr. Healey for any final remarks.

Sean Michael Healey - *Affiliated Managers Group, Inc. - Chairman and CEO*

Thank you again for joining us this morning. As you've heard, we're pleased with our results for the quarter, and we're confident in our ability to continue to create shareholder value through the organic growth of our existing Affiliates, accretive investments in new Affiliates and consistent capital return to investors. We look forward to speaking with you next quarter.

Operator

Thank you. This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.
