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# EDITED TRANSCRIPT

AMG - Q4 2016 Affiliated Managers Group Inc Earnings Call

EVENT DATE/TIME: JANUARY 30, 2017 / 1:30PM GMT

## OVERVIEW:

Co. reported 4Q16 GAAP EPS of \$2.67 and economic EPS of \$3.80. Expects 2017 economic EPS to be \$13.75-15.75.



## JANUARY 30, 2017 / 1:30PM, AMG - Q4 2016 Affiliated Managers Group Inc Earnings Call

### CORPORATE PARTICIPANTS

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

**Nate Dalton** *Affiliated Managers Group, Inc. - President & COO*

**Jay Horgen** *Affiliated Managers Group, Inc. - CFO*

### CONFERENCE CALL PARTICIPANTS

**Michael Carrier** *Bank of America Merrill Lynch - Analyst*

**Robert Lee** *Keefe, Bruyette & Woods - Analyst*

**William Katz** *Citigroup - Analyst*

**Chris Shutler** *William Blair - Analyst*

**Dan Fannon** *Jefferies & Co. - Analyst*

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**Patrick Davitt** *Autonomous Research - Analyst*

**Craig Siegenthaler** *Credit Suisse - Analyst*

### PRESENTATION

#### Operator

Greetings and welcome to the AMG fourth-quarter 2016 earnings 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 - Affiliated Managers Group, Inc. - VP, IR

Thank you for joining AMG to discuss the results for the fourth quarter of 2016. 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](http://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 will turn the call over to Sean Healey.

#### Sean Healey - Affiliated Managers Group, Inc. - Chairman & CEO

Thanks, Selene and good morning, everyone. AMG reported economic earnings per share of \$3.80 for the fourth quarter and \$12.84 for the full year, both at record levels and representing growth of 6% and 3% over their respective previous periods. Against the backdrop of earnings declines across the asset management industry broadly, we were pleased to continue to generate growth in our earnings even with only a partial impact

## JANUARY 30, 2017 / 1:30PM, AMG - Q4 2016 Affiliated Managers Group Inc Earnings Call

from new investments closed during the second half of the year and we have meaningfully enhanced the earnings power of our business as you will hear from Jay in the forward earnings guidance.

Our results for 2016, which include 16% growth in assets under management, reflect excellent execution across all aspects of our growth strategy, including strong investment performance across our Affiliate group, positive organic growth and the addition of several industry-leading new Affiliates.

While we saw modest outflows in the fourth quarter, driven in large part by anticipated seasonal client redemptions and realization activity, our Affiliates generated positive net flows in global equity and alternative products in the quarter and positive net flows of \$7.4 billion for the full year. Over the last five years, we've generated over \$100 billion in net inflows during a period in which, as we all know, active equities have been in outflow and industry flows have been concentrated in passive and fixed income products. Looking ahead, with post-election market expectations for economic growth, tax and regulatory reform and as volatility has increased and correlations have fallen, we expect a much more favorable environment for active managers.

The increasing dispersion in asset returns will allow the best active managers to distinguish themselves. In addition, we believe that clients will increasingly seek products offering true alpha, as well as less correlated sources of alpha, and will continue to be attracted to global equities and alternatives, where specialized firms have particular competitive advantages in generating excess returns.

Across our group of Affiliates, we have strategically and deliberately assembled a very large and diverse set of alternative strategies, including private equity and real assets, fixed income and equity relative value, systematic diversified, and multi-strategy products, which, taken as a whole, provide true diversification relative to traditional equity and fixed income markets, and also have a low correlation with each other.

And our range of alternate strategies also provides a strong complement to our outstanding long-only equity products and meaningful balance and resilience to AMG's earnings. For example, while systematic and trend-following strategies generally had a difficult year in 2016, these strategies remain highly attractive to clients for the diversification they offer as these products are uncorrelated with equities and other alternative strategies and in periods of declining markets, they can be negatively correlated with equities and produce strong positive returns.

More broadly, we believe that client interest in uncorrelated alternative products is an enduring trend. Given the range and diversity of our alpha-oriented product set and our Affiliates' industry-leading track records of investment performance, AMG is positioned to continue to generate strong organic growth over time.

We believe that the breadth and quality of our performance-oriented product range will be increasingly attractive as clients around the world continue to concentrate their active portfolios with a select group of managers and relationships. Against the backdrop of this trend, the scale of AMG's global platform and the depth of the strategic relationships we have built with major global clients and intermediaries are clear competitive advantages.

Our global distribution strategy generated net inflows across each of our institutional coverage regions over the course of the year through our offices in key financial centers across the UK, Continental Europe, the Middle East, Australia and Asia. With ongoing strong business momentum in each of these regions, we have excellent prospects for continued organic growth ahead.

During the quarter, we appointed Hugh Cutler as head of Global Distribution based in our London office. With previous senior leadership roles across a range of asset management firms offering active equities and alternatives, and where he led multi-region sales and marketing organizations, Hugh brings excellent experience to AMG and is a great addition to our senior team. We look forward to his contributions to the continued long-term success of our global distribution business.

Turning to new investments, we were pleased to add a number of outstanding new Affiliates in 2016. Given AMG's unparalleled competitive position, including our excellent track record as a partner to our Affiliates through multiple market environments, the proprietary relationships we have been building over the past two decades with prospective Affiliates, virtually all of which will inevitably face the need for a succession planning



## JANUARY 30, 2017 / 1:30PM, AMG - Q4 2016 Affiliated Managers Group Inc Earnings Call

solution, AMG has a unique opportunity to selectively invest in the highest quality firms and generate meaningful earnings accretion over the long term.

Looking ahead, given the growing scale of our business and the substantial cash flow AMG generates, we have increasing capacity to invest in additional new Affiliates while also consistently returning capital to our shareholders through share repurchases. In addition, as you saw this morning, we have now initiated a quarterly cash dividend. Going forward, we expect to increase the dividend as our earnings grow while also continuing to enhance shareholder returns through accretive investments in new Affiliates and share repurchases.

Entering 2017, we are very well-positioned across all aspects of our business, which is today larger and more diverse across Affiliates, investment strategies and client geographies than ever before. We have an outstanding group of performance-oriented Affiliates recognized as industry leaders in highly attractive alpha-generating product areas. We are successfully executing our growth strategy through both the organic growth of extant Affiliates and new affiliate investments. And most importantly, our reputation as a partner to our Affiliates, along with their individual reputations as outstanding firms, create a whole that is much more than the sum of its parts.

Going forward, we are uniquely well-positioned to continue to enhance the scale, diversity and earnings power of our business and we are confident in our ability to build significant long-term shareholder value. With that, I will turn it to Nate to discuss our affiliate results in more detail.

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**Nate Dalton** - *Affiliated Managers Group, Inc. - President & COO*

Thanks and good morning, everyone. As Sean said, against the backdrop of a challenging year for active managers, we had a good year overall, generating positive net flows in 2016 of \$7.4 billion. This was driven by our Affiliates' strong long-term performance and track records, as well as a diverse product set that broadly continued to be in demand.

In terms of the quarter specifically, we had net outflows of \$4.1 billion caused in large part by anticipated seasonal client redemptions and realization activity in private equity and similar strategies. As we indicated on our last call, we saw the seasonality coming really across channels. In our institutional and high net worth businesses, we had net withdrawals from annual and multi-year locked products where the redemption dates feel at the end of the year. While in the mutual fund channel, the seasonality came through in distribution, as well as tax-loss harvesting, including from some of our liquid alternatives mutual funds, which I will note are back to net inflows in the first quarter.

In addition, we had elevated levels of realization and capital return within our private equity and similar strategies as Affiliates have been opportunistically capitalizing on volatility in attractively priced markets to harvest returns. Now, while we expect some level of continued realization activity in the near term, all of our PE Affiliates are entering or expect to enter fundraising cycles for significant products over the next 12 to 18 months with well in excess of \$10 billion of new capital expected.

Now turning to the specifics for the quarter by channel, within the institutional channel, we had net inflows of \$100 million, following a very strong growth sales quarter of \$14.4 billion. As described earlier, the elevated outflow activity from seasonal client redemptions and realization activity was enough to turn a strong sales quarter into only slightly positive net flows. That being said, positive contributions came from both alternatives and global equities while US and emerging market equities were in net outflow.

In our high net worth channel, we had positive flows of \$341 million, which marks 12 straight quarters of net inflows in the channel. Each of AMG Wealth Partners, as well as our Affiliates separately managed accounts, including those sold through our AMG funds platform, contributed to positive net flows this quarter as well. In the mutual fund channel, we have net outflows of \$4.5 billion as a result of continued pressure on active US equity strategies within US retail, plus the seasonal factors, which I described earlier, as well as a few large subadvisory losses. As we have said before, the subadvisory channel, both wins and losses, tends to be lumpy and the bulk of the outflows this quarter were not performance-related.

For example, most of the subadvisory outflows were from one strong performing affiliate where the loss freed up capacity and we are very confident it will be quickly replaced. Overall, even with those factors, alternative and emerging markets equities posted slight net inflows while global equities and US equities were net redemptions in the channel.



## JANUARY 30, 2017 / 1:30PM, AMG - Q4 2016 Affiliated Managers Group Inc Earnings Call

Now looking ahead, in terms of the forward sales pipeline across channels, while it is still early in the quarter, we've already seen a turnback to positive flows within our US mutual fund business. We also see broader positive sales momentum as the uncertainty immediately following the US election subsides. Across the affiliate group, we had a good level of finals activity in the fourth quarter, which should translate into continued strong sales momentum in 2017.

Now turning to Affiliate performance. Within the global developed equities category, which accounts for approximately 24% of our business by assets, global indices were modestly positive in the quarter with the MSCI World and MSCI Equity Indices up 2% and 1.3% respectively. Against this backdrop, our major global equity strategies from Tweedy Browne and AQR outperformed, while the major global equity strategies at Artemis and Harding Loevner underperformed in the period, but all continue to have good long-term track records.

In the emerging markets category, which makes up approximately 9% of our business by assets, the benchmark MSCI EM Index was down 4.1% for the quarter. In that environment, our flagship strategies at AQR and Genesis significantly outperformed the index, while Harding Loevner's performance was in line with the benchmark for the quarter. AQR, Genesis and Harding Loevner all have very strong performance over longer time periods.

With respect to US equities, which is approximately 15% of our business by assets, market performance was strong in particular in the value and smaller cap indices, where AMG has a number of strategies. For example, the Russell 2000 Value was up 14.1% while the Russell 1000 Growth was only up 1%. Now against this backdrop of wide dispersion across value and growth and small and large, our Affiliates, including Yacktman, TimesSquare, Frontier and River Road, had mixed relative performance, although their long-term track records are mostly very good.

Now, turning to our alternatives strategies. In the private equity and real assets category, which accounts for approximately 9% of our business by assets, our Affiliates continue to feature excellent long-term track records. We see significant opportunities for firms like Pantheon, Baring Asia and EIG to continue to raise significant capital for new flagship products over the next year or so and beyond that, each is continuing to broaden and diversify their industry-leading investment platforms.

In the fixed income and equity relative value segment, which is approximately 9% of our assets under management, major hedge fund indices were positive with the HFRI Relative Value Index up 1.9% and the HFRI Equity Hedge Index up 1.3%. Our Affiliates, including AQR, BlueMountain, Capula and ValueAct, all were able to generate strong positive returns in the quarter and all of their major strategies feature excellent returns over a longer time period.

In our multi-strategy and other category, which accounts for approximately 13% of our assets, the broad indices were up modestly. For example, the HFRI fund weighted composite was up 1.3% for the quarter. Against that backdrop, most of AQR and First Quadrant's flagship strategies produced solid positive returns while the risk parity strategies experienced a modest pullback in the quarter, but still ended the year with excellent absolute returns and were significantly ahead of traditional global balance benchmarks.

Within our systematic diversified category, which accounts for approximately 9% of our assets under management, performance was more challenged with the Soc Gen Trend Index down 4.5% and the Soc Gen CTA Index down 3.8%. This was largely due to sharp unexpected trend reversals across multiple asset classes in the quarter. Our Affiliates, including AQR and Systematica, were not immune to these pullbacks; however, these strategies have shown throughout their history to be able to rebound quickly from drawdowns once trends are reasserted.

Now, stepping back for a minute, while it is important that our Affiliates manage a very diverse portfolio of alternate strategies across a wide range of investment categories, an equally important point is that we have substantial participation in areas of alternatives that are in high demand from institutional and retail investors and that our managers of alternative products tend to be very active in product development and the evolution of packaging these return streams for different distribution channels. Now one final point here is that we also see tremendous business diversification benefits from these high-quality alternative products, which are uncorrelated with each other and especially when they are coupled with our excellent traditional long-only product set.

Now picking up on the evolving market dynamics that Sean described, we may be entering an environment where alternative managers in particular can add significant value as many of them exhibit low betas, low correlations to markets, and downside protection in periods of market stress.



## JANUARY 30, 2017 / 1:30PM, AMG - Q4 2016 Affiliated Managers Group Inc Earnings Call

Finally, even though 2016 was a very challenging year for active asset managers, we were pleased to generate positive net flows on the back of very strong gross sales across all three of our channels. In an improving environment for active managers, especially in global equities and alternatives and with our Affiliates' outstanding track record, we believe we are very well-positioned to continue to drive significant flows through both our affiliate distribution teams, as well as our complementary AMG-level institutional and retail salesforce.

With that, let me turn it over to Jay to discuss the financials.

**Jay Horgen** - *Affiliated Managers Group, Inc. - CFO*

Thank you, Nate. As Sean discussed, in a tough environment for active managers, we are pleased to have generated stable and growing earnings for the fourth quarter and for the full-year 2016 notwithstanding only a limited contribution from recent new investments given the timing and reporting lag. Looking forward with year-end pro-forma assets under management of \$727 billion, we have meaningfully increased the diversity, scale and earnings power of our business.

As you saw in the release, we reported economic earnings per share of \$3.80 for the fourth quarter and \$12.84 for 2016. Economic earnings per share for the fourth quarter included net performance fees of \$0.74 bringing our total to \$0.95 for the full year. On a GAAP basis, we reported earnings per share of \$2.67 for the fourth quarter and \$8.57 for 2016.

Turning to more specific modeling items, as you saw in the release, this quarter, we added two new operating metrics, equity method revenue and aggregate revenue. As you know, GAAP revenue consists only of revenue from consolidated Affiliates and does not include revenue from equity method Affiliates. So unlike GAAP revenue, when you look at aggregate revenue, you can see revenue that includes all of our Affiliates.

For the fourth quarter, aggregate revenue grew 11% to \$1.3 billion and for the full year, aggregate revenue grew 4% to \$4.3 billion. The ratio of aggregate revenue to average assets under management was consistent year-over-year at 66 basis points. We reported adjusted EBITDA of \$289.7 million for the quarter and \$945.5 million for the year, which, as I mentioned, only included a partial-year contribution from recent new investments.

For the fourth quarter, the ratio of adjusted EBITDA to average assets under management was 16.9 basis points and for the full-year 2016, this ratio was 14.4 basis points or 13.1 basis points excluding performance fees. We expect this ratio to be approximately 13 basis points in the first quarter and approximately 14.8 basis points for the full year at the midpoint of our 2017 guidance range.

With regard to our taxes, our effective GAAP tax rate was approximately 33% both in the fourth quarter and for the full-year 2016. Our cash tax rate was 23.4% in the fourth quarter and 20.6% for 2016. Going forward, for modeling purposes, we expect our GAAP tax rate to be approximately 33% both in the first quarter and for the full-year 2017. In addition, we expect our cash tax rate to be approximately 21% in the first quarter and 23% for the full-year 2017.

Intangible-related deferred taxes were \$21.4 million for the fourth quarter and \$84.3 million for 2016. We expect intangible-related deferred taxes to be approximately \$20 million in the first quarter and approximately \$80 million for the full-year 2017. Our share of reported amortization was \$36.9 million for the fourth quarter, which includes \$16.2 million of amortization from Affiliates accounted for under the equity method. For the full year, our share of reported amortization was \$142.5 million, which includes \$59.2 million of amortization for Affiliates accounted for under the equity method. We expect our share of reported amortization to be approximately \$38.5 million for the first quarter and approximately \$155 million for the full year. Our share of interest expense was \$23.1 million for the fourth quarter and \$89.4 million for the full-year 2016. We expect interest expense to be approximately \$23 million in the first quarter and \$90 million in the full-year 2017.

Other economic items for the fourth quarter were approximately \$2.7 million and \$4 million for the full year. As we look forward for modeling purposes, we expect other economic items to be approximately \$1 million per quarter.

Turning to our balance sheet, in the fourth quarter, we settled our equity forward and closed our investment in Winton. During the year, we successfully funded \$1.3 billion in new investments and at year-end, our economic share count was 57.2 million. With the full-year effect of new

## JANUARY 30, 2017 / 1:30PM, AMG - Q4 2016 Affiliated Managers Group Inc Earnings Call

investments, the earnings power of our business has increased generating run rate EBITDA of over \$1 billion and we are well-positioned to continue to execute on our growth strategy.

As you saw in the release, the Board has authorized the initiation of a quarterly cash dividend of \$0.20 per share and increased our share repurchase authorization to 4 million shares. Looking ahead, given the significant and growing scale of our business, we are confident in our ability to continue to generate meaningful earnings growth through accretive new investments while also consistently returning capital to shareholders and building capacity for future new investments.

Now turning to guidance, over the past two decades, our guidance framework for estimating earnings and the key metrics that drive earnings growth have become well-known and understood. Given the diversity and stability of our business today, going forward, we plan to provide guidance only at the beginning of each year. In addition, we are removing our existing model convention for share repurchases. Instead, we will only include known or anticipated repurchases and as always, we do not include future new investments in our guidance.

As we look forward in 2017, based on our expectation for increased cash flow and the pacing of new investments, we plan to repurchase approximately \$200 million in the first half of 2017, which is included in our guidance. With this change and updating for markets, we now expect 2017 economic earnings per share to be in the range of \$13.75 to \$15.75.

As you know, our guidance range reflects market performance through last Friday for the current quarter and our normal model convention of 2% quarterly market growth beginning in the second quarter. We expect performance fees to contribute approximately 13% at the midpoint of our guidance range. We also expect our weighted average share count to be approximately 56.4 million for 2017, which includes the share repurchases I mentioned earlier. As always, substantial changes in markets and earnings contribution of our Affiliates would impact these expectations. Now we will be happy to answer your questions.

## QUESTIONS AND ANSWERS

### Operator

Thank you. (Operator Instructions). Michael Carrier, Bank of America.

### Michael Carrier - Bank of America Merrill Lynch - Analyst

Thanks, guys. Maybe first just on the change in capital policy. Just wanted to get a sense -- I think every company goes through this process and at some point, you are looking at all the options and I think with you guys, given the valuation, the buybacks make a lot of sense. But just wanted to get a sense when you think about the strategy, particularly on the deal side, how active do you expect and how much can that continue to contribute to your earnings growth versus the other options like authorization, obviously, of the dividend and just the thought process on why now in terms of making that shift.

### Sean Healey - Affiliated Managers Group, Inc. - Chairman & CEO

Sure. The first thing to say is the initiation of a dividend is just a natural evolution for us. Jay tells me we may be, until now, the only public asset management firm in the world which doesn't have a dividend. So we always knew that this was a step we would take. The dividend is set at a level that will clearly not impact our financial flexibility and we are confident we'll regularly increase the dividend as our earnings rise.

More broadly, it's important to note that the \$850 million of free cash flow which our business generates is a very important source of value, as you note in your question. We are committed to consistently returning capital through share repurchases. We've made that clear. Now we've added a dividend. But we absolutely see a long-term opportunity for continued value creation through accretive investments in new Affiliates.





## JANUARY 30, 2017 / 1:30PM, AMG - Q4 2016 Affiliated Managers Group Inc Earnings Call

For us, as I think everyone understands, the forward new investment opportunities that we have arise out of relationships with outstanding boutique firms, which we've built over years, and in some cases, decades. With all of these firms, the founding partners will ultimately need a succession planning solution. And from the relationships we build, we will see tremendous opportunities to make new investments, to make accretive investments, in these firms. It's just a question of when, not if. So we remain enormously optimistic about the potential for new investments to add materially to shareholder value over time.

**Operator**

Robert Lee, KBW.

**Robert Lee** - *Keefe, Bruyette & Woods - Analyst*

Great, thanks. Good morning, everyone. Maybe just -- let me follow up a little bit on a couple of -- on the flows. Can you maybe -- and I apologize if I missed these comments, but if we look at the fourth-quarter flows, any quantification of how much of that may have been related to, number one, just seasonality around unreinvested distributions? And then also I wanted to make sure I understood your comments that -- was it the mutual fund outflows that were driven primarily by global and US equities and that the alternatives and other fund products had modest inflows in aggregate? Did I understand that correctly?

**Nate Dalton** - *Affiliated Managers Group, Inc. - President & COO*

Yes, let me take those both. So to the first part of your question about how much, dimensioning the net outflows against those themes we talked about, so if you look at both the theme of seasonality, which we had talked about a little bit on our last call as well, we had seen that coming, as you say, especially alternative management products, there's often a pickup in redemption and you have multi-year locks coming through the year that all get handled at the end of the year.

If you take that primarily in institutional, but also a little bit the high net worth channel, as well as the uptick in realization activity, those two together really do account for the bulk of the net outflows.

And then your comments on the mutual fund channel flows, we see very strong -- if you take the subadvisory flows out of it, we continue to see very good flows in global and alternative funds, especially -- although again this quarter there was a little bit of a downtick in some of the liquid alts funds, especially managed futures, but we did see good flows generally in those areas. This quarter, we saw the global was actually -- was negative, but that was because of that subadvisory comment that I made, which is we had a couple of large lumpy subadvisory wins. So if you take that away, we continue to see good flows in global and alternatives in the mutual fund channel.

**Operator**

William Katz, Citigroup.

**William Katz** - *Citigroup - Analyst*

Thanks so much. We really appreciate the extra disclosure; very helpful, but I do want to focus on gross sales. I think you mentioned some very good momentum going into the new part of the year, so I guess I don't know if you can quantify what kind of pipeline we are looking at. My broader question is if we look at your gross sales year-on-year, that is about flat at about \$118 billion in terms of total size. Can you talk about, and I know you have a new person that may be leading up the effort, but can you talk a little bit about strategies to potentially increase the unit growth just to offset any kind of lumpy redemption that may come through?





## JANUARY 30, 2017 / 1:30PM, AMG - Q4 2016 Affiliated Managers Group Inc Earnings Call

**Nate Dalton** - *Affiliated Managers Group, Inc. - President & COO*

Got it. So a bunch of pieces and I will try to hit all of them. First, I think that sounds about right in terms of year-over-year, but you will recall the second quarter this year was low gross sales. So if you look at the last two quarters or really pull that one out, gross sales are actually running quite well and mutual fund gross sales have been running well. This quarter, again a little slower on the liquid alts, which you will see has already turned around in the first quarter here. And then high net worth gross sales have been running really well. So I think we feel good about where we are with gross sales momentum.

As you look to the first quarter, I guess I would make two comments. The first is we look at the finals activity -- so, one, there was some -- it's a volatile environment; there has been some slowdowns in fundings and maybe attributable to that and also you can see a little bit of some slowdowns activity. That said, we had a fantastic fourth quarter in terms of finals activity, which I think I referenced in the prepared remarks, which should translate into good sales through 2017.

Maybe I will also take the opportunity to step back a little bit because you mentioned the addition of Hugh, which we are very excited about and we think he will bring some really good energy and ideas to what we have been executing in global institutional and our increasing wholesale both in the US and elsewhere. But I would say this has been a challenging environment for active asset managers and you heard Sean speak to that, but over the last five years, as Sean said, we've generated roughly \$100 billion in positive net flows, sort of countertrend. And why is this happening? We have a really good performing product. We think we have got the business positioned very well with global emerging markets and especially alternatives and we've got Affiliates that are doing some very good work in terms of product development and bringing product packaging into new channels. And then we are augmenting all that with our distribution. So I think we feel really good about the opportunity set here to drive sales both through our affiliate's distribution, as well as our complementary AMG distribution.

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

I think one broader point I would make is that, while a discussion of gross flow levels is appropriate at one level, that's very incomplete. We are in an environment where much of the industry is recording declining earnings and obviously, that, in many cases, reflects declining levels of fees. For us -- and I will ask Jay to speak to this in a moment just so that we have an opportunity to get this on the record -- for us, I think there has been some confusion around the stability and strength of our franchise and the underlying profitability of the business, which to us is obviously what is most important.

We are focused on driving sustained earnings growth over time and not on top-line flows by themselves. The strength of the earnings I think has been clear, but what has been maybe less clear are the elements to get there and some of that I think has been based on accounting and maybe, Jay, you could talk to that.

**Jay Horgen** - *Affiliated Managers Group, Inc. - CFO*

Yes, I will just give a little more background about the two operating metrics that we have now included in our disclosure, the first being equity method revenue and the second being aggregate revenue, which takes equity method revenue together with GAAP revenue. And as just a historical statement, in the early years of AMG, we only had or predominantly had consolidated Affiliates, so GAAP revenue was a proxy for top-line growth. It's just not today because what's happened is we've added a number of equity method Affiliates and today, that's about half of our revenues across all of our Affiliates.

So if you just looked at GAAP revenue, you would see a decline and there are some reasons for that, but it's a modest decline and there's also a modest decline in our average fee ratio. However, to the contrary, I guess, if you add equity method Affiliates or you look at equity method Affiliates, you'll see a 28% increase year-over-year in equity method revenue and when you add the two together and make aggregate revenue, you will see a 4% year-over-year increase in aggregate revenue and our fee rates have been flat year-over-year. So you are seeing flat fee rates, growth in revenue and that speaks to what Sean was mentioning and it has been difficult because of the accounting, but when you look at this new metric, you can see all of our Affiliates at one time.



## JANUARY 30, 2017 / 1:30PM, AMG - Q4 2016 Affiliated Managers Group Inc Earnings Call

**Operator**

Chris Shutler, William Blair.

**Chris Shutler - William Blair - Analyst**

Good morning. Jay, you talked about performance fees for the full year. Can you maybe just get a little more granular on Q1? I know that Winton and Capula are going to be in there. Can you just help us out from a seasonality perspective? Thanks.

**Jay Horgen - Affiliated Managers Group, Inc. - CFO**

Sure. Yes, that's right. Over the course of the year, we do expect a midpoint of our range, 13% contribution to our earnings from performance fees and there is a range around that and of course, that makes up the larger part of our range. In the first quarter, we do expect to see some performance fee contribution. Typically, I think some of you have heard me say that we typically see some in the first quarter anyway. That tends to be a \$0.03 to \$0.06 quarter in the historical period. We do think that we will have a higher contribution from performance fees in the first quarter than that. It's hard to say exactly the level, but I do think it's higher than \$0.06 and we will see where we end up, but going forward it will be in that \$0.06 to \$0.15 range over the course of time, I expect, because of just the contribution of the number of contracts that come due in the first quarter or from the reporting lag, Capula and Winton who really will report in the first quarter their fourth-quarter performance fee.

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

Nate, why don't you talk through some of the underlying strategies and where we see potential for performance fees just to give broader context?

**Nate Dalton - Affiliated Managers Group, Inc. - President & COO**

Sure. So, in our prepared remarks today, you see we added in a bit more description of the way we categorize or separate out our alternatives business. And so while our performance fee opportunity is not limited to our alternatives business, there are traditional products that have performance fee opportunity. I thought maybe it would be hopeful to just spend a minute going through those categories and where we see, in both the short term and over the long term, the performance fee opportunity.

So if you take those buckets, we have one, which is the private equity and real assets category, that's including things like Pantheon's PE and infrastructure products, Baring Asia', PE and increasingly real estate and EIG with energy and related infrastructure products, it's those kinds of things. So the long-term performance track records are very good and as we talked about, there's significant capital-raising opportunities, but, in the short run, there's probably not a lot of opportunity here in this category for performance fees and some of that is realizations are coming in mature funds where a lot of the track record predates our investment, especially in Baring and EIG and then Pantheon being fund to funds, the performance fee opportunity is just less.

And then, I guess, finally, I would just note that since we are on method one, we don't realize performance fees until there is no possibility of clawback. So that one, while there is lots of very good long-term opportunity, the short-run opportunity for performance fees for us in terms of realizations are not that great.

Then we have the systematic diversified category, which includes the managed futures and CTA products at firms like AQR, Systematica and Winton and we talked about the performance there. These are again, to be clear, things which we believe are generally uncorrelated with the equity markets and how traditional business and can often outperform in declining markets. There we've talked about the performance and so we look forward to performance fees there as these bounce back.



## JANUARY 30, 2017 / 1:30PM, AMG - Q4 2016 Affiliated Managers Group Inc Earnings Call

The next bucket I described is the fixed income equity relative value and there firms like BlueMountain and Capula and the long short equity firms. Their performance is actually very good in the back half of last year in the main and we think there's significant opportunity as we look ahead to this year in that category. And they are actually starting the year off again -- in the main, starting off the year very well.

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

In both the fixed income, as well as the equity long-short element of that?

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**Nate Dalton** - *Affiliated Managers Group, Inc. - President & COO*

Yes, the long short element of that. There's some beta-sensitive ones in there as well. And then the last bucket, the multi-strategy, obviously includes a large number of strategies, about 13% of our assets and that was a good category for us last year and firms are coming into this year with good momentum. There is no high watermark issues or anything and so we feel very good about the opportunity to generate performance fees in that category as well this year.

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**Operator**

Dan Fannon, Jefferies.

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**Dan Fannon** - *Jefferies & Co. - Analyst*

Thanks. Good morning. Jay, first, on your guidance and the changes, if we think about -- just remind us, there was \$200 million you are saying is in the \$13.75 to \$15.75 this year where previously I think it would have been about double that the way your prior methodology works. I just want to get the puts and takes to the changes so we can think about that.

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**Jay Horgen** - *Affiliated Managers Group, Inc. - CFO*

Yes, it's really simple. The change, which was \$0.25 down, it can be wholly attributable to two simple things. Our AUM levels at year-end were slightly lower than we expected, just a combination of flows, FX and markets, but just only slightly, and then we had a slightly higher share count of 56.4 million versus 56 million in our prior guidance of 56.4 million. That 56.4 million does represent that model convention change to where we have moved to only known or anticipated share repurchases away from the old model methodology.

So those two items clearly are the reason for the \$0.25 difference, but they are really not apples and apples because there is less capital in there, which leads me to my last point, and Sean mentioned it. At the midpoint of our range, we would expect free cash flow to be around \$850 million for AMG. So when you think about it, with the dividend and the share repurchases that are anticipated, we still have \$600 million of additional cash that's just not included in our guidance. So that should be viewed as upside. Of course, the timing of the deployment will impact the calendar year 2017, but on a run rate basis that clearly is incremental.

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

And we would expect, Dan, that investors and analysts will make their own judgments based on information and direction that we give them, but make their own judgments about how to include the earnings contribution of that cash and obviously, in addition to the dividend, which is starting at a relatively low level, the other uses of that cash would be, of course, new investments, and we've indicated that at least for this year the pipeline is at the earlier stages, share repurchases, and we have described our near-term intention to repurchase at least 200 million, but as you can hear from our discussion of a consistent commitment, we certainly envision that element being increasingly important, and then paying down debt, building capacity for future new investments as another element.



## JANUARY 30, 2017 / 1:30PM, AMG - Q4 2016 Affiliated Managers Group Inc Earnings Call

And all of this is not to say that new investments will not over time continue to be an important driver of our forward earnings growth. Absolutely, it will, but given the environment and given the scale of our business, we wanted to make sure that the attractiveness of share repurchase is something that is clear to all.

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### Operator

Alex Blostein, Goldman Sachs.

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### Alex Blostein - Goldman Sachs - Analyst

Thanks, guys. So just on this last point, any way for us just to simply think about what percentage of your free cash flow you expect to return to shareholders in the year when you have no deals? And I guess in years when you do have deals, does it still make sense for us to think about no share repurchases while you are integrating, like the way you did this year?

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### Sean Healey - Affiliated Managers Group, Inc. - Chairman & CEO

I think giving a formula that will apply in the future is unfortunately not something that I think we can do in a meaningful way. For this year, I think we've given you some good context around where we think the greatest use of cash will be. We will update quarterly our judgment about where cash use is best employed and talk about the new investment environment and opportunities and to a great extent that will evolve as a function of the market environment and the new investment environment and the inevitable fortuity of when new investment opportunities are available.

I think the overall strategy of selectively carefully investing in new Affiliates, as we have done for more than two decades and where we see enormous forward opportunities, that will continue. But given the scale of our business and the growth and stability of our cash flow, increasingly returning that cash flow to shareholders through share repurchases is going to be a more and more important element of our shareholder value creation over time.

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### Operator

Brian Bedell, Deutsche Bank.

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### Brian Bedell - Deutsche Bank - Analyst

Good morning, folks. Maybe just drilling in a little bit on some of the flow dynamics again in the fourth quarter. Nate, sorry if I missed this, but can you give us a dollar amount on the realization activity that negatively impacted the institutional flows just to get a sense of the core dynamic there? And the subadvisory mandate, we were calculating about \$2.5 billion in mutual fund outflows, so is about \$2 billion the right number for the lumpy outflow there? And then if you could just give the AUM that is still in subadvised mandates and also in sovereign wealth petro dollar funds.

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### Nate Dalton - Affiliated Managers Group, Inc. - President & COO

Okay. That is one question with lots of parts and I will try to cover all of them, although I may miss a few here or there. So if you go back to dimensioning the seasonality and realization, which I think was the first part of the question, so I think I've said if you take the seasonality and realization, that together accounts for all of the net negative flows for the quarter. So I guess about the size of that. I should say just one other thing on the realization activity- sometimes these cycles line up and sometimes they don't and what we saw here was, partly because of markets, we saw some elevated realization activity coming across a few of our Affiliates and then there's a little bit of a lag it seems so it didn't line up, the fundraising.



## JANUARY 30, 2017 / 1:30PM, AMG - Q4 2016 Affiliated Managers Group Inc Earnings Call

But as we said in our prepared remarks, these firms are entering a period where they will be raising both for their flagship funds, or what you can think of as flagship funds in the case of a firm like an EIG or a Baring Asia, both entering periods where they will be raising money for what you can think of as flagship funds and they are also extending their franchises and adding other funds as well. So some of those are specialty, but some of those are potentially very large franchises.

So if you think about a firm like a Pantheon, as they extend and raise infrastructure and real assets, those are potentially very large franchises. So while those dimensioned together are about the size of the net outflow, there's a very significant forward opportunity with those. I think that was the first one.

On the second part, if I recall correctly, was on the -- you mentioned the subadvisory piece. There, the gap between what I think you are looking at as the public data and our reported, there's a few things that make up the gap, so it's not just subadvisory, although this quarter subadvisory is, I think, the largest part of that gap, but it's subadvisory and then there are other vehicles that are like mutual funds that are non-US. So some of our UK funds, European funds and Canadian funds are also in that bucket.

So I think there's other pieces around it, but this quarter roughly correct that the biggest piece of the difference between what you're looking at as publicly reported and what we've reported is -- publicly reported by data sources and what we've reported is subadvisory.

And then if you are looking -- I think maybe the last piece, if I am remembering right -- looking forward, dimensioning some of the other pieces of our business, I think the petro dollar piece, sovereign wealth piece that you mentioned I think is roughly about -- I don't think there have been any dramatic changes from what we've said before - 3% and so I think I have hopefully covered off.

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

On that last piece of the question, having just visited the Middle East, as well as some other important global offices and regions for us, the largest global institutional clients, including in the Middle East, are in our experience looking to add to and build their positions and their allocations toward an array of alternative products. Again, as we mentioned in our prepared remarks, this enduring trend of seeking less correlated sources of alpha through an array of alternative products is one that we think is increasingly evident around the world.

I would also say that there is, in that region and others, a greater interest in global equities, its anecdotal and we haven't really seen it in large mandates yet, but we feel very good about how our products are positioned with global institutional clients generally, as well as in the Middle East.

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**Operator**

Patrick Davitt, Autonomous Research.

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**Patrick Davitt - Autonomous Research - Analyst**

Good morning. You mentioned your performance issues with the trend change and systematic strategies, but the offset being obviously that a lot of institutions have a lot of demand for those kind of strategies and understand how they work. Is that impacting your institutional conversations? Are you worried about a pipeline of redemptions because of what happened in the fourth quarter or is it just too short a period of time to know?

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

I would say no. In the main, institutional clients are quite aware of what the performance expectations, including the lack of correlation with equity markets and other products, are for these kinds of strategies. We feel very good about our position, which is 8% of assets less -- a fair bit less of that in our earnings given where some of them started the year. But, no, as a component of our portfolio, if you will, and broadly for clients as they think



## JANUARY 30, 2017 / 1:30PM, AMG - Q4 2016 Affiliated Managers Group Inc Earnings Call

about the proper role for these kinds of products in their own allocation, we feel more confident than ever that the appeal and attractiveness and utility of these kinds of products is well-understood. And I think over time that will be the case increasingly in retail as well.

And then stepping back more broadly, and this is in the medium to long term, advances around using machine learning, artificial intelligence techniques are going to be led by these firms, such as, AQR, Winton, Systematica, who, in addition to their core managed futures product set have an array of other products that they currently offer and are developing. We think the long-term opportunities with these Affiliates are really very attractive.

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### Operator

Craig Siegenthaler, Credit Suisse.

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### Craig Siegenthaler - Credit Suisse - Analyst

Thanks. Good morning. So new investments, including Winton, added about \$20 billion of AUM in the fourth quarter. I'm just wondering how much EBITDA did they contribute and then as we look forward into 1Q, how much incremental AUM and EBITDA can we expect from the new deals that are closing here, including Capula?

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### Jay Horgen - Affiliated Managers Group, Inc. - CFO

Thanks, Craig. That's a good question. The short answer is Winton didn't have any contribution in the fourth quarter because of the reporting lag as we had described. So the first time you'll see contribution from Winton is in the first quarter and then Capula was only one quarter, so we did see it in the fourth quarter again on a one-quarter lag. It relates back to a question I think that Chris had asked earlier about just the timing of both performance fees and when we will see those businesses come into our earnings.

I think the main point here though is when you look at our 2016 results -- I don't know what the right word is -- they were not expressing the full impact of those new investments from a full-year perspective, but even more so we financed those transactions before we really experienced the earnings. So really we only had one quarter of Capula and nothing else. So when you look forward and you look at our guidance, taken together with our run rate, we really are starting 2017 on our front foot with respect to EBITDA and earnings from these businesses.

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### Operator

(Operator Instructions). Michael Carrier, Bank of America.

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### Michael Carrier - Bank of America Merrill Lynch - Analyst

Thanks a lot. Jay, just wanted to get maybe an update -- given that you are changing a bit in terms of the guidance, doing it once a year and then not including the typical buyback convention, just wanted to get some sense when we think about deal activity -- I think in the past, you said \$100 million was \$0.10 to \$0.14 given where valuations were in the industry. Any change there?

I guess same thing on the market side. Obviously, markets were up in the quarter. Less of an impact just given the diversity and that can work in both ways in different environments, but just any way we should be thinking about going forward given the mix of the Affiliates on how markets or which markets would be impacting your earnings?

## JANUARY 30, 2017 / 1:30PM, AMG - Q4 2016 Affiliated Managers Group Inc Earnings Call

**Jay Horgen** - *Affiliated Managers Group, Inc. - CFO*

Just to answer the question on markets first because the other one is a simple one. On markets, so far in this quarter, the quarter that we are in, first quarter, our market blend is up about 1.5% and I didn't give that number earlier, but that would have been included in our guidance and then we assume no more market beta for the rest of the quarter and 2% quarterly growth thereafter. So that helps you roll the AUM forward.

I think Nate -- and I know that it's hard to digest everything all at once, but Nate gave some helpful metrics in his part of the presentation earlier, segmenting each of our alternative buckets and talking about comparison to HFR indices and other indices, which I think will help you going forward not only in the long-only equity side, but also in the alternative side matching up against segments so that you can see generally performance as you track through the year. So I think we intentionally did that so it will be more helpful since we are only giving guidance at this time and you'll be able to track it both by our actual reported, but intraquarter with these new metrics.

Then lastly on new investments. Yes, you are right. On balance, I think it's more like \$0.11 to \$0.14. It's rare that we end up with a \$0.10 new investment, so it's a little higher than you said, but it's in that same range per \$100 million spent.

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

And just to emphasize, the change in guidance convention is not at all to be confused with a change in strategy. The strategy has been consistent and obviously, given the environment and the fact that our pipeline is more concentrated at earlier stages, we expect to see more share repurchase. I think the thing that we want to make clear is that while there will over time of course be some building of capacity and delevering as the business grows and generates cash and there is a dividend now, the large part of the cash the business generates will generate earnings growth either through repurchase or new investments. I think our hope is that, in making the change in the way that we are articulating our guidance, that analysts and investors understand the magnitude or don't lose sight of the magnitude of the free cash flow the business generates and the important element that that plays in shareholder value creation.

**Operator**

Robert Lee, KBW.

**Robert Lee** - *Keefe, Bruyette & Woods - Analyst*

Great. Thanks for taking my follow-up. I know you guys have always been reluctant to comment on specific Affiliates, but since I guess it's fortunately or unfortunately on investors' minds, AQR and a big chunk of your reported assets, at least optically, can you just maybe give us some color? We know what fund flows were more or less last quarter, obviously better so far this quarter, but maybe give us a little bit more color on how the rest of their business has been performing from a flow perspective or new business perspective?

**Nate Dalton** - *Affiliated Managers Group, Inc. - President & COO*

Sure. So I will take this in a couple different pieces. So maybe the first piece is to just describe their business overall first. So AQR by itself, while we talk about it as an affiliate, they have a very diverse book of business and you could say, looking at their existing business, you could break it into probably three distinct business lines, maybe, which is a very large traditional long-only quantitative equity strategies business, an absolute return-oriented business, which is also a sizable business, and some of the things you are seeing publicly, the managed futures business, the equity market neutral stuff and maybe style premia things, those are in that segment of their business. So long-only business is probably the biggest by assets, I would say. The absolute return business also a very sizable business and the total return piece to it, which has got the risk parity and real assets and some other strategies in there as well, also a large-scale business.





## JANUARY 30, 2017 / 1:30PM, AMG - Q4 2016 Affiliated Managers Group Inc Earnings Call

So one way to think about it is that way and they have been doing an unbelievable job both diversifying the franchise along those different segments that I described, but then also expanding into their franchise into different distribution channels really around the world. And so that business remains very strong, doing well.

That pullback you saw in the fourth-quarter published mutual funds was really largely the liquid alts book and probably mostly just that managed futures. Interestingly, I think that was also part of that selling for tax purposes I mentioned because it was down. It was one of the few categories that was really down sharply and so that may be part of why you saw it reverse, frankly.

The other thing I would say is -- so again, a very diverse business. Performance is generally good and they are doing quite a good job and we are working well with them in lots of places to help with that distribution.

The other thing is they continue to evolve and innovate the business. They have begun -- for example, they have begun to build really another business line around credit and the opportunity set -- they have their own way of thinking about it and doing it, and the opportunity set for that business is, again, quite extraordinary. And that's not the only thing they are working on. They are working on lots of other things. So the business is performing well, performance and flows both and the forward opportunity as well.

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### **Sean Healey** - *Affiliated Managers Group, Inc. - Chairman & CEO*

Just two dimensionalize as well, while AQR's assets are, as you note in your question, proportionately much larger, the earnings contribution to us is smaller than the assets might lead you to believe, so something like 15%.

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### **Operator**

Dan Fannon, Jefferies.

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### **Dan Fannon** - *Jefferies & Co. - Analyst*

Thanks. You mentioned the \$10 billion opportunity in private equity and the draw-down funds over the next 12, 18 months. Can you characterize that versus what you've raised in those strategies in the previous 12 months?

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### **Nate Dalton** - *Affiliated Managers Group, Inc. - President & COO*

Significantly more than what we've raised in the previous 12 months by a significant margin. As I said, I think we've just gone through a period where there have been these realizations, but just as the way fundraising cycles have stacked up, we are coming into a period where there are significant fundraising cycles coming.

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### **Sean Healey** - *Affiliated Managers Group, Inc. - Chairman & CEO*

Baring Asia is a new affiliate and we made an investment as they finished a fundraise, so the timing there I think is not at all surprising, and is proceeding, I think if anything, ahead of what we would have contemplated. EIG may be, given what happened in the energy space, a slight lag there, but again we think they are tremendously well-positioned. Pantheon I think very much in line with what we would've expected. And so looking back, if you take a longer-time series, the health of these franchises and the prospects for continued growth and future fundraisers is very much in line with their past experience and our hopes and expectations.



## JANUARY 30, 2017 / 1:30PM, AMG - Q4 2016 Affiliated Managers Group Inc Earnings Call

**Operator**

Brian Bedell, Deutsche Bank.

**Brian Bedell** - *Deutsche Bank - Analyst*

Thanks, again, Nate and Sean for the answer before. There's one thing I missed in that though that was the -- I think, Nate, you mentioned on the realization activity you were talking about all of the outflows, but the institutional segment was net neutral. So maybe if you could just reframe that number again and then of the fundraising, the \$10 billion to \$15 billion, just clarification. Do you count that when it gets raised or do you count that in the AUM when it actually turns on and it's earning fees?

**Nate Dalton** - *Affiliated Managers Group, Inc. - President & COO*

So, on the second part, I think the answer will be -- some of this will depend on the form in which it comes, so some are coming in the form where it's being charged on committed capital. Some are coming in forms where it's drawn down and charged only when invested. So I think the answer on the second part is it depends.

On the first part, just wanted to make sure I'm tracking the question. I was dimensioning the size of the uptick in net flows -- so the amount of the net outflows in the quarter was roughly the seasonality plus the realization, if that answers the question.

**Jay Horgen** - *Affiliated Managers Group, Inc. - CFO*

Yes, I think maybe where you were off there, Brian, is that Nate was really speaking to the institutional outflows gross too in the context of the realizations being there. Had they not been there, the flows would have been higher, if you will and I think that's maybe the missing link.

**Nate Dalton** - *Affiliated Managers Group, Inc. - President & COO*

And it was both the institutional channel and that was expressing itself also a little bit in the high net worth channel.

**Operator**

Thank you. Ladies and gentlemen, we have come to the end of our time allowed for questions. I would like to turn the floor back to Mr. Healey for any further comments.

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

Thanks again for joining us this morning. As you have heard, we are pleased with our results for the quarter and confident in our ability to continue to create shareholder value through both organic growth and accretive investments in new Affiliates. We look forward to speaking with you again in May. Thank you.

**Operator**

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



## JANUARY 30, 2017 / 1:30PM, AMG - Q4 2016 Affiliated Managers Group Inc Earnings Call

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