S&P Capital IQ

CONTENTS

Apollo Global Management, LLC NYSE:APO

FQ4 2016 Earnings Call Transcripts

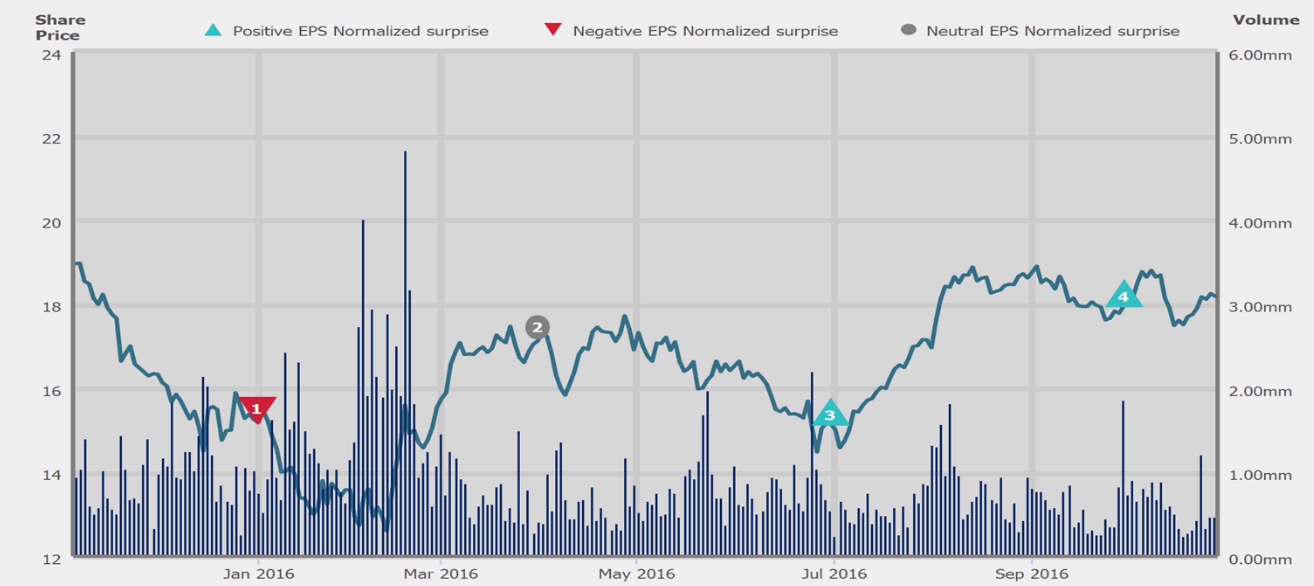
Friday, February 03, 2017 3:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2016-			-FQ1 2017-	-FY 2016-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.80	0.98	▲22.50	0.52	2.12	2.36
Revenue (mm)	564.83	685.40	▲21.35	505.57	1814.22	1970.38

Currency: USD
Consensus as of Feb-02-2017 4:20 AM GMT

Stock Price [USD] vs. Volume [mm] with earnings surprise annotations



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ4 2015	0.26	0.08	▼1 (69.23 %)
FQ1 2016	0.04	(0.18)	NM
FQ2 2016	0.20	0.98	▲2 390.00 %
FQ3 2016	0.46	0.58	▲3 26.09 %

Call Participants

EXECUTIVES

Gary M. Stein
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Leon D. Black
Founding Partner, Chairman & CEO

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Presentation

Operator

Good morning, and welcome to Apollo Global Management's 2016 Fourth Quarter and Full Year Earnings Conference Call. [Operator Instructions] This conference call is being recorded. I would now like to turn the call over to Gary Stein, Head of Corporate Communications.

Gary M. Stein
Head of Corporate Communications

Great. Thanks, operator. Welcome to our fourth quarter and full year 2016 earnings call, and thanks for joining us. Sitting around the table with me this morning are Leon Black, Founder, Chairman and Chief Executive Officer; Josh Harris, Co-Founder and Senior Managing Director; and Martin Kelly, our Chief Financial Officer.

As a reminder, this call may include forward-looking statements and projections, which do not guarantee future events or performance. Please refer to our most recent SEC filings for risk factors related to these statements. We'll be discussing certain non-GAAP measures on this call, including the introduction of FRE or fee related earnings, which management believes are relevant to assess the financial performance of the business. These non-GAAP measures are reconciled to GAAP figures in our earnings presentation, which is available on the Apollo website.

Earlier this morning, we reported non-GAAP economic net income of $0.98 per share for the fourth quarter, and $2.36 per share for the full year ended December 31, 2016.

Apollo also reported distributable earnings to common and equivalent holders of $0.55 per share for the fourth quarter and $1.56 for the full year. We declared a cash distribution of $0.45 per share for the fourth quarter, bringing the total for the full year to $1.42 per share. If you have any questions about the information provided within the earnings presentation or on this call, please feel free to follow up with me or Noah Gunn.

With that, I'd like to turn the call over to Leon Black, Chairman and Chief Executive Officer.

Leon D. Black
Founding Partner, Chairman & CEO

Thanks, Gary, and good morning, and happy new year to everyone. When I spoke with all of you a year ago on our year-end 2015 earnings call, you may recall the world felt much different at that time compared to today. Equity markets were pulling back and credit markets were tightening, which drove a freeze in deal making for most of the market as the world anticipated a turn in the economic cycle. But signs of turmoil and forthcoming distressed investment opportunities were short-lived. And by mid-February of 2016, sentiment began to reverse course as investors regained confidence and markets charged upward throughout the year along with valuation amid historic political events around the globe.

As we reflect on the past year and look forward to the future, I'd like to walk you through some highlights at what we were able to achieve in this environment. While some years could be described as years of reaping, at Apollo 2016 was clearly a year of sowing. The funds we managed, together with co-investment partnerships, invested $16 billion in aggregate during the year. More capital in a calendar period than ever before in our history. This result may surprise you, given the prolonged high-valuation environment we have been operating in over the past years. Despite this backdrop, however, across our integrated global platform, we remained committed to our value orientation and continued to embrace complexity in order to identify a variety of attractive investment opportunities at discounted valuations.

We're particularly active in private equity, where the funds we manage deployed nearly $10 billion in 2016, well in excess of the $4 billion to $5 billion per year historical average, due to opportunities that arose more recently as well as deal flow that had been in the works for the past several years. When financing markets seized up earlier in the year, our team remained active through creative deal structuring and by leveraging Apollo's strong investor relationships. And when markets rebounded, we maintained our discipline and did not chase opportunities, and we were able to identify a number of deals at attractive entry prices. Consistent with our value orientation, the average creation multiple on investments made by Fund VIII during the year was approximately 5 turns, meaningful below the industry average of some 10.5x. So not 1 or 2 multiples lower, but actually half of what the industry average was doing. The pipeline of committed but not yet deployed capital was $2.5 billion at year end, and the team remains active on a number of fronts with plenty of new potential opportunities, including deal activity announced since year end, Fund VIII has committed 70% of its capital to date. And we estimate the fund has approximately $3 billion remaining for investment, which dovetails nicely with the timing of the next vintage Fund IX.

In addition, we have more than $3 billion of incremental dry powder dedicated to natural resources in ANRP II. And we believe, we are well-positioned, given the investment opportunity set that continues to unfold in the energy sector. As a leading global alternative investment manager, we have continued to solidify our position and drive our business forward through organic fund-raising efforts and strategic initiatives, which accumulate permanent or long-dated capital outside of the traditional fund construct. These efforts collectively led to $35 billion of growth inflows for the year, driving us to more than $190 billion of total assets under management. $14 billion of the $35 billion in total inflows was sourced through traditional fund-raising activity for mostly long-dated capital. This organic growth was driven by our team's continued success in meeting the strong investor demand we're seeing for our differentiated investment capabilities, particularly across the credit spectrum through raising larger success through vintage funds, bespoke managed accounts and newer open-end product like total return.

As we look forward to 2017 and think about fund raising, the largest single driver of AUM growth will likely be our ninth flagship private equity fund, which recently kicked off on the offering process. Our current expectation is for that fund to have a meaningful closing sometime in the middle of this year. Augmenting the $14 billion of fund-raising activity during the year was $18 billion of inflows related to what we broadly referred to as nontraditional asset management structure, which includes permanent capital vehicles, such as Athene and MidCap and other platforms that manage long-dated capital through unique structures such as AAME. We believe, these initiatives are highly strategic for Apollo and can offer significant growth potential over time. For perspective, Athene, which represents $71 billion of Apollo's AUM was created just 8 years ago. MidCap, which already has more than $7 billion of assets became an affiliate of Apollo in 2013. And AAME was just created last year and is now advising on $14 billion of portfolio company balance sheet assets.

In aggregate, these and other nontraditional asset management structures currently represent approximately $100 billion in aggregate, or just over 50% of our total AUM, which is a significant increase from just 8 years ago when these types of vehicles amounted to only $3 billion or less than 10% of our total AUM at that time. We believe, these structures are great examples of how we can identify market opportunities and create innovative solutions to drive meaningful growth for Apollo.

With respect to Athene, in particular, the company recently completed its initial public offering on the New York Stock Exchange and began trading on December 9. Everyone is very excited about the positive reception Athene has received over the past couple of months. The IPO marks another important milestone in the evolution of the company. And as we've done from the very beginning when it was created 8 years ago, we plan to continue to do our part to help drive their business forward.

While I'm proud to share these business highlights with you, it's important to acknowledge that these achievements and our path forward would not be possible without the dedicated efforts of our incredible global team. With nearly 1,000 strong and counting, we have been able to achieve remarkable feats. Since talent continues to be the lifeblood of what we do here at Apollo, we have developed a strong culture where the majority of our talent is homegrown. That said, at times, we identify talent outside the company, which we believe can have a positive impact in helping to achieve our long-term goal. A recent example of this is the addition of Gary Parr as the Senior Managing Director, who joined us just last week and will work on a variety of strategic, financial and capital markets related matters. In addition, Gary will Co-chair the firm's management operating committee, which comprises a deep bench of our most senior leaders, who work to implement and execute the company's strategy alongside the founders. We're very excited to have Gary join our team and believe his long career in financial services to date, sound judgment and extensive network of relationships will be valuable to the continued growth of Apollo.

With that, I'd like to turn the call over to Josh for some additional comments.

Joshua J. Harris
Co-Founder, Senior MD & Director

Thanks, Leon. I'd like to continue the call by providing some specific commentary around a few of our key business drivers that produced the stronger fourth quarter results and capped the year of solid performance overall.

Starting with investment performance, the funds we managed generated positive results across all of our segments for the quarter with private equity up 5.9%, real estate up 5.3% and credit up 2.1%. In private equity, the healthy appreciation of 6% we saw across the portfolio was driven by a 4% appreciation in private portfolio company holdings, and 13% appreciation in public portfolio company holdings.

More specifically, Fund VIII continued to display a positive momentum, appreciating by 4% in the quarter. Energy-related private equity investments were a contributor to the quarter's strong appreciation as evidenced by the solid performance of -- in the stock price of EP Energy as well as other portfolio company holdings which are private. These companies had exposure to rising oil prices.

In credit, the positive performance was broad based. Apollo's credit drawdown funds generated a gross return of 3.1%, and a Liquid/Performing fund delivered a gross return of 1.6% in the quarter. As a result of strong investment performance across our platform during the quarter, and over the past year, there has been significant growth in carry-generating assets. Only $27 billion or 1/3 of our carry-eligible AUM was generating carry at the end of '15. At present, the pool of carry-generating asset has more than doubled to $56 billion, representing nearly 2/3 of our total carry-eligible assets. Looking at this another way, excluding dry powder, $0.87 of every carry-eligible dollar in the ground today is generating carry.

As I mentioned last quarter, we believe this dynamic of carry-eligible asset moving into carry-generating territory and continuing to grow these assets as funds we manage build value, as more capital gets invested, sets the stage for the possibility of substantial realized carry income that could be distributed to investors in the future. We believe the public markets have largely ignored the embedded value of this upside potential. And for the most part, it is not reflected in the current stock price of our company.

Turning to asset growth in fund raising. As Leon mentioned, we generated nearly $35 billion of inflows across the platform during the year, including $7 billion in the fourth quarter. Our credit business generated more than $5 billion of the quarter's inflow, including a $2.6 billion first closing for our third European Principal Finance fund, a strategy, which is primarily focused on buying portfolios of assets and businesses from financial institutions in Europe. Fund raising is ongoing. And as previously mentioned, we believe this vintage will meet or exceed the size of its predecessor fund, which reached $3.4 billion in total commitments. There was a $1 billion -- there were $1 billion of inflows related to Apollo Asset Management Europe, AAME, resulting from the on-boarding of new assets from the balance sheet of existing portfolio companies. We raised more than $700 million across a variety of Liquid/Performing credit strategies during the quarter, including total returns, credit hedged funds and emerging markets debt. We also raised more than $650 million for a new strategic managed account relationship. And finally, MidCap grew by more than $500 million during the quarter reflecting continued origination activities for their direct lending business.

Within private equity, during the quarter, we held a final close for our second natural resources fund bringing commitments for ANRP II to approximately $3.5 billion, making it 2.5x the size of our first vintage. This is an example of the multiplier effects, a product can have when the prior vintage performs well.

In addition, we raised nearly $600 million of capital for equity co-investment partnerships to help finance the Rackspace private equity transaction.

Before I turn the call over to Martin, I'd like to highlight the strong level of fee related earnings or FRE we generated in 2016. Fee related earnings or FRE is a close resemblance to what we formerly referred to as management business distributable earnings. This quarter, we decided to transition our disclosures to align with the FRE metric, which is much more commonly used by our sector. We viewed fee related earnings as an important indicator of Apollo's ability to measure more stable and predictable earnings streams of the business. The revenues we generated for FRE are primarily derived from management fees we earn from the long-lived assets we manage in our funds and in our permanent capital vehicles.

As we've noted, in the past, regardless of the volatility in our realized carry income, we expect to distribute at least $1 dollar per share per year in cash. This is supported by the stability in growth of our FRE. You can calculate it from our disclosures that we generated nearly $1.30 of FRE per share in 2016, and that, that was complemented by realized carry income to result in a total distribution of $1.42 per share. The distribution amount equates to a yield of approximately 7% on our share price today. Clearly, 2016 was not a strong year of realized carry production. In fact, it represented the lowest amount of net realized carry income for a calendar year since our IPO in 2011. That said, given our growing carry receivable balance, which Martin will highlight in a moment, we believe the potential for increasing realized carry income is on the horizon as we opportunistically harvest gains that have been created in the funds that we manage.

Going forward, you can expect us to continue to be very focused on growing FRE as well as realizing carry dollars. FRE is a metric that has grown from less than $0.50 per share in 2011 to $1.30 in 2016, which represents nearly a threefold increase over the past 5 years. An additional catalyst to boost FRE is coming into view. Most importantly our net flagship private equity fund that Leon highlighted. We believe FRE is an important indicator of the operational performance of the business and provides insight into our base yields -- based yield earnings profile.

Now I will turn it over to Martin for some additional comments. Martin?

Martin Kelly
Chief Financial Officer

Thanks, Josh, and good morning, again, everyone. Turning to our results for the quarter. We generated $394 million or $0.98 per share of total ENI in the quarter, and $947 million or $2.36 per share for the full year. The performance for the quarter and the year was driven by the various types of incomes we earned, including fee related earnings, carried interest and investment income.

Starting with FRE, we earned $131 million for the fourth quarter and $539 for the full year, up significantly from 2015, primarily, due to the heightened transaction fees related to the strong capital deployment trend discussed earlier. While fee related revenue grew by 15% year-over-year, expenses were well-managed with combined base compensation and total noncompensation expenses increasing by only 6%. Noncompensation expenses increased quarter-over-quarter due to the previously communicated distribution related placement fees in the amount of $19 million, and we currently expect $7 million to $10 million more of these expenses in the first half of 2017 with more than half likely to fall in the second quarter. Excluding these placement fees, which will be fully recouped with incremental management fees over the time, non-compensation expenses were roughly flat sequentially. As we think about the outlook for FRE, we currently expect the robust capital deployment we saw in 2016 to normalize somewhat, likely offering fewer opportunities for the strong transaction fees we saw last year. However, the addition of a large flagship private equity fund would offer sizable step function in FRE. To put some context around it, if we were to assume the next fund is the same size and has the same turns as Fund VIII, we estimate the new fund would add approximately $0.20 to $0.25 per share of annualized FRE before accounting for the impact of future realizations and predecessor funds.

In terms of performance fees and balance sheet related income, we earned $343 million of net carry and investment related income during the quarter and $662 million for the full year. The results for the quarter were driven by 2 primary factors. One, positive investment performance across businesses, which drove rising carry-generating AUM in all segments and produced combined carry of approximately $300 million. And two, appreciation in value of Athene, which produced combined investment and carry income of approximately $150 million. In private equity, carry income earned in the quarter was broad-based, driven primarily by appreciation in Fund VIII and natural resources funds. In credit, carry income was also broad-based with all fund categories contributing. PE-style drawdown fund credit strategies contributed the greatest amount of carry in the quarter, with strength coming from our European Principal Finance II fund, the energy opportunity debt fund and the third structure credit recovery fund.

In real estate, carry income was driven by both the U.S. equity funds, which helped the segment close its highest quarterly economic income result to date. The most recent U.S. fund has a 17% net IRR and is performing well today.

Turning to Athene, the fair value increased by approximately 16% from the valuation of the end of the third quarter. The sequential increase in the valuation was driven by the pricing of its initial public offering and the upward trading activity of its stock, thereafter, partially offset by our liquidity discount we applied of approximately 10%. The liquidity discount relates to the fact that there is a lockup arrangement on our shares. We expect this discount to gradually phase out by the end of 2018, concurrent with the expiration of the lock-up. The increase in the fair value of Athene during the quarter, resulted in $101 million of unrealized gain within other income as well as $48 million of net carry interest income from AAA and related accounts, driving an aggregate contribution to the fourth quarter ENI of approximately $0.37 per share. Taking a step back and looking more holistically at our balance sheet. At year end, we had $4.31 per share of value, which is up meaningfully from just a year ago when the balance sheet value was $2.88 per share. This growth was primarily driven by the strong appreciation in the value of Athene as well as the significant increase in the value of our net carried interest receivable, which more than doubled from $0.87 per share at the end of 2015 to $1.77 per share at the end of 2016.

With regard to our cash distribution, the $0.45 we declared today for the fourth quarter was driven by 2 primary factors. First, the relative cash flow stability of our fee related earnings, and the upside it can create by leveraging the funds integrated platforms as it relates to sourcing, financing and executing sizable transactions. And second, realized net carry driven by the crystallization of a portion of AAA carry in conjunction with the Athene IPO. Our payout ratio for the quarter was a bit lower than recent quarters because we retained realized gains from balance sheet investments, and there was a contingent cash-based performance award related to our prior acquisition that was triggered in relation to strong carry income earned. For the full year, our cash distribution of $1.42 per share represents a 91% payout ratio in line with our historical average.

One last topic I'd like to touch on is taxes. You may have noticed that our DE tax rate was very low in 2016 versus prior years. Part of the reason for this relates to stock amortization deductions that ended last year. With expect that our 2017 DE tax rate would be low double -- would be in the high-single to low double-digit range to 2017.
With that, we'll now turn the call back to the operator and open the lineup for any of your questions.

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Craig Siegenthaler with Crédit Suisse.

Craig William Siegenthaler
Crédit Suisse AG, Research Division

There has been a nice improvement in carry-generating AUM over the last year. I think we know that the Fund VIII was a really large contributor. But it also looks like a number of credit funds have been driving some of that growth too. Can you walk us through which credit funds have crossed a carry over the last year? And also which funds may be close to crossing the carry in the next couple of quarters here too?

Martin Kelly
Chief Financial Officer

Sure, Craig, it's Martin. So we have -- within credit, we have about 82% of our carry funds that have money in the ground, actually in carry. And there's about $7 billion of assets that are not. The uplift has been pretty broad-based. There are a variety of sort of hedge fund-like funds that we have across the platform that all had a really positive year and we're in carry versus a year ago. We have managed accounts that, in aggregate, contributed to the uplift. And then our CLO business and drawdown funds all, for the most part, had strong performance. So in the earnings deck, there's a page that shows the appreciation needed for the assets not in carry to get into carry. And so of the 7, it's a decent -- half of that has a decent way to go. I would expect that not to get into carry, we're focused on getting invested capital back for those ones, and the other half is sort of within short of getting into carry.

Gary M. Stein
Head of Corporate Communications

Thank you Martin. And then just a follow-up on AAME. You know this kind of had a big slash in the second quarter. But I'm still wondering, when did you think that business could start generating meaningful FE AUM growth?

Joshua J. Harris
Co-Founder, Senior MD & Director

Well, I mean, I'd say that we're -- it's now set up, it's operating. The number is actually $14 billion between Delta Lloyd and some of our portfolio assets. I think that we would -- certainly, we're locating capital to really buy our control between our private equity fund and then capital outside of our private equity fund that we would raise. We think there's a lot of opportunities to set up structures where we control or set up investor groups that control liabilities in Europe. Whether they be bank liabilities, whether they be insurance liabilities, and that's a huge area. And then obviously, we'll manage the assets at that point and earn fees. So I'd say that, that we expect to make progress on this in 2017. This is here and now.

Operator

Your next question comes from the line of Devin Ryan with JMP securities.

Devin Patrick Ryan
JMP Securities LLC, Research Division

So Leon provided some helpful color at the end of last year just around the levels that could, I guess, potentially compel a change in the corporate structure. And so I'm sure you guys have had some more time to think about this and discuss it internally. So I'm just curious if there's anything that's changed in terms of what you're looking for out of DC, around tax reform. And if you feel any different way, one way or another, as you, I'm sure, are thinking about this top of mind moving forward?

Leon D. Black
Founding Partner, Chairman & CEO

Sure. I'm afraid that the answer is still going to have to be from 50,000 feet. We need to know a lot more as to what tax reform is going to look like coming down the pike as it relates to carried interest, as it relates to interest deductibility, as it relates to expensing, capital expenses -- capital expenditures. How much our corporate and personal rates coming down? Those are kind of all the touch points that really need specificity in kind of creating the sausage here, in terms of whether it makes sense to change corporate form and how so. So the devil's going to be in the details of knowing all those things and what gets passed. But look, it's a brave new world for all of us. I think, there's a lot that could be very opportunistic and exciting and there will be some speed bumps that we'll also have to be cautious about.

Devin Patrick Ryan
JMP Securities LLC, Research Division

Got it. I appreciate that. And maybe just as a follow-up to some of the comments you guys were just making on credit. How should we think about the realization trajectory in that business? Or I guess cash contribution potential just based on the types of funds that are in carry-generating today? And then obviously, you've been growing kind of the accrued carry in that part of the business as well. So trying to think about the forward trajectory of cash?

Martin Kelly
Chief Financial Officer

Sure. So I think I'd break into a couple of buckets. There's -- within the carry-generating assets in credit is what we call performing -- Liquid/Performing assets, including the credit hedged fund that I spoke to. That's why it's not sort of predictable it's more stable. And so that's throwing off about $15 million of net carry a year for the last 3 years or so. Above that, I guess in terms of more unpredictable of the drawdown funds including EPS, structure credit and the life settlement business. And like PE, it's hard to pinpoint within a timeframe what the carry -- cash carry coming out of that will be. It depends on favorable asset marks realizations and meeting escrow triggers. And so I think the only way to look at that is in the context of assets in the ground with an assumed return and carry structure and cash carry of the back of that.

Lastly, we have about $10 billion of dry powder in credit, which is largely attached to carry structures and so with that -- we'll, with the investment that will come both management fee income as well as carry income. And that depends on this appointment scenario.

Operator

Your next question comes from the line of Mike Carrier with Bank of America Merrill Lynch.

Michael Roger Carrier
BofA Merrill Lynch, Research Division

Maybe one, just on the return outlook. I mean, I think, when we look at the past 2 quarters, private equity has done -- had done really well. There's obviously a lot of changes going on, on the policy side. I just wanted to get a sense, how have the portfolio companies been performing? And maybe more importantly, in an environment where there's a lot of change out there. How do you think your position -- I mean, it seems like if it's pro-growth, it should be good. But obviously, there's rising rates and other offsets there?

Joshua J. Harris
Co-Founder, Senior MD & Director

Yes. No. No. I think -- so first of all, the portfolio EBITDA and revenues are all up, year-to-year, quarter-to-quarter. Portfolio is doing well. And obviously, the portfolio -- certainly, the return environment in PE at large is very, very difficult. The average multiple -- as Leon mentioned, the average multiple paid for transactions over $500 million exceeded 10x EBITDA, and that actually has been coming down because of regulatory pressure on the banks. So the average equity check is up, and the average leverage levels are down. So we can all do the math that returns are coming down in a relatively slow growth environment.

For us, obviously, it’s different because we're -- we've created our portfolio at 5.5x EBITDA. So we're in at a huge arbitrage in discount to the average player. In terms of the environment, I would say that most of the things that are talking about policy-wise are pro-growth. So lower corporate taxes, lower individual taxes, infrastructure spending. All those are pro-growth. And at the same time, obviously, I think, as rates -- I think rates will go up, clearly. But when rates are growing up in a pro-growth environment, as long as this Federal Reserve manages that well, that will be positive. That will be a net positive. There are 2 offsetting factors, clearly, but that will be a net positive. So -- and then, there's -- so that's sort of the base case. The base case as we sort of just go along and you look at all the things that are on the table, you could see growth in the U.S. go from 2% to 3%. I mean, it's pretty significant in terms of the fiscal stimulus. So -- and I -- so that's the positive story. Look, there's a lot of tail risk. Certainly, we all have to watch what happens in Washington, and then what happens globally in the EC and in China, relative to some of the political events that are going on in the EC, Brexit, the size of the banks globally in both Europe and China, the leverage in the Chinese economy. I mean there's a lot to really be watching for. And from our point of view as Apollo, that's an environment that we actually tend to shine in. And so I think, if the pro-growth environment works like I think, certainly, we'll be sending a lot of cash your way. And if there's volatility, we'll certainly be creating more cash to send your way later as value steps back and creates opportunities for us. So that would be -- that's our crystal ball.

Michael Roger Carrier
BofA Merrill Lynch, Research Division

All right. That's helpful. And then, maybe just as a follow up. When I look at the net accrued, it keeps ticking up with the performance. Martin, I know we always think about the outlook for realizations and cash carry. It's always tough to try to predict. But I'm just trying to get a sense, when we look at the portfolio, when it was invested, maybe the seasonality of it, where the returns are. I don't know if the fund is tracking in line with historical trends? Better than historical trends, in terms of you typically deploy, and then, we see kind of the realization phase. So I don't know, any broad color there? I know it's tough to predict.

Joshua J. Harris
Co-Founder, Senior MD & Director

Yes, I mean, so Fund VIII, which is going to be the largest driver of carry is that gross returns in the mid to high 20s, which is wildly above any sort of return expectation that is attributed to private equity or us. Turns out, our gross returns historically are higher than that. Certainly, those -- that was a different environment. They were in the mid to high 30s. But Fund VIII is only just over 1 year old on average. But we are seeing -- I mean, again, like I said, when you buy -- when everyone else is buying a 10 and you're buying a 5, there's value creation that occurs on the buy. So certainly, we are looking at -- and there are things that we're looking hard at, how we take some capital back and create some distributions. And so, as Martin said, it's unpredictable, but I expect that we'll make some progress this year.

Operator

Your next question comes from Alex Blostein with Goldman Sachs.

Alexander Blostein
Goldman Sachs Group Inc., Research Division

Question around Athene. So a, maybe you guys can touch just on your broadest thoughts on Athene's growth outlook, given the changes we've seen in the rates backdrop, and obviously, there's all this chatter around the DOL repeal discussion. So kind of updated thoughts on Athene growth since, I guess, the last update of the IPO. That's the first question.

Leon D. Black
Founding Partner, Chairman & CEO

Yes, thanks for the question. It's tough for us to comment broadly on Athene's growth, now that they're a public company. We have to be, certainly, cautious. They will -- they have not yet announced when they're going to report earnings, and clearly, that would be a big topic of discussion on their call. That said, clearly, they are very focused on growth. It was a big part of the story of their offering. They continue to focus on a number of different levers, whether it's reinsurance flows, new product sales, and also they just did another funding agreement, backed note, which helps derive more assets for them. So I think there's a lot of different things happening. Clearly, the news overnight about the DOL is interesting. I think we're all watching that carefully. It's unclear where that all lands. But that was obviously a headwind for them and for the industry. And so to the extent that either gets revised or revoked, that certainly removes the headwind. So I think there's a lot of positive things that are in motion for Athene, in terms of driving growth. And then, there's always potential for strategic opportunities, given the acquisition currency they know how through their stock as well as the capital they have on their balance sheet.

Alexander Blostein
Goldman Sachs Group Inc., Research Division

Got you. And then, my second question is kind of related to Athene as well, but I guess, looking at roughly $300 million of gross accrued carry in the AAA vehicle for you guys. Can you just remind us again, how we would think about that potentially being converted to DE over time?

Martin Kelly
Chief Financial Officer

Sure. It's Martin. So there's markups in place. A series of markups, actually. Our shares that we own direct in Athene are locked up for 24 months. And then AAA has a series of lockups that expire on 3 different dates. And our carry, its actually still is to those unwon dates. So there will be a lock -- and I'll remind, in 2017, and another one in 2018. So that will -- that -- whether or not we actually take cash versus shares, we'll make a decision at the time. But that's the future choice.

Alexander Blostein
Goldman Sachs Group Inc., Research Division

Got it. But it's a 2017, 2018 potential additional kind of cash carry event for you guys?

Martin Kelly
Chief Financial Officer

One of 3 to come is 2017.

Leon D. Black
Founding Partner, Chairman & CEO

Yes. Just to reiterate, that's separate and apart from the direct ownership stake we have. In Athene and Apollo, we own 15.1 million shares of Athene.

Alexander Blostein
Goldman Sachs Group Inc., Research Division

Yes. That's right. This is the triple AAA you call? Got it.

Leon D. Black
Founding Partner, Chairman & CEO

Yes. Correct.

Operator

Your next question comes from Bill Katz with Citigroup.

William R Katz
Citigroup Inc, Research Division

First, was big picture. I joined the call a little late, so I apologize if you did cover this. I think, recently, you added Gary Parr to the leadership. Just given his background, so I'm curious if you could comment how you're thinking about M&A at a strategic level? What properties or geographies or product sense might be of interest on sort of go-forward basis?

Joshua J. Harris
Co-Founder, Senior MD & Director

Yes. So obviously, we're really excited to have Gary on board, and he adds a lot of capability and deep, deep relationships across the financial world. And clearly, we are constantly looking at how to grow our platform in a way that is accretive to our value and our long run growth and prospects. And so, Gary will help with that. In terms of things that -- we're -- it's hard to talk specifically about what we're doing. I mean, clearly, as we said previously, we're a little small in real estate. Forget about this one, we are too small in real estate. We'd like to get bigger. And then, from a credit point of view, there are a whole bunch of different things where there are growth opportunities for us. And so those would be kind of the areas that we would be looking at. Right now, we're kind of 75% to 80% North America, and then, kind of 15% to 20% Europe and only 3% rest of world. And we -- right now, we're kind of focused in our core markets. But in that, just the value proposition. While we're global, the value proposition continues to be, for at least us, better here than we're seeing in the emerging markets. But we're also going to look there. But we're kind of focused in our core geographies right now. So I hope that gives you enough -- that's about as much color as I can give you.

William R Katz
Citigroup Inc, Research Division

Okay. And then, I may have missed this, perhaps Martin. Within the FRE -- so a personal thank you for the any disclosures. Within that, G&A and even comps was a little bit light, with recent run rates. Anything unusual there? And I apologize if you already covered this in your prepared commentary?

Joshua J. Harris
Co-Founder, Senior MD & Director

G&A.

Martin Kelly
Chief Financial Officer

Oh, G&A? Yes. Look G&A, we manage carefully. So the volatile line within noncomp is placement fees, which we talk about. I would look at the current G&A numbers sort of run rate levels.

Operator

You're next question comes from Glenn Schorr with Evercore.

Glenn Paul Schorr
Evercore ISI, Research Division

One quickie follow up on the Athene side. Was -- at the time of the float, I think, people in the insurance committee were -- I'm sorry, insurance community, were having questions about exclusivity of the relationship with you all and the fee, exactly. And from an Apollo analyst or investor standpoint, we think it’s an awesome thing, and we think you had tremendous value. From their side, they didn't know if there were any conflicts there. So curious about on the today forward of new assets raised and as they grow their business. Is it okay for us to expect the same relationship at the same levels to continue?

Leon D. Black
Founding Partner, Chairman & CEO

Yes. Look, I think, we, together with Athene, helped start the business back 8 or 9 years ago. It's been a great relationship. I think Athena has grown, I think, to levels that probably weren't expected at the time the business was created. And as we talked about just a couple of minutes ago, there's a lot of growth still in front of them. It's been a great partnership, I think, us providing asset management services to them has helped them deliver really leading ROEs. And so I think as long as we continue to perform, we would expect the relationship to be very strategic and really positive for both us and Athene.

Joshua J. Harris
Co-Founder, Senior MD & Director

Yes, and in terms of the community, I mean, the -- certainly the stock itself was very well received. The offering was well over-subscribed. And the centerpiece of Athene is its relationship with Apollo. So I really wouldn't expect it to change.

Leon D. Black
Founding Partner, Chairman & CEO

Yes. And we should add, we have a long-term contract in place that comes up for renewal at the end of 2018 -- October of 2018, a 3 year rolling contract. We did make a slight concession towards the end of last year on a certain portion of their organic assets, where we gave a fee rebate for just a small portion of their assets for the balance of 2016. So again, as being good partners, helping them have profitable growth. We will do what we need to.

Glenn Paul Schorr
Evercore ISI, Research Division

Got you. Okay. I appreciate that. Also on -- just curious for any update on the retail opportunity that you guys are pursuing. It looks like the sub-advice fund through Waddell has been doing okay. Just curious on an update there, that'll be great.

Joshua J. Harris
Co-Founder, Senior MD & Director

Yes. I mean, I'd say there's -- we continue to believe that the retail community has more demand for us. There's way more growth there that they're under-allocated relative to, certainly, more liquid alternatives yield. So yield, yield, yield, in terms of, certainly, some of our debt products and some real estate products and real estate data, and even going to real estate core equity. And so we're seeing growth there in terms of what we do. We're also seeing some of the high net worth systems from the wire houses embrace some of our more deeper alternative products such as our core private equity fund and ETF. Those had big -- big retail demand. We're seeing growth there. So I just think we're going to see a continued positive growth and positive momentum, a scenario that we're investing in as a firm in terms of people. And certainly, the deal, I'll think of it, if it happens, would be a positive, both for Athene and for that part of our business.

Operator

Your next question comes from Ken Worthington with JPMorgan.

Kenneth Brooks Worthington
JP Morgan Chase & Co, Research Division

Leon highlighted energy is holding unusually good investment potential for Apollo. The theme of energy has sort of evolved over time. Three years ago, there is one theme. Maybe a year ago, the regions to get involved in energy were different. So as we think about energy more broadly now, oil prices have kind of recovered smartly, some of the pressure's been taken off. What are the themes that you think you guys want to invest behind today as you think about the energy business for the next couple of years?

Joshua J. Harris
Co-Founder, Senior MD & Director

Yes. So I mean, I think we have a very developed proprietary expertise in energy like -- and what that amounts to is teams all over North America of scientists, of land men, of engineers, of petroleum experts that can look at a field of reserves and kind of figure out what it's worth and how to produce it more effectively than others. And when you pair that with very seasoned, private equity professionals and debt investors, we feel like we have a very big edge in energy. It's been a really positive aspect of our franchise. If you think about what -- and it does move around. I mean, obviously, the opportunities change. I think relative to the opportunities today, what we're finding is the ability to buy reserves and acreage, both producing and nonproducing in the best fields in the U.S. while at significant discounts to fair value as measured by acreage value or actually -- or cash flow value, SEC PV10. And we're just seeing that the problems that existed in the energy sector when oil went from $100 to $30 has put enough pressure on all of the producers that people just don't have the capital to spend in even the best fields. And so we're able to really cherry pick and end up with the absolutely best real estate in North America, in the U.S. and Canada. And controlled reserves that are economic at very low prices of oil and gas, well below the current curve. And so when you can get that type of reserve, what you find is even in -- even around volatility in oil price, you have a lot of downside protection and you have real upside volatility. And so we're creating these asymmetric risk return opportunities, particularly, in private equity which is the most active part of our energy investing business right now, where between hedging and the cost that we can bring reserves out of the ground. We're sort of really comfortable that we're going to get a positive return on almost -- under almost any energy scenario. But if the curve happens or above the curve, we get 20%, 30%, 40% returns. And so this is an area that, right now, is relatively active and interesting, and that's how it's shifted today. There's also -- there's a bit of distrust, but much more buying assets right now.

Kenneth Brooks Worthington
JP Morgan Chase & Co, Research Division

Okay. Great. And then, sort of clean-up question, Fund VI and Fund VII still low in escrow. Do you guys expect these funds to make their way back above that escrow threshold? Or is that just something that is you guys believe is less realistic?

Martin Kelly
Chief Financial Officer

I think in the case of VI, it's unlikely we get above escrow. It's possible we get cash out, but not until the end of the fund. The escrow ratio there is in the low 80s, and there's about $160 million of cash carried that's being realized that's sort of trapped. And so the way the math and the formula works is it's unlikely, I think. In the case of VII, I think it’s much more likely. VII's ratio is at 103%, and it didn't increase as much as you may have thought, given that we sold an asset as part of the Hostess transaction. And so we sort of took some cash in. So VII is at 103%. It has $60 million of cash sitting in escrow. It needs 13% appreciation to clear its escrow, which would, itself, create another $100 million of carry. So that's certainly within the realm of possibility or is not likely. But it needs to close the GAAP on the values to clear $115 million.

Operator

Your next question comes from the line of Chris Harris with Wells Fargo.

Christopher Meo Harris
Wells Fargo Securities, LLC, Research Division

Wondering if you guys could comment on how important you think tax deductibility of interest expense is to your returns and your business model in general? And I'm asking this question because there's quite a few investors that think the PE industry will be materially impacted if that gets changed. So a, do you agree with that notion. And then, b, what's the impact on Apollo?

Leon D. Black
Founding Partner, Chairman & CEO

Sure. This is Leon. I would say a definite maybe. And the reason I say that, if interest rates stay relatively low, it has a much less of an impact as interest rates go up, the impact goes up. But again, referring to my previous answer, it also is tied into what the whole picture is going to look like. Part of what Paul Ryan is talking about in his tax bill is not only interest deductibility and -- but also being able to expense all capital expenditures up front, which could have a huge beneficial offset to the interest deductibility hit. So the answer is we don't know. Certainly, on the face of it, if you're dealing in a high-rate environment, and that's the only thing happening to you, it would have a negative impact on private equity, which whose other name is leverage buyout. But in the context of other offsetting things and the fact that interest rates historically are relatively low, it may not have much of an impact at all. The other thing is who knows if it happens? As we talked before, so much of this is intertwined with how much are corporate rates supposed to be going down. What happens with border taxes to make it up? The whole capital expenditure thing. Interest deductibility is a whole area that I don't think from a qualitative point of view has really been studied yet. It's not only has impact on the credit markets, its impact on the real estate sector, but basically on small businesses and new jobs growth, where an entrepreneur, basically, wants to take a loan out to expand the factory. That creates jobs. So I think there's a long way before any of us are going to be able to predict the outcome here.

Joshua J. Harris
Co-Founder, Senior MD & Director

And as the business model, I think, that the public markets are leveraged 3x, the private markets are leveraged 5x, about a little over 5x. So on the margin, certainly, they're a little bit more leveraged than the private markets. So the private markets -- the private equity markets provide a lot of -- whether, it will be unearthing things that are too cheap in the public markets. Whether it be of solving management issues or helping companies grow. There are plenty of things for -- there's going to be a lot for private equity to do with or without interest deductibility. And so I think -- and I think there'll be -- if either interest deductibility or the border tax or any of this other stuff happens, there will be a fair amount of dislocation industry-by-industry, company-by-company. And that will kind of create a lot of opportunity for people that are smart and nimble and opportunistic.

Leon D. Black
Founding Partner, Chairman & CEO

The last thing I would say is that Apollo and Private Equity really does have a differentiated model than our peers. We've already pointed out on this call, but on a 10 multiple environments, 10 plus, that we're buying our portfolios at a 5% to 5.5%. Well, what does that mean, also, as it relates to leverage? It means that we're leveraged less than our peers. If you're buying it 10x times, you're leveraging up to the cap of 6x. If you're buying at 5x or 5.5x, it means, you're, on average, leveraged about 4x. So we're relying on less leverage in our model than most of our peers.

Christopher Meo Harris
Wells Fargo Securities, LLC, Research Division

And just a quick follow-up, if I may, on this point. Is it fair to assume that the returns you guys generate in PE, the vast majority of the upside is coming from, really, the price you pay for companies versus your exit multiple as opposed to things having to do with deductibility of interest expense and so on?

Leon D. Black
Founding Partner, Chairman & CEO

I think that what we've learned in our 27 years at Apollo, almost 27, is that to be good in private equity. You have to be good at 3 things: one, you have to buy right; two, you have to build value; and three, you have to sell right. All 3 are critically important. I think part of our differentiated model is that we focus an awful lot on the value orientation on the buy side. So there are a lot of things that go into buying a good company, barriers to entry, good management, growth statistics, margins, all of those are important. What we have kind of felt is the single most important is price paid. So it's part of our focus, but it’s certainly not a replacement for building value or selling right also.

Joshua J. Harris
Co-Founder, Senior MD & Director

And just to hit your question directly, very little of our value creation comes from interest deductibility. Almost -- it's negligible. So I mean, a lot of it is buying right, and a bunch of it is EBITDA growth and cash flow generation. I mean, I haven't kind of calculated the specific number, but it's not going to be a big number.

Operator

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

Brian Bertram Bedell
Deutsche Bank AG, Research Division

That's actually a great segue to my question. Just looking at your historical creation multiples and your prior funds, Fund V at 6.6%, Fund VI at 7.7%, Fund VII at 6.1%, and now you're at 5.5%. Can you -- and you're in a higher, obviously, multiple environment. So can you talk about, I guess, what's made you better at buying through these cycles. And as we think about Fund IX, and you think about the opportunities in Fund IX, are you bullish on being able to mimic Fund VIII? Or even do better than Fund VIII, on creation?

Joshua J. Harris
Co-Founder, Senior MD & Director

Yes, I mean, I'd say that, look we're just getting better at our craft, the team is getting more experienced. We're adding a lot of capability to allow us to source transactions in a much more proprietary way, such as energy, would be an example of our financial services in Europe. So I think all of those things -- I think, we're just getting to be more seasoned and better at our craft. I think, also, we've added broker dealer that allows us to go outside the traditional financing market. So in the case of a number of transactions, the largest -- the most notable one being ADT. We were able to get a deal done on a multibillion dollar financing by placing a preferred with a nontraditional source that other people couldn't do. And therefore, we got a really good price on -- we think, we got a very good price on ADT. And then, I'd say to you -- so that's -- there's the whole sort of series of internal factors in terms of the development of our team. Externally, we're finding for the first time, that the public markets have, really -- well, the post market multiple has been high, that there's been a real differentiation between the haves and the have-nots. And in many cases, we're finding great companies at low prices. We did 6 public to privates in this fund and that's relative to a very small number in our history, where even though you put a premium on a company like ADT or Rackspace or Diamond Resorts or Outerwall, we found that there's misvaluation, in our opinion, in the markets. And I think a bunch of that has to do with, I think, value strategies were out of favor in the marketplace. Certainly, index funds were growing, active as investors many times are now lurking around enforcing undervalued companies to do something about it. The hedge funds have a lot of wind in their face. And so, I think, there's some external factors that are providing some opportunities hospitably in the public markets. But those are all the reasons why, I think, we're doing better. I'd say in Fund IX, I think the big opportunity for us is that only 4% of Fund VIII was distressed, which is the lowest in our history and that really had to do with, I think, the monetary environment that existed, the quantitative easing and the liquidity that was in the markets as well as the fact that we haven't had a recession in 7 or plus years. And so when I look at Fund IX, which is going to be 6 years going forward, I feel like we'll have some -- in the aging credit cycle, we're going to have some distressed opportunities, those tend to be traditionally at lower multiples. Whether we'll, get below 5.5%, I mean, I think that's a tall order. I mean 5.5% is a really good number, but we're certainly going to try.

Leon D. Black
Founding Partner, Chairman & CEO

Just to add to what Josh said. Look, we really do have a differentiated model in PE. And the reason we're able to pay lower valuations is kind of the fact that we follow kind of 3 pathways. One, during recessions, and when we've had 4 of those since we started 26.5 years ago. We dial to our distress capabilities. A lot of people know that, that pathway is one that allows you to back into good buyouts through buying in the right part of the capital structure and delevering companies in the restructuring process. And hopefully, we end up owning them. If we don't end up owning them, we make a lot of money on the debt and we recycle. What a lot of people don't realize is that the entry level of what we've been able to do in distress has been at about a 5 multiple, historically. That's about 1/3 of our capital over history in private equity. Another 1/3 has been in complex deals. Carve-outs, build-ups, things that take a year to get done, under-managed companies, undercapitalized divisions of companies. The average on those has been about a 6 multiple because of the complexities involved. Finally, we do idiosyncratic buyouts where we are competitive. We do look at auctions in the 9 industries that we cover really well. There, we're looking for an edge. What's an edge? ADT, the fact that we already own 2 security alarm companies and that we could bring $200 million of synergies to the table, was an edge. Also, the fact that we had the management, best in the industry, that came from ADT and knew it well. And as Josh already pointed out, the ability to get things done through our capabilities in the credit markets allowed us to get it financed in a very difficult market a year ago. So there we're willing to pay as much as 7x. When you add all of this up, it gets us into the high 5s or low 6s. It's a good model and you asked about the progression, historically, we had that model, but we made some exceptions in earlier funds. I think we stumbled when we did Reology and we did Caesar's, because we paid very high prices for those. For what we thought were good reasons, we knew the industries well, they were the best brands. But since then, we've said, "No exceptions." You haven't seen anything like those multiples paid for anything in Fund VII, Fund VIII, nor will you in Fund IX. So the discipline's there. So you don't know in each vintage, vintage 7 was 2/3 distress as Josh pointed out. It was less than 5% in Fund VIII. So that is our differentiated model. Many roads to Rome, many of our competitors do well. But I think by paying lower prices and sticking to that, we have more room for error than they do. So it's a very good model for us, and has worked well for us, and that's what we plan to continue with.

Operator

Ladies and gentlemen, we have reached our allotted time for questions. It is now my pleasure to hand the program over to Gary Stein for any additional or closing remarks.

Gary M. Stein
Head of Corporate Communications

Great. Thanks, operator, and thanks, again, everyone, for joining us today. As I mentioned earlier, if you have any follow-up questions, please feel free to give Noah Gunn or me a call.

Leon D. Black
Founding Partner, Chairman & CEO

Thanks.

Operator
Thank you, ladies and gentlemen. This does conclude today's conference call. You may now disconnect your lines.