

# Apollo Global Management, LLC NYSE:APO

## FQ3 2017 Earnings Call Transcripts

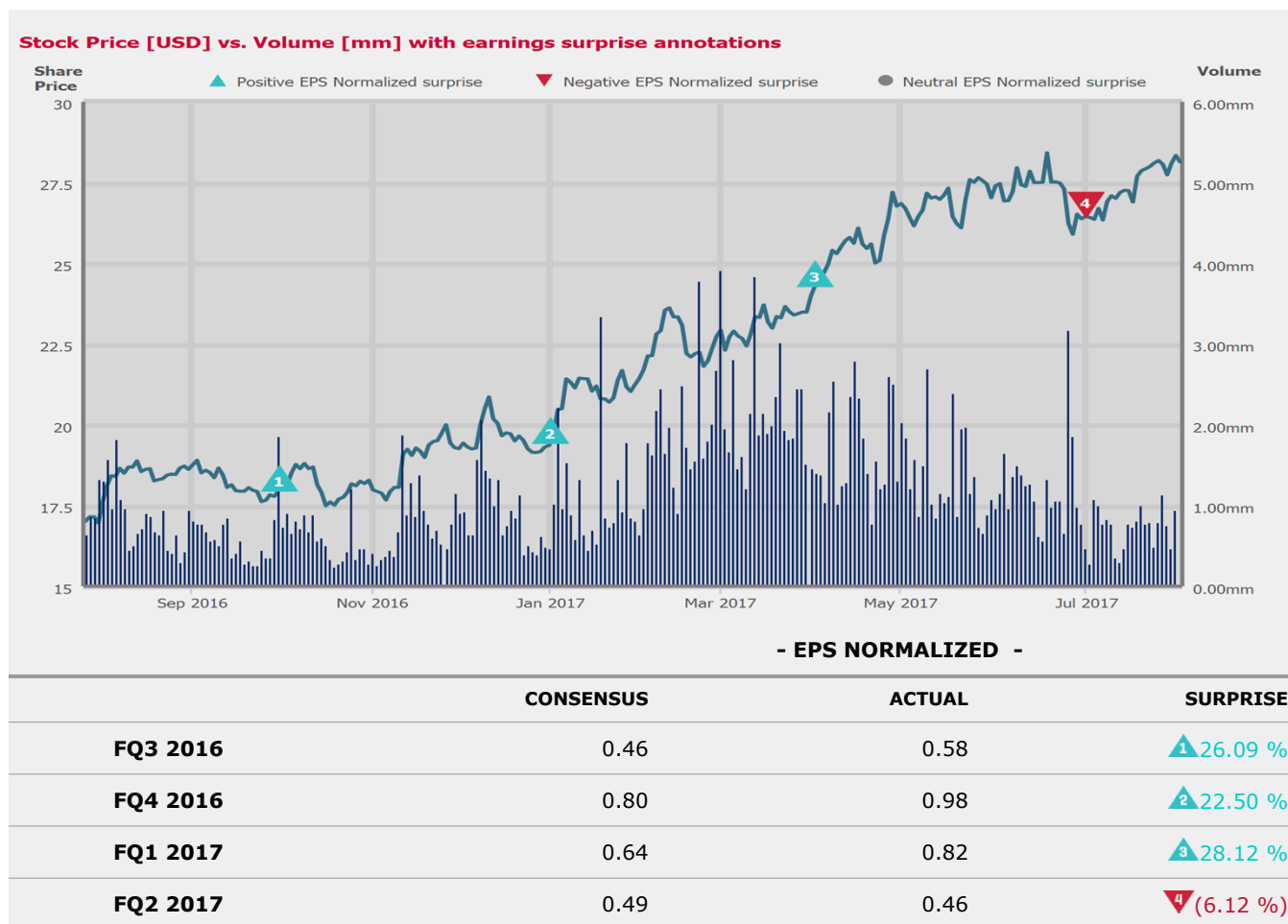
Wednesday, November 01, 2017 2:00 PM GMT

### S&P Capital IQ Estimates

	-FQ3 2017-			-FQ4 2017-	-FY 2017-	-FY 2018-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
<b>EPS Normalized</b>	0.59	1.07	<span style="color: green;">▲ 81.36</span>	0.61	2.50	2.91
<b>Revenue (mm)</b>	467.72	664.20	<span style="color: green;">▲ 42.01</span>	555.48	2070.04	2484.31

Currency: USD

Consensus as of Oct-18-2017 10:30 AM GMT



# Call Participants

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## EXECUTIVES

**Gary M. Stein**  
*Head of Corporate Communications*

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

**Martin Kelly**  
*Chief Financial Officer*

## ANALYSTS

**Alexander Blostein**  
*Goldman Sachs Group Inc., Research Division*

**Brian Bertram Bedell**  
*Deutsche Bank AG, Research Division*

**Christopher Meo Harris**  
*Wells Fargo Securities, LLC, Research Division*

**Devin Patrick Ryan**  
*JMP Securities LLC, Research Division*

**Gerald Edward O'Hara**  
*Jefferies LLC, Research Division*

**Jordan Freediner**

**Kenneth Brooks Worthington**  
*JP Morgan Chase & Co, Research Division*

**Michael J. Cyprys**  
*Morgan Stanley, Research Division*

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

**Patrick Davitt**

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

**Unknown Analyst**

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

# Presentation

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## Operator

Good morning and welcome to Apollo Global Management 2017 Third Quarter Earnings Conference Call. [Operator Instructions] This conference call is being recorded. I will now turn the call over to Gary Stein, Head of Corporate Communications. Please go ahead.

## Gary M. Stein

*Head of Corporate Communications*

Great. Thanks, Operator. Welcome to our third quarter 2017 earnings call, and thanks for joining us. With me today from Apollo are Josh Harris, Co-Founder and Senior Managing Director; and Martin Kelly, Chief Financial Officer.

This call includes forward-looking statements and projections including with respect to future distributions by the company. These statements 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 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 or ENI of \$1.07 per share for the third quarter ended September 30, 2017, including \$0.40 per share of fee related earnings or FRE. Apollo also reported distributable earnings to common and equivalent holders of \$0.42 per share, driving a cash distribution of \$0.39 per Class A share. If you have any questions about the information provided within the earnings presentation 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 Josh Harris, Co-Founder and Senior Managing Director of Apollo Global Management.

## Joshua J. Harris

*Co-Founder, Senior MD & Director*

Thanks, Gary, and thank you all for your continued interest in Apollo. I'd like to take this opportunity to walk through the key drivers of our business that helped produce our strong third quarter results including continued asset growth and strong investment performance. I'd also like to provide you with some context around capital performance, and the expected timing of the commencement of Fund IX's investment period. As usual, Martin will conclude with some comments regarding Apollo's financial results before we take your questions.

Starting with asset growth, Apollo has now surpassed \$240 billion of total assets under management. Today the platform includes the largest alternative credit business, and the largest dedicated private equity fund. We are driving our business forward through traditional fundraising efforts, and strategic capital initiatives which we believe provides us with a strong base of nearly \$100 billion of permanent capital to manage. The third quarter continued to reflect our strong momentum in one of the most significant asset growth periods in our history, with gross inflows totaling \$56 billion over the last 12 months.

Third quarter inflows of \$8 billion included approximately \$6.5 billion from our credit business. Credit inflows were generated by a diverse group of products concentrated around a \$2.4 billion increase in assets managed for Athene, primarily driven by continued organic growth in their business; approximately \$2 billion from drawdown funds where we are raising larger amounts for every flagship successor fund in the market. Total -- for example, total capital commitments for EPF III, the third vintage of our European Principal Finance strategy rose to \$4.3 billion, after the fund held an \$800 million close during the quarter; FCI III, the third vintage of our life settlement strategy rose to \$1.9 billion following a \$1 billion final close during the quarter.

And the fund has already been actively deploying capital, recently completing a transaction which utilized more than \$1 billion of the fund's capital driving the fund to be approximately 2/3 deployed. We also had approximately \$2 billion of inflows from a combination of CLOs, advisory assets, midcap, hedge funds, and other credit mandates during the quarter.

Lastly, subsequent to quarter-end, the fourth vintage of our structured credit recovery strategy SCRF IV, Structured Credit Recovery IV had a strong first close of nearly \$1 billion. We expect this fund will be larger than its predecessor which had total commitments of \$1.2 billion.

Turning to investment performance, the funds we managed delivered solid results across each of our businesses during the quarter and served as the primary driver of our significant earnings and net receivable growth that Martin will discuss further. On a gross basis, for the quarter private equity was up 7.3% and was the largest contributor to our unrealized net carrying income during the period. In addition, credit was up 1.9% and real assets up 3.8%. The 7.3% appreciation in private equity funds we manage are driven by a continued strong performance among our funds' private portfolio company holdings.

Importantly, we are seeing continued positive momentum from Fund VIII which appreciated 11.5% during the quarter, and is up 25% year-to-date. At the end of the third quarter, Fund VIII had since inception gross and net IRRs of 29% and 19% respectively. Fund VIII net IRR has increased by 600 basis points in just the last 12 months, and we expect additional value creation from this fund for 2 primary reasons. First, with the average hold period of just under 2 years for Fund VIII's investments, many of these companies are still in the early to middle stages of implementing their respective value optimization and strategic initiatives that were central to the original investment thesis.

And second, since the average creation multiple Fund VIII's portfolio companies in nearly 5 multiple points below industry averages of approximately 10.5 enterprise value to EBITDA, there's meaningful upside potential as these portfolio companies execute their business plans and are increasingly valued more in line with relevant market metrics.

In credit, despite a tight credit environment, the investment performance of the funds we managed continued their year-to-date upward trajectory during the quarter, appreciating 1.9% on a gross basis, and up 1.6% on a net basis. If we look at some of the course drivers within our credit business, our drawdown funds generated gross and net returns of 2.7% and 2.2% respectively during the quarter, primarily driven by our European Principal Finance strategy. Within real assets, our U.S. real estate funds continued to perform well, appreciating 3.8% during the quarter on a gross basis, with since-inception net IRRs in the mid-teens.

Touching on capital deployment for a moment, we are maintaining our value-oriented discipline across the platform. In private equity, although market valuations remain near all-time highs, we are continuing to utilize our differentiated sourcing capabilities to find what we believe are good investments at attractive prices, and we have an active pipeline of potential opportunities. The pipeline includes prospective investments in both the U.S. and Europe, reflecting a variety of transaction types such as corporate carve-out and opportunistic buyouts. These prospects also include take private opportunities driven a notable component of our capital deployment strategy during the last 24 months as we seek to identify companies that have lagged in the public market for a variety of reasons.

As we finish up committing the capital in Fund VIII, there is approximately \$1.5 billion remaining for new investments that we expect will be allocated to deals in the coming months, therefore our current expectation is that Fund IX will enter its investment period some time during the first quarter of 2018. When Fund IX enters its investment period and begins generating management fees, Fund VIII's fees will move into the post-investment period. In addition, on January 1, 2018, Fund VI, which is a 2006 vintage fund will stop collecting management fees. It is worth reiterating that we expect that the net effect of these movements will add approximately \$200 million, or \$0.50 per share pre-tax of annualized accretion to our fee related earnings.

Accordingly, this will allow us to deliver a net minimum cash distribution of \$1.30 per share on an annualized basis, a 30% increase from the prior level of \$1 per share we had been indicating previously. Importantly, the \$1.30 per share reflects what we believe is a conservative baseline distribution, equating

to a 4% yield on our current share price, and does not include any FRE upside or any incremental distributions from realized cash incentive fees which have averaged more than \$1.50 per share annually over the last 5 years, and it is worth noting that there is 1/3 more private equity fund capital invested today versus the average level during those same 5 years. As Fund VIII, which is a 2013 vintage, heads into its 5th year in 2018, assuming markets remain accommodative to portfolio exits, we believe the fund's maturity profile will provide the opportunity for private equity realizations over the next multi-year period.

Before handing the call over to Martin, I'd like to mention one last item as we started to discuss one of our permanent capital vehicles we've been helping to build out in Europe is currently named AGRE. By yearend AGRE will complete a re-branding and will be named [ Athora ] going forward. Athora is a strategic platform established to acquire or reinsure blocks of insurance business in Germany and broader European life insurance markets where we believe there is a need for capital. Athene and Apollo are minority investors in Athora, and long-term strategic partners. An affiliate of Apollo AAME is acting as an advisor with respect to Athora's investment portfolio which currently stands at approximately \$8 billion. The team at Athora is continuing to evaluate investment opportunities for its business which is well capitalized with \$2.5 billion of equity, and we remain optimistic about the vehicle's growth potential over time.

Now I'd like to turn the call over to Martin to walk through our financial results in more detail. Thanks Martin.

**Martin Kelly**  
Chief Financial Officer

Thanks Josh, and good morning again, everyone. Overall our strong third quarter results contributed to Apollo's significant earnings growth so far in 2017. Year-to-date total economic net income of \$947 million or \$2.35 per share is more than 70% greater than total ENI for the comparable period last year. This is primarily driven by improving carry income resulting from strong investment performance across all of our business segments so far in 2017. Private equity funds have appreciated 18%, while real assets funds have appreciated 14%, and credit funds have appreciated 6%. In addition, our fee related earnings continue to grow and we believe this will continue in 2018 as Josh mentioned. Our solid balance sheet is also delivering meaningful contributions as strategic investments like Athene continue to accrete in value. It's clear that the breadth and scale of our platform is expanding. Total assets under management are up 28% year-over-year to \$242 billion, which equates to a 6-fold increase or a 21% compound annual growth rate over the past 10 years.

Focusing on the financial performance in the third quarter, we generated total ENI of \$432 million or \$1.07 per share. Pre-tax our economic income was \$458 million or \$1.14 per share driven by the following key components; FRE of \$162 million which contributed \$0.40 per share; total net carry of \$209 million which contributed \$0.52 per share; and total other income -- predominantly investment income of \$117 million which contributed \$0.29 per share. FRE rose quarter-over-quarter due to higher management fees and onetime proceeds of \$19 million from the buyout of an office lease, while expenses remained well-controlled.

Our credit segment drove the quarter-over-quarter lift in management fees as fee generating AUM grew 5% sequentially from strong inflows. Some of the inflows pertain to follow-on closes in active funds which resulted in approximately \$12 million of onetime catch-up management fees during the quarter. While the catch-up management fees in Q3 will not recur, we believe other fee related revenue will provide an offset in the near term. Thus far in Q4 we have earned approximately \$30 million in fee related revenue in connection with capital deployment activity.

In terms of performance fee and balance sheet related income, we earned \$326 million of net carry and investment income during the quarter driven by 2 primary factors; positive investment performance across all of our businesses with a particularly robust contribution from private equity; and appreciation in the fair value of Athene. In private equity the vast majority of the carry income earned in the quarter was derived by the strong appreciation in Fund VIII that Josh described. The appreciation was broad based with more than 3/4 of the 30 or so portfolio companies in Fund VIII generating positive marks. In terms

of sector strength, we saw the greatest contributions from investments in the consumer services, business services and manufacturing and industrial sectors.

Turning to Athene, the fair value of our investment increased by approximately 10% during the third quarter, resulting in \$73 million of gains within other income, as well as \$14 million of net carried interest income from AAA and related accounts, driving an aggregate contribution to third quarter ENI of approximately \$0.22 per share. Looking at our balance sheet, at the end of the third quarter we had nearly \$6 per share value which is up meaningfully from just a year ago when the balance sheet represented less than \$4 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 carriage interest receivable which has nearly quadrupled from its trough level of \$0.58 per share in March 2016 to \$2.16 per share today. Regarding our cash distribution, the \$0.39 per Class A share we declared today for the first quarter was primarily driven by fee related earnings which benefited from continuing growth in our management fees and in part from the lease proceeds.

One final note with regard to taxes, you'll notice that our ENI tax rate for the quarter was lower than normal largely due to the mix of income earned during the period, which contain a higher concentration of pass-through carry and investment income.

With that, we'll now turn the call back to the operator and open up the line for any of your questions.

## Question and Answer

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### Operator

[Operator Instructions] Your first question comes from the line of Alex Blostein with Goldman Sachs.

### Alexander Blostein

*Goldman Sachs Group Inc., Research Division*

First question, just guess I believe to the question around timing of Fund VIII realizations, the funds obviously moving through its kind of lifecycle very nicely obviously much faster than you guys had expected. So on prior calls you gave higher level of use and when you could start to realize some of these -- some of the earlier vintage investments, so maybe just an update there would be helpful.

### Joshua J. Harris

*Co-Founder, Senior MD & Director*

Yes, I mean, I think like -- I mean, I would just sort of somewhat parrot the remarks that I gave which is that we're -- the average life is 2 years, but certainly some of the earlier investment now are approaching 5 years, and so that's around when you start to harvest, and there's definitely a lot of things right now that we're looking at. So I would expect that distributions will ramp up starting next year. The other thing that I'd point out is that we bought that portfolio as we mentioned at a 5-multiple-point discount and really when we look at the -- the companies themselves are doing well. Revenue, EBITDA and aggregate was up mid-single-digit year-to-year for the portfolio and much of the accretion in that 5-multiple discount remains still not in the marks. So if you think about that 5-multiple-point discount, really only 1 multiple point has been introduced into the mark, that's what our process has put in there. And so we expect there's not only realization upside in that portfolio, but -- in terms of cash, but also there's just more significant upside coming from that portfolio. I mean, obviously it depends on the economy and the market and how the specific companies do, but we feel like there's still a lot of value creation left even as we start to realize.

### Alexander Blostein

*Goldman Sachs Group Inc., Research Division*

I guess just as a follow-up, a little bit of a bigger picture question, but several years ago at the Investor Day you guys kind of talked about aspirationally \$250 billion to \$300 billion in AUM, you are \$240 billion and change today. So just taking a step back I guess how do you guys think about that still as a target, and if the ultimate number is higher, can you just talk about the kind of scope and scale like kind of where the incremental growth opportunities could be for Apollo today and any incremental investments that you need to make to kind of support significantly higher level of growth?

### Joshua J. Harris

*Co-Founder, Senior MD & Director*

Yes, I mean what I would say is that obviously we're ahead of pace relative to growth there, and what we've been saying traditionally is that the core business is growing AUM at high single-digit to low double-digit just on its own, and then we have this what I call the R&D lab which adds value sporadically and stair steps to growth. Certainly that occurred during the financial -- when there's a big financial pullback, we tend to raise a lot of capital, and we did that during the last financial crisis and then obviously the creation of a scene where we managed the assets, added a lot of value there. And then now we have Athora, I mean I think the one that's sort of out there right now that's really kind of clearly focused today is Athora, right? We've raised the capital. It gives us a lot of buying power in Europe and there's -- it's an industry that -- in terms of insurance that really needs capital infusion, and so we see a lot of opportunities in Athora. We see a bunch of opportunities as we move our product line from what I would call higher alpha generating credit into what I call yield which is call it 5%-10%, that's an area that we have a number of products that are making real headway like we have one in particular total return that really it's just about finding investment opportunities, not finding capital. We're almost having to turn capital away and



then our hedge fund product is performing very well. That is -- we have optimism that will grow. And so we see opportunities really across our platform and we're investing. When we throw out the number of \$1.30, right, that includes -- we're setting aside a bunch of operating expense or G&A to invest in really proprietary origination around the world in Europe and in the U.S. and even a little bit in Asia where we're trying to go off the run and outside the markets whether it be middle market origination in Europe; whether it be enhancing other products that might be more akin to a GE capital in terms of asset-based lending; whether it be energy credit, we're building up -- in that number we've already set aside a bunch of money to invest in this origination because what we're finding is that the capital today is really there for us. Our investors I mean really trust us and we -- and so we just need to keep delivering on the investment returns and so anything in the public market today is overvalued because of the quantitative easing that's going on central bank-wise, and so we've got to get off the run and so we're trying to stay ahead of the wave of money that hits the markets and really develop arbitrage opportunities in credit, and so that's really what's going on.

### Operator

Our next question comes from Mike Carrier with Bank of America Merrill Lynch.

### Michael Roger Carrier

*BofA Merrill Lynch, Research Division*

First one, Josh, on funding the distribution outlook, just trying to understand, you mentioned where you guys have deployed in terms of around a 5-time-multiple versus the industry. Are there any other nuances in the portfolio when we compare say this fund versus the private funds and how we should be thinking about the process of exiting some of those investments whether it's in the private markets or in the public markets, just trying to gauge kind of that potential over the next 3 years and if there's any nuances relative to that?

### Joshua J. Harris

*Co-Founder, Senior MD & Director*

Yes, look, first of all, there -- in some cases they're bigger company, I mean it's a bigger fund, right, so you've got like a company like ADT where it's bigger company, Rackspace. You have many companies that were public companies once where for whatever reason, whether it be the portfolio is too broad and not understood by the public markets, or whether it be we've built the companies over time such as ADT where we took -- we've really added a lot of extra half to the company and changed the company's strategy, or in some cases we had portfolios where they owned a lot of different things and the company itself wasn't even -- the corporate structure didn't even make sense. I won't say publicly what those companies are, but -- and so in many cases we're able to reposition the company, change it materially and then reintroduce it into the public market. So the bigger companies -- the fact that we bought the portfolios so cheaply is -- with less leverage on the companies. And so -- and then I'd say chiefly the portfolio is less cyclical than it has been in the past. Just last -- when you look at the mix between services, business services, healthcare and more cyclical things like chemicals, not that we've walked away from those cyclical businesses, but it just happens to be very less cyclical. And so that would be another attribute. So I'd say, look, it's -- and then there's very -- I mean obviously our average of our history has been about 1/3 distrust for control where we bought companies to the debt markets, and in this case it's only 5%. So there's very little distress in this fund. I mean I think we've been able to prove to I think our investors very clearly that distressed, non-distressed obviously the great stress environment helps us, but we're able to originate off-market transactions at low multiples without that distress market and that this fund spoke clearly to it. So all of those things I'd say -- so I think it's sort of a good story relative to our past funds in terms of bigger and some cases better companies, and less kind of distressed. And then I think also last thing I would say is that in this fund we've done a lot of these corporate buildups where we've really added a lot of heft to many of these companies and made them bigger. So that's what I would talk -- would say generally speaking the public market and the debt markets tend to be greater than 50% of our exit, and so obviously that's going to be important that [indiscernible] for us. But that's not the only way we can exit. Clearly we can exit to strategic buyers. And when you create a portfolio of -- at 5x or 6x EBITDA, right, like you can exit to a financial buyer at a much higher price because -- so all you need -- so



even if the equity markets don't go so well, the debt markets hanging in there will be another backstop to our ability to exit. So that would be maybe how I would size it up.

**Michael Roger Carrier**

*BofA Merrill Lynch, Research Division*

And then just as a follow-up just on the credit side, so with AGRE or I guess Athora, just how are those opportunities setting up relative to what you saw in the scene? Seems like there's a little bit more competition, but it seems like it's still more in the U.S. versus Europe. And then just broadly with rising rates potentially we're seeing in the U.S. and maybe in Europe, just how does that factor in due to that -- the upside of the opportunity?

**Joshua J. Harris**

*Co-Founder, Senior MD & Director*

Yes, actually there are opportunities both in the U.S. and in Europe, so it's not an either/or, and I think that there's always competition. I don't -- my sense is that it's not that there's any more or less competition there is or was. In terms of rising rates, right, over time clearly rising rates helps financial institutions. The key to much of this is spread. And so over time if rates rise, over many years that will take some of the acute pressure off of insurance companies and banks and other financial institutions, but I don't -- first of all, my outlook is -- I don't know what you're thinking about rates, but I think that the quantitative easing globally continues. Certainly the U.S. will be at least trying to and begin -- they have been raising rates and obviously U.S. is trying to reduce the Federal Reserve's balance sheet. But they're still -- between Japan and the ECB and everyone else, you're still going to have a lot of quantitative easing. Well, it's not clear to me how much rates will go up. Maybe they'll go up -- maybe the long end of the curve will go up some, short end of curve will go up some, but I don't think there's going to be this huge rate increase unless we see inflation. And right now we're seeing the robust economic growth, we haven't seen that. So I think that, first of all, unclear that rates will rise. If they do, I think it will be many, many years -- many of these problems are very, very huge and rate increases won't fix them, they just are fundamentally challenged in financial institutions that need to deleverage, but over many years it will help the financial institutions if rates go up.

**Operator**

Our next question comes from Glenn Schorr with Evercore ISI.

**Unknown Analyst**

This is [ Kevin ] [indiscernible] for Glenn Schorr. Actually recent announcement on the acquisition of the majority stake in Catalina, can you just spend a little time talking about what the deal is, what your plans are for them, what it means for the company, is it the same game plan for that non-life insurance with Athene and so what's the opportunity?

**Martin Kelly**

*Chief Financial Officer*

Yes, so with respect to Catalina, yes, they put out a press release a week or so ago announcing that they were going to be selling some stakes to Apollo managed funds, so when the transaction is complete the funds managed by Apollo will control the equity of Catalina. Management will still own a sizable stake as well. Catalina is a really interesting company. It's been around for 10 years. It is -- has been growing at a pretty rapid clip and is one of the largest players in the space of acquiring runoff portfolios of non-life both in the U.S. and Europe, and we see significant opportunity with a really limited competition. I would note that it is a bit different in terms of the investment than you should think about Athene or Athora in that we're not -- today we're not managing the assets directly of Catalina. So I would think about it more as a fund portfolio opportunity at this point in time, but a lot of upside there.

**Unknown Analyst**

And maybe just as a follow-up, can you give us maybe a update on tax reform as it stands? I know it's kind of early, but how it impacts your firm, your credit business and maybe in particular Athene and Athora?

**Joshua J. Harris**

*Co-Founder, Senior MD & Director*

Yes, I think we're obviously like everyone else watching what comes out of Washington, and it's got -- without seeing the kind of legislation itself, it could go in so many different directions, so we'll probably not speculate on it, but as soon as it actually comes out, if it comes out we will definitely be very, very focused on and be much more able to elaborate on what it means to us.

**Operator**

Our next question comes from Bill Katz with Citigroup.

**William R Katz**

*Citigroup Inc, Research Division*

Just circling back to the discussion about sort of high single, low double-digit organic growth in the core business, can you give us the sense of where you're seeing the best demand from the LP perspective and maybe give us updated thoughts in terms of penetrating a little bit more into the retail channel as well?

**Joshua J. Harris**

*Co-Founder, Senior MD & Director*

Yes, so I mean -- look, the LP community I said yields, so what's happening is that fixed, but it's all over the place, I mean we're growing the whole range of products, but the one that sticks out the most is as yield -- as rates have come in, right, like the ability of the -- most of the LP community or much of the LP community are comprised of pension plans or other liability managers where they have increasing cost, even some of the people that don't are focused on just the inability to make real returns of fixed income. And so as they look to branch out a fixed income, they look at obviously equity and alternative is private equity, but they also look at, okay, how can we earn more on a credit -- how can we invest more in fixed incomes to earn kind of the all 5%, 6%, 7%, 8% that we used to be comfortable with, and so there's the alternatives basket within the context of our investors to sell wealth smaller than fixed income or the equities book. And so this provides a great way for them to earn enough return to keep up with their targets or their liabilities. And the only way you could do it is going off the run off market as I talked about, whether it be structured credit, CLOs, whether it be middle market origination, whether it be insurance type liabilities that people don't understand, energy credit where you need special expertise, aircraft leasing; we're looking at lots of segments in the context of the real economy that aren't necessarily priced to perfection because the central bank money can't flow through the markets and hit those sectors, and so that's one big area that's going on. We're also seeing a lot of demand for direct origination Europe as I mentioned. So that would be what I would say. The last thing is clearly the search for return, right, opens up a lot of the private -- whether it be infrastructure, whether it be our traditional private equity energy investing, some of our competitors have raised poor products, but everyone is looking the run in equities also, there are many of our LPs that are saying, well, the future return in equities might be not that traditional 8% or 6% to 8% that we used to count on, might be lower because as the central banks raise rates, equity prices could -- they might not go down, but they might -- we sort of borrowed from the future return by having rates so low. And so people are looking to get even out of their own equity book and into alternatives. And so really as I said for us it's all about anytime we show with a product, we raise lots of money and so for us it's all about building expertise in these various areas so that we can deliver outsized returns and then we'll raise the money and so we're seeing a lot of demand there as well.

**William R Katz**

*Citigroup Inc, Research Division*

And then just a follow-up, I know you said you don't want to comment on taxes out, I'm taking that as in terms of your structure, but if you were -- if the industry were to face some pressure around interest

expense deductibility, I've been asking this of your peers as well, what's your sense on the economics for the [ LPO ] model?

**Joshua J. Harris**

*Co-Founder, Senior MD & Director*

I mean again I think it's so hard to really react to that. Is there -- are there going to be lower corporate taxes, at what level will interest deductibility be limited, what are the other changes that will occur? I mean I think clearly changes in fundamental things like that will create lots of volatility, lots of companies that get hurt by that, lots of companies that get helped by that and we kind of drive in volatility. I don't -- I think when you look at the private equity model, the public markets are levered just over 3x and private markets are levered just over 5x. It's really not on the margin, it's kind of certainly will impact the cash flows of more levered companies, but I don't personally think that -- I think if there is big changes to the structure of our tax that I think that will provide lot of interesting opportunities for people that get ahead of that and adjust to it, and I think certainly we've demonstrated the ability to do that and I don't think that it will fundamentally change the private equity model.

**Operator**

Our next question comes from Patrick Davitt with Autonomous Research.

**Patrick Davitt**

Just one quick follow-up on the creation multiple conversation; with your experience -- given your experience would you expect the exit multiples to generally be at market then so that if we're going to move from a 5x discount to a 4x discount should we expect that to get to 0 by the time you exit?

**Joshua J. Harris**

*Co-Founder, Senior MD & Director*

Yes, it's really hard, I mean, I think that's just unfortunately too broad of a question. In other words like each company has its own unique story, its own unique situation, and the comparables to that company, the ability of us to exit into the market changes like every day, right? And so certainly we think we bought the portfolio at a significant discount to fair value. Whether that -- what the ultimate exit multiples are it's really hard to predict. I mean I will say that certainly in our prior funds we have exited at many multiple point accretions to where we bought these funds. Whether we'll get a full 5 that's hard to predict.

**Martin Kelly**

*Chief Financial Officer*

And I just say another math that we use internally is can we double our investors' money or will we? And if you do that in Fund VIII and nothing more nothing less, then that creates about \$8 of gross carry out of the fund over its life. So obviously more would be more. We're about a quarter of the way through that in terms of what we've recognized today through our ENI earnings. So that's a way to frame what the outcomes might be.

**Joshua J. Harris**

*Co-Founder, Senior MD & Director*

And what I'll say -- I mean to me we've done about 2.5x over our history, so a little -- a shade under 2.5x. So the double -- right, which is what the community wants. We've always over-delivered that and I would expect Fund VIII to be no different to be honest with you, but at the same time, like it's very hard to predict. We're off to a very fast start.

**Patrick Davitt**

And then quick follow-up, could you remind us of the economics on a store has been, and has there been any change to that with the re-branding?

**Martin Kelly**

*Chief Financial Officer*

No, and we haven't really said much around the economics at this point. Over time we expect to make that more clear, but for the time being the assets that -- they're being managed through Athora, a lot of the assets are portfolio company assets from our private equity funds where we're managing or helping to advise on the balance sheets there and it's generally been sort of cost plus up to this point. There are some assets under management for the former Delta Lloyd portfolio and there the basis points is around 10 basis points earning to advise on those assets, but as Athora grows and adds additional incremental assets, I think we would expect fee rates to be incrementally higher, but at this point haven't disclosed any of that.

**Joshua J. Harris**

*Co-Founder, Senior MD & Director*

I mean relative to the U.S. model when you look at the European model there's more leverage in the European model, roughly double, and -- but the fee rates are lower and the assets are more -- the flexibility is a little more constrained. So I think we haven't said beyond, but certainly we do see this as a really potentially important growth opportunity for us.

**Martin Kelly**

*Chief Financial Officer*

And part of the future outcomes will depend on what portfolios are acquired, but clearly anything that's done is going to be done in an accretive way.

**Operator**

Our next question comes from Chris Harris with Wells Fargo.

**Christopher Meo Harris**

*Wells Fargo Securities, LLC, Research Division*

Yes, I just wanted to follow up on that earlier question regarding where Fund VIII is valued versus the market. I guess we really haven't discussed why Fund VIII is still valued at a prepaid discount to the comps? Just wondering if you could elaborate on that because it seems like the portfolio companies are doing extraordinarily well.

**Joshua J. Harris**

*Co-Founder, Senior MD & Director*

We didn't actually -- so just to be clear, Fund VIII -- I mean Martin will speak about our fast process, but like our mark-to-market process, but like what we said was that we bought -- the private equity market acquired companies of our size like greater than \$500 million of [ TEV ], so even smaller at about a 10.5 multiple. And we value and we create our portfolio at about 5-multiple discount to that. That doesn't really speak to the comps, and then we said that we thought we bought our portfolio, we got it in the good price that we thought we had created our portfolio at a discount because of our ability to source things and then change their strategies. What we didn't say, to be clear, is that it's marketed discounts to the comps because that -- why don't you talk about our [ FAS ] process?

**Martin Kelly**

*Chief Financial Officer*

Yes, so when we buy a company at many multiples less than where the market is, there are different reasons for that, and you need time to address the issues in the companies that you buy. Some of that's capital structure, some of it's operating performance, and that just takes time. And so with an age of under 2 years, we are still actively working through many of the names in the book and that's going to take -- that's going to take 3, 4, 5 years, potentially longer from here to do that and complete it. So we value things where we see an extra price today taking into account all the relevant market data that we can, it's close objective, but yes, there's a value creation timeframe that we're partway through.

**Christopher Meo Harris**

*Wells Fargo Securities, LLC, Research Division*

And then just a quick question on the expenses, I think your management-based expenses are tracking up around 7% year-on-year so far year-to-date, how should we be thinking about the growth rate as we enter 2018? I know you've got Fund IX coming on, I'm not sure if that influences anything.

**Martin Kelly**

*Chief Financial Officer*

Sure, so our margins are up. Our FRE margin for this year-to-date is 50% and if you would take out the lease buyout gain, sort of a non-recurring item, it's 48%. That's slightly higher than where it was last year, and last year had a lot of transaction phase. So we've been able to grow organically the firm. Management fees are up 10% year-on-year, comp is up about 7% and non-comps is up about 2%, so there's real operating leverage that's being created. As we look into '18, we're very focused on margins, and clearly Fund IX will provide an uplift in revenues without a lot of additional direct expenses. And then to Josh's point, we will likely take some of that and invest it in areas where we see compelling growth, but we do it in a way that is margin accretive relative to where we are this year.

**Joshua J. Harris**

*Co-Founder, Senior MD & Director*

Yes, we're seeing operating leverage and we're very focused on it. And the reality is you don't need -- I mean certainly in the context of Fund IX, we're always looking to enhance our team, but there's a lot of operating leverage in raising your next private equity fund.

**Operator**

Our next question comes from Michael Cyprys with Morgan Stanley.

**Michael J. Cyprys**

*Morgan Stanley, Research Division*

I just want to follow up on the point that you were just making about investments in the business putting to work some of the additional revenues that you get from Fund IX, if you could just maybe talk about what some of those compelling growth opportunities might be where we might see you invest in the business in the next couple of years?

**Joshua J. Harris**

*Co-Founder, Senior MD & Director*

So some of this will be repetitive. I think that within the -- most of it will be across our credit platform where we are increasingly seeking to go off the run and outside the market in terms of generating yield and opportunistic with more yield origination capability, so that could range from creating middle market lending presence in Europe similar to the one that we have in the US. It could be investing in any number of what I call asset-based financing businesses. Aircraft leasing would be an example of that type of business where we already have a significant presence. It could be investing in areas like insurance and/or financial institution lending and/or energy where we already have a significant capability. It could be expanding our emerging markets presence and enhancing our capability there. And then it could be -- it could be also looking at expanding our alternatives and the private equity expertise, whether that be adding to our existing team in energy or whether it be getting into infrastructure which we've talked about before and/or real estate and real assets. And so those are all the types of things that we're going to be investing in. And this has been an ongoing -- this isn't -- where we don't talk about it a lot, it is really part of our strategy is to be able to deliver investments that are added significant arbitrage or discount relative to either the yield they generate per unit of risk in the credit markets and/or in the alternative private equity markets is the same thing. And in order to do that you need to stay ahead of the competition in terms of origination. And that's what -- that's been the key to our model and so really -- and by the way, what happens in the financial market is that people copy right away. And so you need to keep moving and keep adding and keep ahead of everyone which is what we try to do, which is why we're marginally obtuse on these calls in terms of specifically talking about that.

**Michael J. Cyprys**

*Morgan Stanley, Research Division*

Just as a quick follow-up, maybe you could just talk a little bit about data and technology fund, just how your investment process today is incorporating that and how you kind of see the evolution of your investment process over the next 5 years given changes in technology, growing amounts of data and how you're thinking about integrating that over the next couple of years?

**Martin Kelly**

*Chief Financial Officer*

Sure, so I'll take this. Yes, we're spending a lot of time on this and we're investing significantly in technology across the platform both within our businesses and then across the infrastructure of the firm. And so beyond the investment decision process which I'll speak about in a minute, it allows us to operate portfolio companies more effectively, it allows us to sort of do things offensively and defensively and allows us to more efficiently operate the firm. So at the firm level we've invested in data warehouses and data scientists across our businesses that allow us to collect and analyze information across the companies that we own and that allows us to operate companies more effectively and also informs the decision process for new investments. And then in credit, it allows us to aggregate risks and report information through LPs in a more useful fashion, and it allows us to grow the firm scalably, so we should see ENI margins. Around the decision -- investment decision process within PE, we have developed relationships with specialized providers of data and technology and they provide analytics and information that they customize to particular industries, and so that ranges from robotics and apps through to mainframe enhancement and sort of legacy platforms. And so there's clearly -- there's a lot going on, there is risks, there is opportunities, lots of changes, but we're trying to embrace that across the businesses as well as at the firm level.

**Operator**

Our next question comes from [ Greg Siginpauler ] with Credit Suisse.

**Jordan Freediner**

This is [ Jordan Freediner ] filling in for Greg. Want to follow up on Bill's question earlier on retail. I know you already have some retail product offerings including a mortgage-free BDC and some other credit fund products, but would you look to further penetrate this channel by building out new products such as maybe a real estate [indiscernible] or interval funds?

**Joshua J. Harris**

*Co-Founder, Senior MD & Director*

Yes, look, we're always looking at opportunities like that where we can get to what we perceive to be sticky low-cost capital. I mean, certainly we have some of that in the commercial real estate area, and so certainly we're always looking at whether there are new public structures or other structures that are kind of available and interesting and where we feel like we can generate arbitrage and good rates of return for those investors and where their needs meet our capabilities. And so we certainly are looking at that. We also obviously I'll just point out, I mean just to go back through it, we -- today we're between 10% and 15% retail, it's a -- we reached the retail investor through a variety of different channels from obviously just public companies, [indiscernible] companies to high net worth channels to we wholesale to other credit providers, and we reach -- for most of our funds we reach high net worth -- we have high net worth channels that invest. And obviously the ones, so the 10%s, the COG between 10% and 15% does not count Athene where clearly their whole business is built on annuities to retail clients. And so if you include that, obviously the number, that would be another 30% of our assets. And so we employ a different approach to retail maybe than what you're hearing on some of the other calls. I mean, the other issue for us chiefly is that with so much institutional demand for our products that again it's not about the sort of real need to reach more and more capital, isn't as acute right now, but certainly where retail provides -- where retail understands our product and provides sticky long-term capital and we feel like we have capabilities that overlap with that, we're going to -- we're not -- we are very much in tune with taking retail capital.



**Operator**

Our next question comes from Brian Bedell with Deutsche Bank.

**Brian Bertram Bedell**

*Deutsche Bank AG, Research Division*

Maybe to circle back on the Fund VIII realizations, Josh, and thanks for all the color on that, as you think about the macro -- or I guess my question is how do you think about the interplay between the macro environment and then trying to improve the valuations on those portfolio companies, realizing obviously it's -- each position is different, but kind of in line with what Martin was saying on the 3 to 4 to 5 year time period to build the evaluations up to where you think they ought to be, would you seek -- if your view on the macro got worse or you thought something was going to happen within the next year or so, would you accelerate that realization process and not fully try to capture the entire economic value?

**Joshua J. Harris**

*Co-Founder, Senior MD & Director*

Yes, so the way we think about it really is, first of all we do have a macro overlay for how we think about our portfolio and certainly it's not lost on us that we're in year 8/going to year 9 of an economic cycle, that interest rates are historically low, that valuations are historically high and certainly we -- that is something that while we don't have a crystal ball pushes us to look very hard at where we can monetize things. And so we're definitely in tune with the macro environment and right now I'd say there is a -- it does orient you towards looking hard now. So with the way we actually put that into practice is on a bottoms up basis where we look at every single company and we look at not just where we bought it, but where we could -- every day that you don't sell, you buy, and so we look at every single company and we say can we generate private equity returns for our investors from where we could sell this company. If the answer is yes, we keep it and if the answer is no we sell it. And certainly what we do within the context of those portfolio reviews and we had one very recently where we literally sat around for an entire day with the entire private equity team and went company by company is we orient around average ultimate -- we orient around interest rate-adjusted market condition-adjusted multiples, right, as the ultimate exit. So we might be able to sell a company today at a high multiple, but when we look out into the future and we decide not to sell it, we normalize for what we expect the environment to be. And so what that does obviously is it puts pressure on the math because we can't predict continued momentum in the marketplace. So that inherent approach puts pressure on our -- kind of our selling and so we are -- once we've created a lot of value, we are oriented towards selling and that's the way that we do it.

**Brian Bertram Bedell**

*Deutsche Bank AG, Research Division*

And you could also accelerate the IRRs I suppose if you are selling those mfaster even if you're not hitting the 2x, 2.5x MOICs, is that also something in the considerations?

**Joshua J. Harris**

*Co-Founder, Senior MD & Director*

I mean, I think it's all in the hopper. I mean, I think that certainly MOIC and rate of return are both very important.

**Brian Bertram Bedell**

*Deutsche Bank AG, Research Division*

And then just lastly maybe just an update on the partnerships with OppenheimerFunds and Waddell in the retail credit products and whether you're looking at other similar types of opportunities?

**Martin Kelly**

*Chief Financial Officer*

Yes, so sitting here today we've got partnership with Waddell which has been growing very nicely and also a partnership with [ K2 Funds ]. We no longer have a partnership with Oppenheimer, so really it's focused

on Waddell and K2 at this point. And they continue to grow and be well received, and as Josh talked earlier about the total return strategy getting a really attractive product, it's true for retail as well, and so that's really where we're seeing a lot of growth and momentum through those advisor relationships.

**Operator**

Our next question comes from Ken Worthington with JP Morgan.

**Kenneth Brooks Worthington**

*JP Morgan Chase & Co, Research Division*

Just quickly, Martin, what were catch up fees again? I know you mentioned them, I missed it, and how much of that was in credit?

**Martin Kelly**

*Chief Financial Officer*

It was \$12 million in Q3. There was a little bit in Q2 as well and it was all in credit.

**Kenneth Brooks Worthington**

*JP Morgan Chase & Co, Research Division*

And then, Josh, to follow up I think on Mike's question earlier in the call, on Athora how far apart are the buyers and the sellers of insurance assets and properties in Europe? Are they really far, are they kind of close? Is there anything for us to consider that would kind of bridge that gap and get us to see more of these deals getting done?

**Joshua J. Harris**

*Co-Founder, Senior MD & Director*

Yes, I mean I think I'm hopeful that we can get some stuff done over the next 6 to 18 months. I mean I don't know that there's -- I mean I think that we raised the capital because we perceive there to be significant opportunities. These things are very complicated, they're regulated, it takes a long -- there's a lot of moving pieces, it's not like you can just go in there and kind of buy these things. You have to -- there's a huge amount of complexity and negotiation and you have to be super careful and handle it very appropriately with all parties including protecting the ultimate policyholders. So I think it's hard to just -- unless you're well -- unless you're known for having the capability to do this, it's hard to just go in and do it, and secondly once you're known, it's still complicated to get it done. And so kind of -- it's not easy, but that's one of the reasons why we gravitate towards it because it takes a lot of skill, but I think that it's -- I think we're well-situated right now.

**Operator**

Our next question comes from Devin Ryan with JMP Securities.

**Devin Patrick Ryan**

*JMP Securities LLC, Research Division*

Maybe a follow-up from me as well. You touched on real estate infrastructure as areas of investment and I understand you want to be obtuse around the opportunities in real assets, but at a high level kind of some of these are harder for us to model, is there anything big brewing that could move the needle over the next year? And then any color just you can give us around you some of the things you're looking at organically or maybe even think about inorganically would be helpful.

**Joshua J. Harris**

*Co-Founder, Senior MD & Director*

Yes, look, I think that I would say that clearly we've been putting together a team in these areas and we are going to approach this in a very Apollosque way where we -- right now there's a tremendous need for capital in the infrastructure and real assets arenas, but at the same time there's that sort of commodity stuff that everyone can do has been bid to pretty high prices driven by lots of capital to do that kind of

stuff. And so we're working painstakingly to develop an edge that allows us to do things that are different similar to how we do private equity where we're either able to assess things that other people can't or execute transactions that other people can't or absorb execution risk that other people aren't willing to, and so all that takes time to build capability. So that's the way we're approaching it. I think certainly our credit business in real assets is growing a lot and we're investing in it. And so that's really how I'd answer it. I don't know how the deals come and go and it's hard to predict some big -- there's not some big elephant lurking out there right now.

**Devin Patrick Ryan**

*JMP Securities LLC, Research Division*

Quick follow-up here so --

**Joshua J. Harris**

*Co-Founder, Senior MD & Director*

I'll keep you guessing. I'll keep you guessing.

**Devin Patrick Ryan**

*JMP Securities LLC, Research Division*

Maybe I'll just ask a quick math question, this is not a tax question. Leon had noted earlier in the year that just the 20% corporate tax rate could be a level where it's pretty much awash to be a [ C Corp ] and I know, yes, there are some shifts occurring in kind of the earnings stream and maybe qualifying incomes increasing. So I just want to think about that rate directionally, would that 20% threshold be moving much lower or is that over the cycle comment? I know it's complicated, but just trying to think about that directionally.

**Martin Kelly**

*Chief Financial Officer*

So what we've said is that when the tax rate today over the cycle as best as we can model it and not specific to any quarter or year is sort of 10% to 15%, like the -- sort of [indiscernible] maintenance-type area. And so if you end up taxing the whole income stream at a single tax rate, call it 20%, it's going to be tax leakage, it's going to be dilutive, but the benefit may be there in the sense of a different shareholder base. So at 20% it's -- it would have to come down to 15% or something like that to be close to a breakeven on paper.

**Joshua J. Harris**

*Co-Founder, Senior MD & Director*

But again a lot of that depends on the treatments of different types of income, and I don't even know that -- how to kind of really answer it because what Martin's saying is 100% accurate if there's one blanket rate, but like there's not today and I don't think anyone talking there being a blanket rate in the future. So I mean, again -- and what your deductions are and so like again it's -- I mean I'm not -- we're not trying to be argumentative in terms of [indiscernible], but it's really hard to predict it right now.

**Operator**

Our next question comes from Robert Lee with KBW.

**Robert Andrew Lee**

*Keefe, Bruyette, & Woods, Inc., Research Division*

I guess, Josh, I'm just curious; you talked about where you kind of see the opportunities, you certainly highlighted some in the U.S. and Europe. I guess because it wasn't included, could you maybe update us on the -- your opportunities or your thoughts around Asia? I mean clearly that's a region of the world where a lot of your peers have raised a lot of capital through a lot of effort and you guys really seem to be a little bit more quiet about opportunities there?

**Joshua J. Harris**

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*Co-Founder, Senior MD & Director*

No, we are. I mean, but we have a whole team in Asia, we've got a team in Hong Kong, we have a smaller team in Singapore, we have people in China, we have people in Australia, India -- we have a big team in India and a decent tax credit in real estate business. And so we have a number of businesses, primarily our credit and real estate sort of special situations-type lending and structured equity. And today the overall business is less than 5% of our assets, and I would say that we are value-oriented, creditor right-oriented investors, and there's a fair -- and control-oriented investors in the case of our private equity funds. And so in each case there are just cultural and structural impediments, whether it be the legal and regulatory environment, or it be the ability to transact on a controlled basis in certain countries that just make our business maybe smaller than other firms that might be more oriented towards growth equity or momentum investing or minority investing or take a less value approach, right, if you're willing to -- that some of the values in Asia are high, and so if you're willing to pay a high price, but you think you can get a higher price in the IPO market or something, that would open up an awful lot of Asian and you want to take a minority stake and kind of wing it, that would open up kind of a lot of investing from our point of view, but it's not who we are, like we need to know that we're getting in at a great price and so that limits the flow, but it doesn't mean that we're not investing in Asia and we certainly have real franchise in India and increasingly a franchise in real estate and credit around Asia and a more limited approach in private equity that's opportunistic.

**Robert Andrew Lee**

*Keefe, Bruyette, & Woods, Inc., Research Division*

And then maybe just one follow up, I guess December it will be about a year where you announced that Gary Parr was coming -- joining the firm and I guess he joined in early this year; just kind of curious, can you maybe update us on how his role has kind of evolved where you kind of feel like maybe there's been the most impact on kind of how you think about things or do things that can help us get a sense of his impact on the business?

**Joshua J. Harris**

*Co-Founder, Senior MD & Director*

Yes, look, Gary comes with a vast reservoir of financial institution experience, like that's where he spent his entire career. Clearly that skill set is applicable across. And we're doing a lot of stuff, whether it be in insurance, whether it be in banks, whether it be in financial services. And we ourselves are asset managers. So I'd say that experience comes across like all of our businesses. He helps us in private equity, he helps us in credit with that expertise. And then certainly relative to the strategy of our own firm in terms of evaluating different opportunities, where we should invest, whether we should make acquisitions or not make acquisitions, all of that is very helpful. And so he's been an enormous help to the firm and anyway he's been a good addition.

**Operator**

Our final question this morning will come from the line of Gerald O'Hara with Jefferies.

**Gerald Edward O'Hara**

*Jefferies LLC, Research Division*

Clearly a lot of focus on the insurance components within the permanent capital vehicles, but was hoping you might just be able to close up the call I suppose with a little bit of an update around midcap as it continues to grow, and what the opportunities that might be there kind of looking forward and what the geographic reach of that vehicle is if you could remind us?

**Joshua J. Harris**

*Co-Founder, Senior MD & Director*

Yes, look -- go ahead.

**Martin Kelly**

*Chief Financial Officer*

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Yes, it's Martin. So midcap is growing, it's diversifying its business away from healthcare across a much broader set of asset classes. It's originating business nicely sort of on par with the plan as said. The challenge it's had this year is [indiscernible] activity has been high, and so pay-downs have taken away some of the net growth. But we've been careful what's underwritten and taking what we perceive to be good quality risk. And it's a good established platform with increasing access points to origination. So it's sort of -- it's picking up, but a little bit more slowly than what we planned.

**Operator**

And with that, I will hand our program back over to Gary Stein for any additional or closing remarks.

**Gary M. Stein**

*Head of Corporate Communications*

Great. Thanks, Operator. Thanks again, everyone, for joining us today. As I noted earlier, if you have any questions regarding the earnings presentation or anything that was discussed on this call, please feel free to give Noah Gunn or me a call. Thanks very much.

**Operator**

Ladies and gentlemen, thank you for joining the Apollo Global's third quarter 2017 earnings conference call. This will conclude our conference call this morning. You may now disconnect and have a wonderful day.

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