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AMG - Q4 2018 Affiliated Managers Group Inc Earnings Call

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OVERVIEW:

Co. reported GAAP EPS of negative \$2.88 and economic EPS of \$3.53.



FEBRUARY 04, 2019 / 1:30PM, AMG - Q4 2018 Affiliated Managers Group Inc Earnings Call

CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Greetings, and welcome to the AMG Fourth Quarter 2018 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 Mr. Jeff Parker, Vice President, Investor Relations for AMG. Thank you. You may begin.

Jeffrey Parker - Affiliated Managers Group, Inc. - VP of IR

Thank you for joining AMG to discuss our results for the fourth quarter of 2018. 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, a copy of our announcement of our results for the quarter and a reconciliation of any non-GAAP financial measures to the most directly comparable GAAP financial measures, including a reconciliation of any estimate of the company's economic earnings per share for future periods that are announced on this call. As a reminder, we have also included an updated investor presentation on this section of our website. AMG encourages investors to consult the Investor Relations section of its website regularly for updated information.

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

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



FEBRUARY 04, 2019 / 1:30PM, AMG - Q4 2018 Affiliated Managers Group Inc Earnings Call

Nathaniel Dalton - *Affiliated Managers Group, Inc. - President, CEO & Director*

Thanks, Jeff, and good morning, everyone. As we all know, the fourth quarter of 2018 was challenging for asset managers due to broadly negative returns across asset classes as well as the resulting client risk aversion, which impacted industry-wide flows. In addition, the quarter had several extraordinary items, so I wanted to briefly put into context our results and forward outlook.

First, while net client cash flows were negative due to both heightened client risk aversion as well as the fourth quarter seasonality we discussed on our last call, our organic growth outlook is already improving in 2019.

Second, our business is structured differently from other asset management firms. This includes not only diversity of our business and the quality of our Affiliates, but also importantly, our investment structure, which limits our exposure to operating leverage at the Affiliate level providing earnings stability.

Third, we are actively positioning our business to focus on the highest growth opportunities ahead. And finally, because we've been disciplined in managing our balance sheet, we have the flexibility to execute on the opportunities this volatility will inevitably create.

Now turning to the quarter. AMG reported economic earnings per share of \$3.53 for the fourth quarter and \$14.50 for the full year. While Q4 was down versus the year-ago quarter, primarily because of lower performance fees, our results for 2018 were in line with those for the full year 2017. The combination of the timing of the market declines at the very end of the year, with the breadth of the declines across asset classes, meant that while a number of our alternative strategies generated good relative performance, they still had low or negative absolute returns and, therefore, we realized lower performance fees than we expected. As we look forward, our performance fee opportunity is broad and diverse across a range of distinctive return streams, with very good track records of outperformance. As a result, we are confident that performance fees will be a meaningful component of our future earnings growth profile as they have been in the past.

Turning next to flows. There are a couple of high-level themes that shaped our quarter. In general, elevated market volatility in the fourth quarter increased industry-wide client risk aversion, which led to slowing sales activity and delayed funding. In addition, we had elevated levels of retail redemptions in equities and liquid alternative due to fourth quarter seasonality, which in the case of liquid alternatives was exacerbated by significant outflows from products with challenging recent performance relative to benchmark.

While it's still early in the first quarter, we're off to a much better start in 2019. If we take a look at our publicly available data for January, our retail net flows are roughly flat. And while some of that's a reversal of the Q4 seasonality, which was particularly acute for us in 2018, the best retail month we've seen since last April. Putting this all together, we expect good 2018 performance by many of our Affiliates as well as improving flow trend dynamics, driving much better Q1 net flow results and continued improvement throughout 2019.

Now while it's an extraordinary quarter in terms of the breadth of negative returns and client risk aversion, it's important to remain focused on the key elements of our business as we execute our growth strategy. Let me first start with the importance of diversity. Over the past decade, we've built an incredibly diverse business through both the addition of new Affiliates as well as organic growth through product development and innovation by the collective efforts of AMG and our Affiliates. Today, our portfolio is diversified not only by asset class and product category, but also client segment, geography and channel as well as by Affiliate, with no single Affiliate contributing more than a low-teen percentage to our EBITDA.

In the fourth quarter, even with the extraordinary breadth of negative market returns, we saw the benefits of the diversity of our asset mix, which is approximately 40% in alternative strategies. For example, our blended asset mix declined by roughly 8% in the quarter compared to the 13% decline in the MSCI World.

While diversity is obviously important, even more important is the ability of our Affiliates to sustain high-quality distinctive return streams -- across our broad set of asset classes. With the return of volatility, many of our fundamental strategies outpaced their respective indices and peers in the fourth quarter as well as for the full year. We believe that in general, volatility is good for active managers. As we noted last quarter, the data from our recently updated white paper, *The Boutique Premium*, illustrates that the long-term outperformance advantage of boutiques has been most significant during more volatile periods, where their investment processes and disciplines are able to create significant alpha for their clients. This



FEBRUARY 04, 2019 / 1:30PM, AMG - Q4 2018 Affiliated Managers Group Inc Earnings Call

stands to reason as the elements that drive superior alpha generation by boutiques in the first place, an investment-led entrepreneurial culture, meaningful equity ownership by the investment professionals and the long-duration alignment with clients and partners, all supported long-term perspective, which encourages these firms to maintain their investment processes through volatile periods.

We're already seeing this reflect in our business, as the fourth quarter provided a more favorable environment for the highest quality active managers, such as our Affiliates to distinguish themselves. While our performance was broadly diversified across Affiliates and geographies, global, U.S. and up and down the cap range, this outperformance was most prominent at some of our world-class value firms, such as Tweedy Browne, Yacktman, Veritas, Beutel and River Road, with a combination of market volatility and very significant outperformance is leading to a noticeable uptick in client interest and demand across channels.

In addition to our strong performance across many fundamental equity strategies and a number of our liquid alternative products with their Affiliates, such as AQR, Capula, Artemis, PFM and Winton, posted strong relative return, which should position them to raise assets going forward.

While performance across our existing products and capabilities is critically important, we and our Affiliates have been continuously innovating and developing new products with diverse, distinctive return streams to match evolving client needs across all market environments.

As we talked about on our last call, we have a differentiated product development approach. We benefit from product development that happens within our Affiliates as well as from products that we develop jointly with Affiliates, and, of course, our unique opportunity to add immediately saleable product with proven track record through our new investments effort. This unique product development approach has been successful in creating a significant number of new products in the last 5 years, including some of our fastest-growing products. Examples are many and diverse, across our traditional managers firms, such as Artemis, Foyston and TimesSquare launching entire new products of suites of global international emerging market strategies.

In the case of GW&K, building out an equity franchise domestic and global as well as most recently adding Trilogy's proven emerging market capabilities.

Within liquid alternatives, firms such BlueMountain, Capula and First Quadrant are taking advantage of market opportunities to build out ranges of systematic products in areas such as alternative credit, market neutral, global macro and volatility.

Our illiquid alternative managers also continue to diversify their product offering, with Pantheon offering infrastructure real asset and credit, Baring Asia extending the credit and real estate products and the introduction of credits direct lending and operating energy capabilities at EIG.

Lastly, AQR continues to innovate its existing equity and alternatives franchises and is in the early innings of what could be a very significant systematic fixed income build out. Alongside this product development opportunity, our unique distribution strategy, which combines the focused resources of each of our Affiliates, with the scope and scale of AMG's global distribution platforms, is an increasingly valuable component of our overall growth strategy. This model affords our Affiliates the opportunity to diversify their distribution capabilities and bring their expanding product sets to the most appropriate pools of capital worldwide. Moreover, as leading clients worldwide and the intermediary to serve them are consolidating their relationships with external managers and looking for more efficient relationships and even partnerships with a smaller number of investment management firms. AMG and our unique model are beginning to capitalize from those trends, as we can bring to bear the largest collection of independently managed distinctive return streams in the world to meet client needs.

As we discussed last quarter, we've been making progress in formalizing some of these relationships. For example, we entered into a strategic relationship with Nordea Asset Management, where we work together to develop and place certain AMG Affiliate strategies under European and Latin American platform. Simply put, we're collectively leveraging our Affiliates manufacturing and product design and structuring work with Nordea strong brand, scale, packaging and distribution expertise in a strategic and additive way to our existing efforts in these regions.

We're currently very active in working on a number of near-term opportunities with them as well as the operational elements of this relationship. As we discussed on previous calls, while this is a relatively new initiative for AMG, we're making good progress towards establishing a range of these strategy relationships with some being more formal and some less so.



FEBRUARY 04, 2019 / 1:30PM, AMG - Q4 2018 Affiliated Managers Group Inc Earnings Call

Finally, as we also discussed in recent quarters, we've been actively reviewing our business to identify opportunities to improve efficiency in general and, in particular, to make sure that AMG's and our Affiliates' resources are focused on the best risk-adjusted return opportunities in the market.

At the Affiliate level, we continue to support the positioning of their businesses for future opportunities. And in some cases, this has included strategic activity, such as the combination of Trilogy and their emerging markets investment team in GW&K, resulting in enhanced opportunities for their collective clients and increasing both the growth opportunity and efficiency for GW&K and AMG.

As Jay will explain further in a moment, we also reduced operating expenses at AMG and worked with many of our Affiliates, including where we participate in categories of expenses to help them ensure they're aligning the infrastructures of their business with the opportunities and challenges they see ahead.

Now in addition to these elements of organic growth in our existing business, we've another complementary growth engine. AMG's business model provides a significant opportunity to generate increased earnings as well as to add immediately salesable products through investments and excellent new Affiliates. AMG's equity-ownership succession and solution is very attractive to asset management boutiques that value their independence, want a permanent solution and access to the scale of distribution platforms we've built. We continue to actively develop our proprietary relationships with leading boutiques. And while the volatility of the fourth quarter inevitably impacted some discussions, and more broadly, the pace of activity is inherently based on the dynamics of each prospective Affiliate, we have a good pipeline of high-quality new prospects, but we remain disciplined on pricing and alignment, particularly at this stage of the cycle.

In addition, as Jay will describe further, we continue to position our balance sheet to prioritize flexibility and prudent financial leverage in anticipation of continued market volatility, which, in our experience, often creates the most compelling investment opportunities.

In addition to maintaining the financial flexibility to invest in new Affiliates and continuing to execute on the other elements of our growth strategy, we also remain committed to consistently returning capital to our shareholders, and we demonstrated this disciplined approach to capital allocation again in the fourth quarter.

Finally, while these are volatile times, we've built our business with diversity across multiple dimensions, asset class, geography, channel and Affiliates, across this diversity, we have very high-quality distinctive return streams managed by extraordinarily experienced investment teams. We also have a unique structure with low-operating leverage, as you think about the revenue sharing model, which underpins a significant majority of our business and we have prudent financial leverage. These characteristics differentiate us from other asset management firms, while providing stability as volatility continues, but also importantly position us to take advantage of the opportunities this volatility will inevitably create.

Now before I turn to Jay, I want to congratulate him on his appointment to President and thank him for a significant contribution as an integral member of AMG's senior team for many years. But in particular, I want to acknowledge his hard work and the true partnership he brought to Sean and to me through the CEO transition. Sean and I are looking forward to working with him in his new role, as we grow our business and create long-term shareholder value.

And with that, I'll turn it to Jay.

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

Good morning, and thank you, Nate, for your kind comments. I echo the sentiment and I look forward to contributing in my new expanded role. And as Nate discussed, AMG's fourth quarter results were impacted by client-risk aversion and declining markets, especially in the last 2 months of the year as reflected in both our net client cash flows for the quarter as well as our annual earnings contribution from performance fees.

We also had a number of onetime items in the quarter, which I will describe in a moment. In contrast to December, we have seen a marked improvement in both client cash flows and markets in January. Additionally, we are beginning to realize the benefits from expense management actions taken in the fourth quarter.

FEBRUARY 04, 2019 / 1:30PM, AMG - Q4 2018 Affiliated Managers Group Inc Earnings Call

And finally, with an uplift in markets in a new calendar year, we expect material growth in the contribution of performance fees to our earnings in 2019. On flows generally, we experienced a higher level of redemptions from seasonality in the fourth quarter than in prior years, which included tax loss harvesting and selling ahead of year-end mutual fund distributions in the retail channel as well as the expiration of annual liquidity lockups in single and multi-year vehicles in both the institutional and high net worth channel.

Taken together in the fourth quarter, we estimate the effect of seasonality in our quarterly flows, which was exacerbated by the market environment, to be between \$7 billion and \$9 billion. In addition, elevated volatility in the fourth quarter increased industry-wide client-risk aversion, which led to slowing sales activity and delayed fundings, especially in the institutional channel.

Looking ahead, the first quarter typically brings a reversal to positive seasonal factors in our net client cash flows. Additionally, improvement in our fundamental equity performance is already contributing to positive publicly visible flow thus far in January.

Turning to our flows by asset class and starting with alternatives, which account for 40% of our AUM. We reported outflows of \$9.5 billion, driven by our liquid alternative strategies and partially offset by positive contributions from our illiquid product set. Our illiquids, which includes strategies such as global and regional private equity, co-investments, credit, real assets, infrastructure and real estate, had a solid level of fundings in the fourth quarter, and we continue to see a steadily growing opportunity in illiquids as our Affiliates build further on existing and new product capabilities. AMG's aggregate performance in illiquids is very strong, with 92% of our recent funds outperforming industry benchmarks on a net IRR basis and 82% outperforming on a net multiple basis.

In our liquid alternative category encompassing our multi-strategy systematic diversified and fixed income and equity relative value strategies, we saw significant outflows as a result of challenging recent relative performance, which was exacerbated by seasonality, especially in the retail channel in the last 2 months of the year.

Our long-term investment performance in liquid alternatives remained strong with 56% and 82% of our assets under management outperforming their benchmarks over a 3- and 5-year period, respectively.

Now turning to equities, which account for 46% of our AUM. In the global equities category, we saw net outflows of \$3 billion in the quarter, almost entirely driven by emerging-market products. AMG continues to generate good long-term aggregate performance in this category with approximately 56% of our assets under management ahead a benchmark over a 5-year period, notwithstanding that our 3-year number was impacted by challenging performance in emerging market products.

Among our Affiliates in this category are some of the industry's leading global and emerging market managers who continue to have excellent competitive positioning. In U.S. equities, we reported net outflows of \$3.9 billion, due to fourth quarter seasonality and macro industry trends. However, looking at our public flows for January, we're beginning to see the benefits of significantly improved performance in this category. A number of our largest fundamental value equity managers are top quartile performers on a relative basis. We now have 51% of our AUM outperforming benchmarks on a 3-year basis in U.S. equities, a notable improvement relative to prior years.

Turning to the multi-asset and other category, which accounts for 14% of our AUM and encompasses multi-asset and balanced mandates within our wealth management business as well as a number of specialty fixed income and multi-asset products. Here, we posted \$600 million in net inflows, primarily driven by our systematic fixed income products, which continue to generate good flow momentum as well as our wealth management business where positive demand trends remain in place.

Now turning to our financials. As you saw in the release, economic earnings per share decreased by 25% to \$3.53 for the fourth quarter, including \$0.15 of net performance fees. This decline was largely due to a decrease in net performance fees down from \$1.09 a year ago.

On a GAAP basis, we reported earnings per share of negative \$2.88, reflecting the reduction in carrying value of Systematica. For the fourth quarter, aggregate fees decreased 27% to \$1.2 billion from a year ago, and the ratio of aggregate fees to average assets under management declined year-over-year from 82 basis points to 63 basis points, entirely driven by lower performance fees. Notably, the ratio of advisory fees to average assets under management remain flat year-over-year.



FEBRUARY 04, 2019 / 1:30PM, AMG - Q4 2018 Affiliated Managers Group Inc Earnings Call

Adjusted EBITDA decreased 47% to \$191.3 million from a year ago, primarily due to the timing and impact of negative markets at the very end of 2018, which led to significantly lower performance fees and other income for the year. In addition, EBITDA was lower due to a number of nonrecurring expenses, including fourth quarter items related to expense management and AMG's donation to Mass General Hospital. Excluding these onetime items, our fourth quarter adjusted EBITDA would have been \$221 million.

Relative to adjusted EBITDA, the smaller year-over-year declines in economic net income of 29% and economic earnings per share of 25% reflected lower taxes from U.S. tax reform, a onetime tax benefit from the liquidation of Ivory as well as lower year-over-year share count due to repurchase activity in the case of Economic earnings per share.

Turning to more specific modeling items for the fourth quarter. The ratio of adjusted EBITDA to average assets under management was 9.9 basis points. However, excluding the onetime expenses I previously mentioned, it would have been 11.4 basis points or 10.8 basis points, excluding performance fees.

In the first quarter, we expect adjusted EBITDA to average assets under management to be in the range of 11.3 basis points to 11.7 basis points, reflecting a net performance fee range of \$0.10 per share to \$0.20 per share.

Stepping back on performance fee guidance for the full year 2019, we expect performance fee contribution to be in the range of \$0.75 to \$1.75 per share. This performance fee range incorporates product high watermarks actual performance through January and a reasonable range around forward growth assumptions across all of our performance fee products. As you know, we have seasonality in our performance fee opportunity with a large majority of performance fee contracts having calendar year-end crystallization and very few contracts crystallizing in the second and third quarters.

Our share of interest expense was \$18.1 million for the fourth quarter. And in the first quarter, we expect our share of interest expense to remain at approximately \$18 million.

Our share of reported amortization and impairments was \$288 million for the fourth quarter, including \$261.9 million from Affiliates accounted for under the equity method. As you saw in the release, this included the \$240 million noncash charge, I mentioned earlier. Looking ahead to the first quarter, we expect our share of reported amortization and impairment to be approximately \$45 million.

Turning to taxes. With regard to our tax rates in the fourth quarter, our effective GAAP and cash tax rates were impacted by onetime items. And as a result, our GAAP tax rate was negative and our cash tax rate was 15.7%. For modeling purposes, we expect our GAAP and cash tax rates to be approximately 26% and 18%, respectively.

Intangible-related deferred taxes were \$49.6 million in the fourth quarter, which were elevated for the liquidation of Ivory and certain other noncash items related to U.S. tax reform. For the first quarter, we expect intangible-related deferred taxes to be approximately \$11 million. Other economic items were negative \$0.5 million for the fourth quarter. And for modeling purposes, we expect other economic items to be approximately \$1 million per quarter.

Our adjusted weighted average share count for the fourth quarter was 52.7 million, and we expect it to be approximately 51.8 million for the first quarter.

Turning to our balance sheet. On capital management broadly speaking, we have maintained a prudent level of leverage to be able to capitalize on growth opportunities even in challenging markets. In addition, we have continued to return capital to our shareholders within a framework of disciplined capital management.

During the fourth quarter in the midst of a volatile market, we paid a \$0.30 per share dividend and repurchased \$76 million in shares, while continuing to position our balance sheet, including extending the maturity of our revolver and term loan.



FEBRUARY 04, 2019 / 1:30PM, AMG - Q4 2018 Affiliated Managers Group Inc Earnings Call

Looking ahead, as you saw in the release, we announced a first quarter dividend of \$0.32 per share, which reflects a 7% increase as well as a 3.3 million share increase to our repurchase authorization for a total of 5 million shares. In the first half of 2019, we expect to repurchase between \$100 million and \$300 million in shares. However, the amount and timing will depend on the potential new investments and market conditions.

Before we take questions, I'd like to make one final point. Over the past 5 years, we have reduced our financial leverage as part of our disciplined approach to capital management. And as you heard Nate say, AMG's unique revenue share structure, which is in place across the large majority of our Affiliate group, limits our exposure to operating leverage, which in periods of heightened volatility enhances the stability of our earnings. This combination of prudent financial leverage and limited operating leverage gives us the flexibility to deploy capital and capitalize on our growth opportunities, including in periods of market dislocation.

Now we'll be happy to answer your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Bill Katz with Citigroup.

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

Maybe, Jay, congratulations first of all on the promotion. Maybe we could start there. Given the promotion, I was wondering what if any change in strategy there might be? Or maybe just tick off the top 2 or 3 incremental things you're looking as we think about 2019 and beyond?

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

Thank you, Bill. Yes, so look, you know this and I think most -- everyone on the phone, I've been at AMG for 12 years now. I've been involved in the strategic decisions across multiple aspects of our business for some time, including distribution. And so this new role is simply an evolution of my responsibilities. It's not a change or major change for our business. I've been working closely with the head of our new -- or the Head of our Global Distribution, Hugh Cutler, has been with us for a couple of years now on a number of projects. He is doing a nice job. He's got a great team. And I look forward to helping him grow our business in this area. In addition to my new responsibilities in distribution, I'll continue to be involved in all aspects of our business as a senior member of the team.

Nathaniel Dalton - *Affiliated Managers Group, Inc. - President, CEO & Director*

And maybe, Bill, I'll add something to that, which is -- look, we have this -- we talked about this, I think, a couple of calls ago, but we've got this an excellent senior team with a really good balanced mix of people who have been with us for a long time, like Jay, obviously, and also newer perspectives and people we brought in across different functional areas. And a lot of people have stepped up over this past year as we've had some transition. But it's clear we're better positioned than ever before in terms of the breadth and depth of the team we've got. And then finally, I'd say also this is a good environment to attract new talent as well. So look, we've built a really strong senior management team, and it's great to watch how that team continues to evolve as we execute against our strategy.

Operator

(Operator Instructions) Our next question comes from the line of Robert Lee with KBW.

FEBRUARY 04, 2019 / 1:30PM, AMG - Q4 2018 Affiliated Managers Group Inc Earnings Call

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

I guess, I'm just -- you touched on the capital management, which always []. I'm just kind of curious. I mean, just how do you think of your kind of deal capacity right now? And within that, understanding one of the key dry powder and -- but have you changed at all how you're thinking about ultimate kind of leverage that you're willing to run at if you find the right transaction? I mean, I guess, historically, in the past, you've, at times, gone 3x or more, but do you -- has that changed at all? I mean, given the environment that there's more of a governor on kind of the amount of leverage you'd add per transaction?

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

Yes. Thanks, Rob. Let me start here. Well, yes, I appreciate the way you asked the question. I mean, taking a step back for a moment, our longer-term view on our balance sheet is to position it for strength, make sure that we are able to execute on our growth opportunities over a cycle. And we have prudently managed our balance sheet over this time. I'd say look at the last 5 years, we've taken leverage down quite a bit. That's led to increase in ratings. It's just a reflection of that leverage coming down. But during the same time, we've been committed to returning capital to shareholders, and we've returned \$1 billion since the beginning of 2017. As far as capacity, let me walk you through that. We did just extend our revolver -- new 5-year revolver in January, extended our term loan as well. So we are well positioned today with leverage in a good place and also enough capacity on our revolver, nearly \$1 billion on our revolver to execute on our new investment pipeline. I think when you look at the capital model over time continuing to limit leverage and reduce that we think we can do that, while also returning capital to shareholders and we have repurchased shares in each of the last 8 quarters with \$76 million being repurchased in this past quarter and maybe I'll just address that a bit further. We met pretty volatile markets in December. And so we did a bit less than we had initially expected to do in the fourth quarter really because of the extreme volatility in the last 2 to 3 weeks of the year. And looking ahead, this year, we expect to continue to repurchase. We mentioned in the prepared remarks \$100 million to \$300 million in the first half of the year. As you also saw, we increased our dividend, we increased our share authorization, so that we could repurchase additional shares throughout the year. We can give ample capacity under that authorization. So taken together, we do think we're going to continue to reduce leverage, continue to repurchase shares, but the most important use of our capital is new investments. We think that's a continued tremendous opportunity for us over the long term, especially in periods of volatility because after those periods, that tends to be times when executing a new investment is most attractive to shareholders.

Nathaniel Dalton - *Affiliated Managers Group, Inc. - President, CEO & Director*

Yes. And the only thing I would add to that is, I think the question ultimately becomes -- especially if you're going to do something larger, the question becomes when do you have that highest degree of confidence in the opportunities set ahead of you? And I think as Jay said, we're positioning ourselves to be able to take advantage of the opportunity to deploy capital.

Operator

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

Shaun Calnan - *BofA Merrill Lynch, Research Division - Research Analyst*

This is actually Shaun on for Mike. Given the more challenging industry trends and the increasing need for scale, do you see opportunities to centralize more Affiliate cost to create some synergy and scale benefits?

Nathaniel Dalton - *Affiliated Managers Group, Inc. - President, CEO & Director*

Yes. So let me start with that. So we've talked about on prior calls, there are parts of asset management where scale definitely advantage and there are parts of it where it's not. And I think this is where it's important to understand the kind of the unique business model that AMG has, which is we are able to manage diverse set of distinctive return streams at effectively enormous scale in this Affiliate model that we have and the place



FEBRUARY 04, 2019 / 1:30PM, AMG - Q4 2018 Affiliated Managers Group Inc Earnings Call

where we have been investing and place where we have been working with our Affiliates is how can you more effectively bring that significant scale of diverse distinct return streams to bear, which plays into some macro trends as well, and we talked in our prepared remarks about the consolidation of buyer behavior and centralization. So that -- those are places we've been investing. And some of that is what we'll be doing with global distribution. But some of it frankly, these things like and we announced, I think, the Nordea relationship today -- Nordea Asset Management, some of it is our ability to continue to do things like that which is through a single point of contact make it very efficient for large buyers or large intermediaries to understand all of the return streams our Affiliates have and then make it really easy for them to get access to the streams they want, which could be a product or could be something new, but get access to the things they want and then get them into their client portfolios in a way that is both better in terms of faster -- getting the return streams faster and into the client portfolios. But also, ultimately done in a way that's the higher margin for us and for them, as we make it really efficient for them to both understand the return streams and understand the evolution as well. And then the final thing I'll say, there's a really good virtuous circle to this, which we learn a lot from these relationships as we've been going through them, which informs not just our product development, but also informs our new investment activity as well. So those are places we're investing. We think there's a tremendous opportunity, and we're really just at the early stages of that.

Operator

Our next 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 on new investments, I know you missed out on some deals because of just being prudent around valuation. But given the scarcity of strong growing asset management firms, I guess, curious to know how you are thinking about valuation in this environment? I know you've historically paid a 10x-ish EBITDA. And more broadly, why are you convinced this business model is still the right one and are you contemplating any kind of changes or moves into adjacencies?

Nathaniel Dalton - *Affiliated Managers Group, Inc. - President, CEO & Director*

Yes. So let me start with a lot of pieces to that question. So first, we think there's -- there remains a very significant opportunity with the sort of fundamental approach we have, which is how do you partner permanent institutional partner, how do you partner with these outstanding manufacturing businesses. That opportunity is, we think, still there. We also think there's an opportunity to be a much better partner to these firms and this goes to some of the kinds of things I was talking about in the prior -- answer to the prior question, which is, we didn't -- we've been building capabilities, which make us a better partner to those kinds of firms. So we think that opportunity is really significant first. You're right, we've been disciplined. But it's not just around pricing, we've been disciplined around a lot of different dimensions. So we've disciplined about the quality of the organizations. And I think we talked on earlier call about what we mean by high-quality firms and what are the kinds of firms we think are going to succeed in this environment. So we've been disciplined about quality. We've been disciplined about alignment, making sure that we really get good long-term alignment in a way that can ultimately be multigenerational with the management team, which we think is important for our model, which we're -- which has a permanent component we talked about. So we've been disciplined about the quality of the firms. We've disciplined about the alignment we get with them. And absolutely, we've been disciplined about pricing. But I'll say that's really just an issue in a subset of the opportunity set in front of us. It is an issue in our subset, but it's really just an issue in our subset of the opportunity in front of us. In terms of adjacencies, we have looked and we continue to look at ways that we can extend what we do. But we think there's such a big opportunity just in collecting these Affiliates, which have these fantastic return streams, these distinctive return streams collecting those as part of AMG and on our platform and then helping them go into client portfolios in a more effective way. We think that opportunity is a really significant and differentiated rich opportunity. We don't think there is anybody else out there who's able to prosecute that same opportunity.

Operator

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

FEBRUARY 04, 2019 / 1:30PM, AMG - Q4 2018 Affiliated Managers Group Inc Earnings Call

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

I was hoping just to get a clean-up question. And I guess, as we're thinking about the baseline kind of management fee EPS for the guys to start off the first quarter, obviously, lots of moving pieces given the painful end of the year and nice rebound here, but also it sounds like you guys are making various kind of corporate investments. So I heard you kind of \$0.10 to \$0.20 in performance fees, but maybe help us with the baseline management fee run rate?

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

Yes. So Alex, it's Jay. Maybe I'll make a couple of comments here. The first just to put the framing out there, we give guidance in a number of areas, and I think you know this: first is just helping you estimate the run rate AUM and EBITDA, second is just the framework for modeling future growth and the third is performance fees. On the first, the run rate, AUM and EBITDA, which is directly to your question, we started the year with \$736 billion in AUM. Our January markets are up, and we've had good flows as well in the retail channel, a reversal from the fourth quarter. So when you take that together, our market blend is up about 4%, maybe a little over at this point. And so that gives you a sense for where AUM is. And as I mentioned in my prepared remarks, we're in a range of -- take the midpoint of that range 11.5 of EBITDA to average AUM and you can get pretty close to what we think is a reasonable EBITDA run rate for the first quarter. Another way to look at it is we gave you what our EBITDA would have been before onetime items in the fourth quarter of \$221 million. We're off a little bit because the carryover effect of the fourth quarter being offset by the market and flows in the first quarter. So far, we're down a couple of percent, call it. So I think, \$215-ish million on a run-rate basis. So that's another way to get to the same number. Obviously, we go through all the other items to help you translate EBITDA down to EPS in the guidance. As it relates to the framework for modeling future growth, I think we see consensus in The Street developing a good framework to track that. As you know, here, we've historically guided people 2% per quarter, but that's really up to you. And I think almost everyone knows how to track that. And then on the third item, we talked about performance fees, given you guidance in the first quarter that in that range of EBITDA to average AUM, we do expect \$0.10 to \$0.20. So at that 11.5, call midpoint of \$0.15 for the first quarter. Second and third quarters, we typically don't have a lot of contracts that crystallize. So a step down in those quarters. And then for the full year, as you heard me say, we expect a range of \$0.75 to \$1.75. And I'll just comment that, again, given the uplift in markets, new calendar year, we've really improved on our high watermarks from last year's performance. And so we feel pretty good about that performance fee opportunity.

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*

Maybe Jay or Nate, if you can go a little bit deeper into some of the alternative outflows in the fourth quarter. And I think, Nate, you mentioned there are delayed funding pipelines. If those are actually turning around now in 1Q? And then just on the one time in the fourth quarter, if you could -- I don't -- sorry, if I missed this, if you could parse out the Mass General versus the other onetime items that you guys took for AMG expenses? And then as you think about expenses going forward, Jay, on the global distribution effort, does it make sense to actually maybe invest more in that given you think you can, obviously, leverage the good performance across a lot of your strategies going forward?

Nathaniel Dalton - *Affiliated Managers Group, Inc. - President, CEO & Director*

Maybe I'll start -- I mean, we'll try -- maybe try and do those in -- maybe we'll try to do that 1 question in reverse order. So let me start with the spending point because we talked about this a little in our prepared remarks and how we invest in the business. And so look, Brian, I think we're pretty decisive -- we and Affiliates were pretty decisive in the fourth quarter in terms of -- and we've been -- look, we talked about this on early calls. We've been looking at this for the last couple of quarters, which is how do we make sure we're allocating our resources to the right things? And so we've reduced spend and we've clearly reduced resources allocated to kind of products, packages, channels that are subject to commoditization all those kinds of things, some of it by us, some of it by Affiliates, some of it is just kind of rightsizing resources, some of it is kind of critically examining



FEBRUARY 04, 2019 / 1:30PM, AMG - Q4 2018 Affiliated Managers Group Inc Earnings Call

opportunities. But then at the same time, we've been investing and increasing spend against both on the product development side, where the places where we can enhance distinctive return streams exist. And this has been a good environment also to add and invest in building out. Again, this volatility creates opportunity to build out at some Affiliates, where there's opportunity to really accelerate product development. And then as you said, a place we have been investing both people and operational build is how do we make sure we get these return streams into the appropriate client portfolios? Now some of that is sort of specifically what we would have referred to as global distribution. And I think we talked about last quarter, for example, opening Japan, where we think there is a very large opportunity, very early innings. And we continue to see good traction. And some of our Affiliates, Pantheon and AQR already have also opened up alongside that. Some of it is also the building against these kind of -- what I'll call, kind of channel partnerships or strategic relationships and some of them were complicated mandates we've talked about on earlier calls, is building those resources so that we can get Affiliate return streams efficiently in the field. So we're absolutely doing that on that part of the question.

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

Yes. So I just wanted to add on the expenses to Nate's. The first thing I would say is, the -- as you know, large majority of our Affiliates are under revenue share. But where we do have exposure to expenses at AMG and at certain of our equity method Affiliates, we and they had reduced expenses pretty decisively in the fourth quarter, gave rise to kind of about \$10 million of onetime items in the fourth quarter. We will experience that sort of savings in '19. So if you look at where we're exposed to expenses, again, at AMG and at certain of our equity method Affiliates, we're going to take expenses down 2% to 3% year-over-year. And so that's already in place. The other onetime expenses just to kind of keep on that theme, obviously, MGH. So the total of MGH and those onetime expense management actions brought our EBITDA from kind of \$191 million to \$221 million, that was in my prepared remarks I mentioned that. We had a couple of other onetime items. Of course, the tax benefits in recovery from Ivory as well as the re-valuation of Systematica, those were the kind of 4 onetime items in the quarter if you're tracking that. They all go through different financial statement line items. So I'm happy to kind of follow up with you, if you like on that. So I think that's on expenses. And I believe there -- was there one more question? I can't remember if there was now.

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

That's -- if that's turning around...

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

Oh, yes. On alternative, yes. So on alternative flows and maybe I'll take flows, sorry, that was the -- I was tracking back in reverse order through your one question. So just the bridge flows for a moment. You did hear me say on the -- in the prepared remarks that we did see some seasonality -- pretty significant seasonality, which exacerbated -- was exacerbated by the December volatility. So when we took a look at the data -- and we do have pretty good visibility into the institutional book as well as retail seasonality, so the institutional, the expiration of multiyear locks and single-year locks. And we had about \$3 billion to \$4 billion of seasonality there with another \$4 billion to \$5 billion in retail that kind of get you to that \$7 billion to \$9 billion number that I mentioned on the call. The other factor, which is a little harder to assess, but we still, I think, think that there's a real number here, the risk aversion, which was causing lower sales given the extreme markets impacted our flows in kind of that \$1 billion to \$2 billion number that level. So when you take all that away, there was still some softness in our flows and that really was alternatives in retail, liquid alternatives. But seasonality really did exacerbate and risk aversion exacerbated. When we look more broadly kind of over the course of the year, we look at first quarter and say in retail, you've got positive flows through January, improving performance in U.S. equities, solid illiquid capital raising activity. The trends for us remain intact. Volatility is good for active management. And we do, broadly speaking, have a lot of good performing product across the diverse business that we have. When you add on to it ample capacity, new product starting to gain traction, like the systematics fixed-income business, that Nate mentioned, together with our distribution efforts, our evolving partnership with Nordea, we do think that we're going to be able to take these distinctive products into new channels, new regions, new partnerships and pulling all that together, where our long-term kind of growth outlook at least for -- through this year -- I should say, the medium-term growth outlook for this year, we do expect to return by the end of 2019 to something like 2% organic growth.



FEBRUARY 04, 2019 / 1:30PM, AMG - Q4 2018 Affiliated Managers Group Inc Earnings Call

Nathaniel Dalton - *Affiliated Managers Group, Inc. - President, CEO & Director*

And then the only thing I would add to that is, because I think that's a really good bridge to, sort of, think about the year, but the only thing I'd add to that is there's a couple of just sort of underlying dynamics and Jay touched on one, which is this kind of balance between the development of product that has -- we believe is distinctive and has good opportunity with the evolution of the book and, frankly, the roll off in the book of a product that we think is more sort of commoditized or susceptible of being commoditized. And you did see that over a period of time in some of our U.S. equity book in the institutional phase as an example. So some of it is just simply that kind of evolution if you look at the mix of our products. We're feeling really good about the distinctive nature of most -- of an increasing percentage of those products. And then the other dynamic I'll just mention is that the pull back in the fourth quarter and some of the volatility combined, we have a number of products that are -- there are fantastic products with very strong long-term track records that have been closed and are reopening or kind of making progress in that way and sort of where they're starting to sort out how are they going to put some of the capacity they've got, both from the fact they've been closed and so you can't have inflows. You have had outflows. But also, from the standpoint of -- with all these outflows that they're seeing real opportunities. So I think that -- those are other dynamics that put together, business extends, but these are longer-term trends. I think, business extends beyond this year. We think the opportunity, ultimately, is we can get back to kind of where we were in the first half of the decade.

Operator

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

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

So just first one to clarify, Jay, positive flows in January versus, I think, Nate said breakeven. So just clarify that on the retail or maybe that was all in? And then in terms of institutional activity, just curious if we see the retail data which, obviously, is only a subset, but is retail within the liquid alternatives acting different than the institutional client base? Or you seeing kind of broadly institutional kind of demand changing for some of the alternative strategies, particularly at AQR?

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

Yes. So yes, let me -- I'll clarify. Yes. No, we did see about \$100 million positive in the publicly visible. So I think Nate characterized that...

Nathaniel Dalton - *Affiliated Managers Group, Inc. - President, CEO & Director*

I think it's in that roughly...

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

Yes and I characterized that as positive. Clearly, that was a significant reversal from December. And just -- I think Nate will probably pick up on the alternative point here and how it's acting in institutional. But I would just say when you look at the retail flows publicly visible this quarter and that's not all of retail, Dan. We do have subadvisory and some nonreporting retail. That's harder for us to see even given that it is just early February. But just commenting on what trends we're seeing in the publicly visible. Clearly, the sort of value managers, both the U.S. and global, have seen a pretty strong reversal in both investment performance and flows. We've had good flows in U.S. equities. And so one of the themes that, I think, is emerging here for us is when we -- where we've had pretty significant outflows for a significant number of years here in U.S. equities. We've seen really good things and the decreasing of outflows or maybe even positive flows. Names like Yacktman, Frontier, River Road have top quartile performance over the long term. And we've seen our U.S. equity kind of 3-year numbers in aggregate for the first time go above 50% and that's probably 3 or 4 years since that happened. So we're very positive about that. Among global equities, we have also seen there a really good performance, especially in global and international mandate as well as the regional -- sorry, global international and regional products. We've been plagued a little bit by EM performance. It's been a tough go for active in EM. Still have great Affiliates positioned well in EM, and some of those

FEBRUARY 04, 2019 / 1:30PM, AMG - Q4 2018 Affiliated Managers Group Inc Earnings Call

Affiliates are opening products back up. When you look into the underlying data, you're seeing global mandates international really being driven by that outstanding performance. So those themes really are emerging here in 2019, and then as it relates to liquid alternatives and institutional maybe.

Nathaniel Dalton - *Affiliated Managers Group, Inc. - President, CEO & Director*

Yes. So maybe I'll make a couple of comments there. So I think -- look I think -- so 2018 was an extraordinary year. I mean, it was a really extraordinary year in terms of the breadth of the negative returns across asset classes. I mean, it was sort of historic. So that was an extraordinary year. But the underlying thesis around why people are trying to get these alternative return streams into their portfolios, they're all remain intact. And I think you'd even see and we talked about this in our prepared remarks, even with that, that extraordinary breadth of negative returns across asset classes, it really did serve a diversifying effect now, that didn't serve a fact that they were up. And so therefore, we would realize performance fees and we talked about that, but they do serve a diversifying effect. And so look, I think the fundamental thesis about why people are using return streams remain fully intact. And we look at the decision-making around the -- in the institutional channel around alternatives and we see -- we continue to see very strong sales activity across a wide range of products, both liquid and illiquid, but certainly in liquids. So it's not a challenge of a pipeline and sales, an opportunity to develop new products on the rise. So that all remains intact. I will say there is one other point, which is -- and Jay touched on this before, which is in the retail channel, part of what happened was really just the combination of the performance plus the seasonality as people went through, whether it was selling ahead of distributions or tax loss selling. No, that was part of what we experienced as well. And then even in the institutional channel and I think Jay mentioned this, there was seasonality in institutional. There's just typically is as you get to the expiration of kind of single and multiyear locks right at the end of the year. So we think that demand trend -- the underlying trends are intact. We think there is really good activity in the pipeline. And so we do think it should be -- it's not acting the same as retail, if that's kind of part of the question. And we think that -- again those underlying trends should continue. All that said, of course, it's ultimately the return streams have to be distinctive and performing.

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

Yes, one last thing. I didn't want to leave these underlying trends without also mentioning just the PE fundraising and illiquids. We had a solid quarter. We had a solid year off of 2 years. We look forward and we see continued growth in illiquids, both kind of new products and the partnerships with large pools of capital. We do see this as an enduring growth opportunity for us as kind of the other major trend this year.

Nathaniel Dalton - *Affiliated Managers Group, Inc. - President, CEO & Director*

Yes. And it's a place where there's really good product development going on.

Operator

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

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

Would it be possible to -- if we think of the -- maybe the flows in the quarter kind of characterize that in terms of its EBITDA impact, if organically it was maybe on just the asset base to stand just under 2%. Would the EBITDA impact be kind of similar? Was there some mix issue that will make it greater or lower? And if we think, Jay, kind of thinking that you can get back to the 2% organic growth maybe by the end of '19. I guess, similar question. Given how you're looking at the mix going forward from what you can see, would that be indicative of kind of the EBITDA contribution?



FEBRUARY 04, 2019 / 1:30PM, AMG - Q4 2018 Affiliated Managers Group Inc Earnings Call

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

Yes. So let's take the EBITDA contribution first. Yes, the asset-weighted EBITDA contribution, it's a little hard to see in the underlying data because performance fees had such an impact on our results in the fourth quarter. But one of the things you can see, as I mentioned, if you kind of track EBITDA from third to fourth to first quarter and I mentioned the \$221 million, before onetime items in the fourth quarter EBITDA going to something, it looks like \$215 million. That's just a couple of percent down. And the way you can also see that, that's tracking, that was consistent with your inference, that's tracking to when you look at average EBITDA to average AUM, it's actually going back up. So what that suggest is that the assets that were lost had an average weighting that was consistent with our overall business and the mix shift for us is actually going back the other way after several quarters, 6, 7 quarters. Rather than going the reverse direction, we see it actually improving on profitability. So our EBITDA to average AUM is improving as we go. So I would say that I think that's partly because of where we're growing, and it's also partly based upon the ownership mix of our business.

Operator

Ladies and gentlemen, that concludes our time for questions. I'll turn the floor back to Mr. Dalton for any final comments.

Nathaniel Dalton - Affiliated Managers Group, Inc. - President, CEO & Director

Thank you again for joining us this morning. As you heard, we are confident in our prospects for significant long-term growth. We've built a diverse business, which includes some of the highest quality boutique firms in the industry, with established long-term track records of outperformance across a wide range of investment strategies. And as Jay said, all of this is within a business model that is low operating leverage and a flexible capital structure, which positions us to execute on our business strategy and create long-term value for our shareholders. And 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.

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