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AMG - Q4 2019 Affiliated Managers Group Inc Earnings Call

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OVERVIEW:

Co. reported 2019 economic EPS of $14.22. 4Q19 economic EPS was $4.52.

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PRESENTATION

Operator

Greetings, and welcome to the AMG Fourth Quarter 2019 Earnings Call. (Operator Instructions)

As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Anjali Aggarwal, Vice President, Investor Relations. Thank you. You may begin.

Anjali Aggarwal - *Affiliated Managers Group, Inc. - Vice President, Investor Relations*

Thank you for joining AMG to discuss our results for the fourth quarter of 2019. During this call, certain matters discussed will constitute forward-looking statements. Our actual results could differ materially from those projected due to a number of factors, including those referenced in our Form 10-K and other SEC filings. We assume no obligation to update any forward-looking statements made during this call.

AMG will provide, on the Investor Relations section of its website, a replay of this call, a copy of our earnings release, as well as a reconciliation of any non-GAAP financial measures, including any earnings guidance announced on this call.

As a reminder, we posted an updated investor presentation on our website this morning, and encourage investors to consult our site regularly for updated information.

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

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

Jay C. Horgen - *Affiliated Managers Group, Inc. - CEO, President & Director*

Thanks, Anjali, and good morning, everyone. 2019 was a year of change and evolution at AMG. We completed a generational transition and succession within the management team, further evolved our core strategy and took action to position our business for future growth. Given the significant competitive advantages we have built over nearly three decades, together with the entrepreneurial spirit of a new management team, we are confident in our forward growth prospects. I'll discuss the progress we have made against our strategy in more detail, but first, let me summarize our earnings for the quarter.

AMG reported Economic earnings per share of $4.52 for the fourth quarter and $14.22 for the full year 2019. AMG's fourth quarter Adjusted EBITDA grew by 5% year-over-year, driven by higher performance fees, which offset declines in margin-based Affiliates.

Our outflows moderated in the quarter and continue to be driven by certain quantitative strategies, coupled with seasonal client redemptions. I would note that while quantitative strategies account for approximately 30% of our AUM today, they contribute less than 10% of our run-rate EBITDA. The large majority of our EBITDA is generated by Affiliates and strategies that have strong long-term performance track records and are aligned with secular client demand trends. For example, our illiquid alternatives Affiliates, which collectively manage $100 billion of AUM, are benefiting from record levels of client allocations to private markets and contribute stable and growing fee streams to AMG's earnings.

Our wealth management Affiliates, which collectively manage $50 billion of AUM, posted another year of consistent inflows. With their solutions orientation and a focus on innovation, these Affiliates also contribute stable and growing fee streams to AMG's earnings.

In addition, a number of our fundamental managers across active equities and liquid alternatives, enhanced their long-term performance track records during the year, delivering excellent returns to clients and contributing to AMG's strong performance fees. Finally, as investors increasingly focus on ESG, many of our Affiliates have launched ESG products that are gaining momentum.

With strength across these areas, AMG is well positioned for long-term organic growth - and earnings growth, - and we are focused on aligning our resources with these Affiliates and strategies.

During the quarter through a number of strategic initiatives, AMG freed up capital and resources to reallocate to growth areas, and certain of our margin-based Affiliates addressed costs in order to offset revenue declines. In addition, as we discussed last quarter, we are collaborating with certain Affiliates facing industry headwinds to reposition their businesses to achieve optimal outcomes for Affiliate partners, their clients and AMG shareholders. Through these collective efforts, we will realize benefits on a forward basis, and Tom will discuss the impact of these initiatives on our financial results and disclosure.

At the highest level, we continue to execute on our core strategy of partnering with leading independent active managers, and we are focused on allocating resources to the areas of highest growth and return. Through the successful execution of this strategy over time, we have built a global business, which is well-diversified across Affiliates, strategies, geographies and clients. And today, AMG operates at scale, generating substantial, recurring free cash flow, which we are investing to enhance future growth across 3 principal areas: investments in new Affiliates, investments in existing Affiliates and investments in AMG to enhance the growth of our Affiliates.

Let me expand further. Through new investments, AMG gains additional exposure to the fastest-growing segments of the market, which are aligned with future client demand trends and will generate long-term organic growth. Our unique ability to evolve and scale our business through New Investments - without the risk or cost of integration - is a distinct competitive advantage. We are dedicating significant resources to this effort, further increasing momentum, and our transaction pipeline includes a diverse array of high-quality, growing firms that are self-selecting into AMG's unique partnership approach. We remain highly selective and have focused on further refining our discipline in structuring new partnerships to generate attractive shareholder returns.

While the timing of individual new investments is inherently uncertain, we expect to generate incremental earnings growth from accretive investments in 2020.

Through investments in existing Affiliates with attractive growth prospects, we have an opportunity to accelerate their ability to meet evolving client needs. For example, in the fourth quarter, we expanded our seed capital program and supported the launch of new products at Artemis, Pantheon and GW&K - and we continue to identify additional ways to leverage our scale and expertise to create value for Affiliates, including partnering on opportunities for differentiated distribution and working together to evaluate lift-out opportunities.

And finally, we are reallocating AMG's resources to further invest in capabilities in support of our Affiliates' strategic objectives. For example, we recently repositioned our global distribution effort to focus on clients that represent the largest growth opportunities for our Affiliates. We've also added resources to enhance AMG's distribution of illiquid products to LPs globally, and we have seen early success with Baring Asia. And we continue to explore strategic partnerships that leverage the collective strength of AMG's relationships on behalf of our Affiliates. Taken together, we are focused on leveraging AMG's unique competitive advantages and allocating capital across investments in new and existing Affiliates as well as high-value centralized resources that enhance our Affiliates' growth potential.

Our highest priority is to invest in these growth opportunities to create shareholder value, and then continue to return capital to shareholders through repurchases and dividends. Over the past year, given our focus on management transition and repositioning our business for the future, we invested approximately one-third of our annual cash flow into growth initiatives. The remaining two-thirds was returned to shareholders. As we continue to execute on our strategy over the next several years, we see a shift in that mix towards growth investments, but at all times, will maintain discipline in allocating our capital to maximize shareholder returns over the long-term.

Stepping back - during a period of ongoing change and evolution in the asset management industry, we took further steps in 2019 to position our business for the future. We have reshaped our resources and footprint and reallocated capital to areas of growth. We have collaborated with certain Affiliates to reposition their businesses while also investing alongside Affiliates with growth opportunities. We completed a new investment in Garda Capital, which has meaningfully outperformed in the first year of our partnership, and we are highly confident in our forward new investment pipeline. And finally, the next generation of AMG's leadership is firmly in place and fully aligned with business performance and shareholder returns.

2019 was a year of change and evolution at AMG. Moving forward, with the quality of our Affiliates and the strength and diversity of our business, we are well-positioned for 2020 and opportunities ahead.

With that, I'll turn it over to Tom to review the details of the quarter.

Thomas M. Wojcik - *Affiliated Managers Group, Inc. - CFO*

Thank you, Jay, and good morning, everyone. As Jay described, in the fourth quarter, we implemented a number of strategic initiatives to position our business for growth. These actions led to several one-time items and updates to our disclosure that I will go through in more detail.

The strategic initiatives that AMG and certain margin-based Affiliates effectuated in the quarter resulted in approximately $30 million of costs, primarily related to resource repositioning and footprint rationalization. Collectively, these initiatives will free up approximately $50 million of capital annually, to offset revenue declines and enable reallocation to higher growth areas, the benefits of which we will realize in future periods. Additionally, our economic earnings included a $60 million tax benefit related to the BlueMountain transaction.

We are also collaborating with certain Affiliates facing industry headwinds to reposition their businesses, and we have adjusted our AUM disclosure for the fourth quarter to better reflect Affiliates where we are focusing AMG resources.

We included a line item in our AUM tables called "Strategic Repositioning," which removes $44 billion of AUM associated with this effort that is not meaningfully contributing to AMG's financial results. The largest component, or approximately $20 billion relates to the sale of our interests in BlueMountain and JM Hartwell. The remainder represents Affiliates we are collaborating with to optimize outcomes for their clients and management partners, while also retaining potential future upside for AMG shareholders. Having walked through the impact of our strategic initiatives, let me now turn to our financial results, starting with flows.

Net client cash outflows of $11 billion moderated from Q3 levels and were driven by certain quantitative strategies and seasonal client redemptions. In Alternatives, we reported net outflows of $(7.5) billion, driven by quantitative strategies and seasonality, partially offset by positive contributions from illiquid alternative and fixed income products. While near-term performance in certain quantitative strategies has been challenged, others, for example, at Winton and Systematica, are generating strong results. We also continue to see outperformance in our fundamental liquid alternatives book including at ValueAct, and in relative value fixed income strategies at Capula and Garda, both of which continue to generate solid organic growth.

We are benefiting from strong client demand in illiquid alternatives and private markets as our Affiliates build on existing and new product capabilities, with ongoing fundraising at EIG, Pantheon and Baring Asia. AMG's performance in this category remains very strong, with 94% of our recent vintages outperforming industry benchmarks on an IRR basis.

Turning to global equities, we saw net outflows of $(3.8) billion in the quarter, split roughly evenly between global and emerging market strategies. Our Affiliates continue to generate strong long-term performance in this category, particularly in fundamental strategies, with 84% of our AUM ahead of benchmark over a 5-year period.

In U.S. equities, we reported net outflows of $(1.4) billion, an improvement over recent periods, particularly when taking into account retail seasonality in the quarter.

Turning to Multi-Asset and Fixed Income, we posted our 12th consecutive quarter of net inflows, and our Affiliates generated $1.4 billion in flows, primarily driven by muni bond and wealth management products at GW&K and Baker Street, respectively. Fixed income products at Artemis and AQR also generated positive net flows and we continue to be excited about the momentum in these strategies as well as more broadly within our fixed income and wealth management categories.

As Jay said earlier, given strength across several high-growth areas, including illiquid alternatives, wealth management and ESG strategies and excellent investment performance in many of our fundamental strategies, we are well-positioned for long-term organic growth and earnings growth and we are actively focusing our resources to support these areas.

Now turning to our financials. For the fourth quarter, adjusted EBITDA grew 5% to $200 million, driven primarily by stronger performance fees which offset lower contributions from certain quantitative strategies versus a year ago.

Adjusted EBITDA was impacted by approximately $30 million in costs related to the strategic repositioning initiatives mentioned previously.

Economic earnings per share of $4.52 included $0.68 of performance fees.

Turning to specific modeling items. Looking ahead in an effort to simplify our guidance, we plan to provide an estimated EBITDA range, along with an estimate of performance fees for the upcoming quarter. Given our increasing private markets carry opportunity, over time our performance fees will trend toward being less seasonal and more distributed throughout the year.

Based on current AUM levels, which reflect assets down 1% versus year-end, we expect Adjusted EBITDA in the first quarter to be between $215 million and $225 million, with performance fees ranging from $15 million to $25 million. Our share of interest expense was $19 million for the fourth quarter, and we expect a consistent level for the first quarter.

Our share of reported amortization and impairments was $162 million for the fourth quarter, including $98 million relating to equity method Affiliates. We expect this line item to return to more normalized levels in the first quarter of approximately $50 million.

Our effective GAAP and cash tax rates were not meaningful in the fourth quarter, primarily given the impact of amortization and impairments and the BlueMountain tax benefit. For modeling purposes, we expect our GAAP and cash tax rates to be approximately 25% and 20%, respectively, going forward.

Intangible-related deferred taxes were $32 million in the fourth quarter, and we expect intangible-related deferred taxes to return to more normalized levels in the first quarter of approximately $6 million.

Other economic items were $5 million for the fourth quarter and are expected to be $1 million in the first quarter. Our adjusted weighted average share count for the fourth quarter was 49.1 million, and we expect share count to be approximately 47.7 million for the first quarter.

And finally, turning to our balance sheet. Jay spoke earlier about the diversified nature of our business and the strong recurring cash flows that support our strategy to invest for future growth - including investing in new Affiliates, investing in existing Affiliates and investing in AMG to enhance the growth of our Affiliates. Through the strength of our balance sheet and cash flow generation, we have substantial resources and flexibility to execute on growth opportunities to generate shareholder returns over time.

We are disciplined in our approach to capital allocation as we seek to deploy resources to the areas of highest growth and return in our business before efficiently returning excess capital to our shareholders. We continue to maintain a prudent level of leverage and have repositioned our balance sheet over the last several quarters, extending duration while maintaining flexibility and capacity to capitalize on growth opportunities, even in challenging markets.

Over the course of 2019, we deployed approximately one-third of our available capital in growth investments, which included our new investment in Garda and incremental investments in existing Affiliates, including seed and coinvestment capital. We continued to manage our leverage levels, paying down the remaining balance on our revolver earlier in the year, and we then returned the remainder of our capital to shareholders through a dividend of $65 million and $360 million in share repurchases, including $110 million in the fourth quarter, which reduced our share count by nearly 8% year-over-year.

As we look forward to 2020 and shift our focus from repositioning toward future growth, we expect to allocate more of our capital to investments in our business while continuing to return capital to shareholders. In the first half of 2020, we expect share repurchases to be approximately $150 million to $200 million, subject to market conditions and transaction activity. We expect our quarterly dividend will remain at $0.32 per share as we prioritize allocating capital toward areas of higher growth and return.

And finally, given AMG's combination of distinctive independent Affiliates that are well-aligned with future client demand trends, our unique ability to make new investments that deliver both earnings and organic growth accretion, our stable cash flow profile and our flexible balance sheet, we are well-positioned to create long-term value for our shareholders.

With that, I'll open it up to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from the line of Bill Katz with Citi.

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

Maybe sort of kick off the questioning on the deal side. So both Jay and Tom, you've both mentioned a refocused more deal-oriented type of capital deployment. Can you talk a little bit about maybe where you see the greatest opportunity? Whether it be distribution side or product side? And then maybe a thought process on where your pricing is right now? We've seen some pretty elevated deals in the wealth management space. And then finally, the funding mix on that?

Jay C. Horgen - *Affiliated Managers Group, Inc. - CEO, President & Director*

Yes. Great. Good morning Bill, thank you for your question. Really glad you asked it since you've known us for a long time, and you know new investments is core to our strategy. And yes, I think you picked up that there is a focus on that and there's a growth opportunity. The short answer to your question is, we are dedicating significant resources to the effort. As you heard me say, our pipeline has gained momentum in recent months, and we're in advanced discussions with a number of high-quality prospects. We do expect to make new investments in the near term. We are focused on prospecting in areas of secular growth trends and client demand trends, as you would expect. Those areas include: private markets, multi-asset solutions, ESG, fixed income alternatives, emerging markets. And today, we have a pipeline that's representative of these areas.

One thing to note is, we don't necessarily need to do large deals. What's important is the growth potential of new prospects and AMG's ability to accelerate that growth. On your point regarding pricing, you're right, pricing in certain areas of the market is high, wealth management and illiquid businesses in particular. In other areas, [pricing has] (added by company after the call) come down pretty dramatically. We remain disciplined in structuring new investments to address future outcomes and align that with shareholder value creation.

Maybe stepping back for a minute. How are we positioned at AMG? That's worth noting. We're one of the very few firms that can execute transactions across the full life cycle of a business. From early transactions that provide growth capital through to succession-oriented solutions to support generational transition, which we've always been known for. As you know, we take a permanent partnership approach to preserve culture and independence. It allows us to scale without the cost of integration. We've built a reputation for being a successful partner; that takes decades. And through those decades, there have been opportunities for us to learn and adapt, both from our successes and our mistakes. We think we've built an outstanding reputation in the industry for addressing the needs of high-quality independent entrepreneurial firms that want to build enduring franchises. And as I mentioned, we continue to think about refining our structure and finding additional ways to support our Affiliates' growth which will let them achieve long-term success.

So taking all of that together, both the specifics as well as the positioning, we are bullish on our near-term pipeline and equally bullish on building AMG's position on being the partner of choice to independent firms over the long term. Thanks for your question.

Operator

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

Craig William Siegenthaler - *Crédit Suisse AG, Research Division - MD*

First, just on the strategic repositioning. If we back out the AUM from BlueMountain and Hartwell, that are no longer with AMG today, how much of the remaining AUM will remain at AMG Affiliates? And also, what is the EBITDA contribution from the remaining AUM in that bucket that still sits in AMG as of 1Q?

Jay C. Horgen - *Affiliated Managers Group, Inc. - CEO, President & Director*

Yes. Thanks, Craig, for your question. Maybe, Tom, you start

Thomas M. Wojcik - *Affiliated Managers Group, Inc. - CFO*

Sure. Thanks, Craig. So Jay talked on the call about a number of the strategic initiatives that we've taken, and that you just referenced, with respect to Affiliates both to better position their businesses for the future and also to enable AMG to more effectively allocate our resources going forward. So to take your question at a high level, we revised our disclosure on AUM and added the new strategic repositioning line item this quarter and removed $44 billion of assets that aren't going to be part of our reported AUM any further.

I think very importantly, and to your question, the financial contribution of these assets is not significant from an EBITDA perspective. It hasn't been historically and we don't expect it to be going forward.

As you noted, about half of that AUM is related to BlueMountain and J.M. Hartwell, and the remaining portion really relates to Affiliates where we're continuing to work with those Affiliates to reposition their business and to appropriately realign incentives. The arrangements we're working on with them, are not only designed to help better position those Affiliates, but also to enable us to allocate our time and resources at the AMG level toward areas of growth in our business and also maintain optionality and upside for shareholders on those businesses. So to your question, the remaining AUM is still with us right now. And as we work through those agreements, ultimately, we'll see how that transpires over time.

I'd say, lastly, before I turn it over to Jay, this change results in a reported AUM number that better reflects the assets to which we're actively dedicating AMG time and capital and the strategies that we expect to contribute to AMG's economics on a go-forward basis.

Jay C. Horgen - *Affiliated Managers Group, Inc. - CEO, President & Director*

Yes. Thanks, Tom. That was a good summary Craig, maybe I'll even take it at a higher level. This work that we're doing is rooted in strategic initiatives that we took in 2019 and also to reposition ourselves towards these growth opportunities that Tom mentioned. At the highest level, we invest in successful growing firms with entrepreneurial management teams that want to remain independent. As you know, our structure preserves independence and culture. Our guiding principle of aligning interest, informs everything we do from the time of investment and thereafter. But naturally, all partnerships evolve. The vast majority of our Affiliate partnerships have endured across generations and continue to endure. In the context of evolving circumstances, we collaborate with our Affiliates that are facing headwinds; we try to help them position their businesses, consider alternatives, try to achieve the best outcomes for their clients, their partners, our shareholders, and that's what we did with BlueMountain and Hartwell.

In other cases, the alternatives may be different. As you may recall, at the beginning of last year, we helped Trilogy and GW&K partner, and that combination has worked very well. Trilogy's products have grown within the GW&K system.

But importantly, to land the point, this is not a change in our strategy. We continue to adhere to the permanent partnership approach. And finally, it's just worth saying that we spent a lot of time in 2019 on these efforts, but as we look to 2020, we expect to spend more of our time and our resources on growth opportunities, as I discussed in the prepared remarks: new investments, Affiliates positioned for growth and our centralized services.

Operator

Our next question comes from the line of Chris Shutler with William Blair.

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

Could you talk about the growing opportunity with some of your private equity Affiliates, both in terms of the magnitude of any unrealized carry and timing of when that could start showing up in the numbers?

Jay C. Horgen - *Affiliated Managers Group, Inc. - CEO, President & Director*

Yes. Let me have Tom take that one. It's a good opportunity for us, the performance fees and realized carry that comes from private equity, but maybe we'll take it -- the growth that we've experienced in that duration.

Thomas M. Wojcik - *Affiliated Managers Group, Inc. - CFO*

Yes. So Chris, thanks for your question. So if you take a step back and think about our illiquid book overall, we've now got about $100 billion in AUM across our Affiliates, primarily at Pantheon, EIG and Baring Asia. Those businesses have generated around $20 billion in flows over the course of the last couple of years and are now generating close to 20% of our overall run-rate EBITDA. To your point on performance fees, we did recognize some carry from Pantheon earlier this year, as you may recall. And over time, as those businesses season and the funds that they have on the ground season, we do see a growing opportunity for us to realize performance fees. Importantly, we recognize performance fees on method one, so really only as they're earned - so we're not marking to market in the context of our financial results, we're only taking those as they're earned.

The other point I'd make is, as we've shifted our guidance a bit on performance fees now going forward versus what we've done historically, part of that is in recognition of the fact that over time, as that carry opportunity continues to grow, we'll have slightly less seasonality in our performance fees, and you'll start to see results distributed a little bit more throughout the year as we realize carry.

Operator

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

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

So a couple of questions on the strategic repositioning. How many Affiliates are part of that excluding the two you've mentioned? And going forward, are you anticipating for this line item, to still be reported with go-forward metrics in it? Or is this kind of, as you said in 2019, [a one-time] (corrected by company after the call) type of restructuring, and going forward, we won't see it? And then lastly, just from a forward guidance perspective, should we expect to get just, on a quarterly basis, next quarter's EBITDA and performance fee contribution? That's what you're going to now in terms of your consistent guidance?

Jay C. Horgen - *Affiliated Managers Group, Inc. - CEO, President & Director*

Yes. Thanks, Dan, and thank you for joining us early. I know it's very early on the West Coast after Super Bowl Sunday.

To your point -- and I'll let Tom answer part of your question. Given that the strategic initiatives really were born in the 2019 period, and most of the work is well on its way to help these Affiliates, we do not expect to see this line item reappear. This, we believe, is taking out those assets that are not material to AMG and that's part of what we want to land on the message here.

Maybe, Tom will take the second and third part of the question.

Thomas M. Wojcik - *Affiliated Managers Group, Inc. - CFO*

Sure. So I think just with respect to the names that are in there, as you can probably appreciate, we're still in ongoing dialogue with a lot of those Affiliates. And at this point, it really wouldn't be appropriate to go into further color. But as Jay said, they tend to be smaller Affiliates. And very importantly, as we've mentioned a couple of times that aren't really contributing in any significant way to our economics.

On your EBITDA guidance question, I think where we stand today, we'd like to give you color on the period immediately ahead - a quarter ahead. We also gave you some half year guidance in terms of capital allocation. And I think for the time being that, that's kind of what we feel most comfortable providing.

Operator

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

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

Maybe just on the flows, I know you guys mentioned there was some year-end activity that we've seen across the industry. But I just wanted to see if you can provide any color around that? And then just on the strategic repositioning, of that $44 billion, has that been a big driver of some of the outflows over the past few quarters? Just wanted to try to quantify that, if it was material or not?

Thomas M. Wojcik - *Affiliated Managers Group, Inc. - CFO*

Thanks, Mike. Let me try and hit a couple of different parts of your question there. So with respect to the fourth quarter seasonality, we see seasonality in two areas of our business: first, on tax loss harvesting on the mutual fund side; and then we also have some alternative names that tend to have windows for liquidity in the fourth quarter. Overall, it wasn't a huge contributor. This is sort of what I would call more of a normalized seasonal quarter.

If you recall, the fourth quarter of 2018 was quite an outsized seasonal quarter for the industry. This is more normalized, so you can think kind of probably a couple-few billion across different strategies. With respect to the AUM that we've taken out via strategic repositioning, there are some areas there --where businesses have gotten smaller over time, whether that's been performance-driven or flow-driven. We did see some outflows there over the course of the year, but I wouldn't point to it as being anything materially outsized. I think it's just a book that ultimately hasn't really been contributing and won't on an EBITDA basis. And we're better trying to reflect for you what the economic profile of AMG looks like and tying that a little more closely to AUM.

Jay C. Horgen - *Affiliated Managers Group, Inc. - CEO, President & Director*

Yes. And just to punctuate that the large majority of our flows has been driven by quantitative strategies. I think everyone is aware of that. So while there is a materiality to this AUM, which is not material, the change in flows is not a noticeable amount.

Thomas M. Wojcik - *Affiliated Managers Group, Inc. - CFO*

Right.

Operator

Our next question comes from the line of Patrick Davitt with Bernstein (sic) [Autonomous Research LLP].

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

Perhaps more broadly on flows to that last question. Do you think there's a path to inflow this year when you look at the pool of AUM outflowing against the pool of AUM inflowing? And what do you see as the key lever in getting you there, if so?

Thomas M. Wojcik - *Affiliated Managers Group, Inc. - CFO*

Patrick, why don't I start, and then maybe Jay can share some color as well. Thanks for your question. So we spent a lot of time in our prepared remarks talking about our strategy. And really importantly, our strategy is all about driving long-term earnings growth. When you look at our existing Affiliates, we feel very good about the combination of their positioning against long-term client demand trends and where those products can live and add to client portfolios as well as their long-term performance track record. So when we think about the organic growth profile of our existing Affiliate base over the long term, we continue to be very bullish. We're also confident that as we add new investments, we'll continue to add new Affiliates that also have substantial organic growth potential and can act as an accelerant to our organic growth overall.

In the near term, as you know, we continue to have some performance challenges on the quant side. And as Jay just mentioned, that's where we've really seen headwinds in recent flows. And as those performance challenges are addressed, we do expect to see continued near-term pressure from a flow perspective in that area. Importantly though, those areas are now really contributing less than 10% of our EBITDA on a run-rate basis. So while we're seeing it in our flow profile, the impact on our earnings is significantly less. I'd also note that at the same time, we're seeing significant positives in our business in areas that are contributing a much greater amount to our EBITDA, and Jay referenced a number of these, but I'll recap them. First, our illiquid alternatives Affiliates are benefiting from record allocations in the industry and very strong fundraising at our Affiliates. On the wealth management side, we have sticky assets that are contributing to a stable and growing earnings streams. Jay referenced ESG, where we've seen some strong fundraising and where we think we've got some opportunities going forward. And we've got very strong performance in our fundamental managers.

So to recap, I think in the short term, we will still see some quant headwinds. But over the long term, we're very, very bullish, both on our organic growth prospects, but perhaps more importantly, on our earnings growth prospects.

Jay C. Horgen - *Affiliated Managers Group, Inc. - CEO, President & Director*

Yes. Again, not to belabor the point, Patrick. I think it is a nuanced thing that you have to digest. We're in this period where we are having outflows, but the impact to our EBITDA is muted. And so you very well could see a scenario where -- and if you look at the guidance for the first quarter where base before performance fee EBITDA is flat and going back up, even in the context of moderating, but still outflows.

So I think you're going to have to watch that if you're an analyst and try to digest what that means.

Operator

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

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

Just kind of curious, in all the restructuring and the initiatives that took place last year, just -- maybe dig down inside a little bit. I'm just curious how much of that may have included kind of rethinking the detailed strategy versus kind of more broadly targeting institutional investors. I don't know if that was part of it because -- why don't I leave that as the first question.

Thomas M. Wojcik - *Affiliated Managers Group, Inc. - CFO*

Thanks, Rob. Why don't I maybe give you a little bit of just detail on the numbers, and then Jay can give you a little bit more detail on some of the strategic actions we've taken.

As I mentioned, we had one-time costs that impacted EBITDA of about $30 million in the quarter. That was across both AMG and certain of our margin-based Affiliates and was really primarily related to resource repositioning, footprint rationalization, and I think some of the changes that you mentioned impacted, in particular, the resource reallocation side of that.

Collectively, we think these initiatives will free up about $50 million of capital annually, both to offset revenue declines and enable reallocation to higher growth areas, and we expect to recognize the benefits of that in future periods. A lot of that reallocation, as we talked about last quarter, as we talked about in our prepared remarks this quarter, is coming at the AMG level, and Jay will talk a little bit about where some of that is impacting us.

Importantly, also, the Q1 EBITDA guidance that we provided, does include the impact of these actions. So you should think about that as a clean number as it relates to the overall earnings power of the business going forward. And I guess I'd just land on, I wouldn't look at the $50 million as dollars that dropped directly to the bottom line as much as I would think about it as dollars that are helping to stabilize margins at certain Affiliates, and then capital that we're reallocating toward growth areas at the AMG level.

Jay C. Horgen - *Affiliated Managers Group, Inc. - CEO, President & Director*

Yes. And thanks, Tom, that was a really good summary. And Rob, it's a good question.

Let me just recap a bit here because I know a lot went on in 2019. Obviously, we went through a management transition and succession, as I mentioned. We did some reallocation at the AMG level to pivot towards growth. That includes not only capital but resources and people and time and effort. Some of our margin-based Affiliates took the opportunity to offset revenue declines. We worked with certain of our Affiliates that we're facing headwinds, and we talked about that.

We've rotated to growth, and that's really the story for 2020; looking for new investments to be a driver, also existing Affiliates positioned for growth and investing in those Affiliates. We mentioned our seed capital program, but we are also investing directly with those Affiliates and in those Affiliates, and then finding ways to help those Affiliates grow at the AMG level.

The specific actions that we took at AMG, and Tom mentioned the cost number that went through our financials and the savings in total, but just to put a finer point on it, we freed up about $25 million of capital and resources at AMG. We've done a few things. We repositioned our global distribution resources to focus on clients that represent the largest opportunities for our Affiliates. We're dedicating more resources to the largest asset owners and intermediaries. We've added resources to distribution on illiquid products to LPs globally.

With respect to our U.S. retail platform, we've focused our sales efforts on the most attractive product areas. We've rightsized the fund family and related infrastructure. We've reshaped noncore and unprofitable operating activities. For example, we are outsourcing and have a strategic relationship now with ACA, a leading provider of legal and compliance services that allows our Affiliates a greater breadth, but also lower costs.

And finally, we've just reduced our global footprint, including selective headcount reduction, we've consolidated offices, and we've closed some of our smaller satellite offices. So when you take all this together, we're trying to get through 2019 and towards growth in 2020 and the opportunities ahead.

Operator

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

Ryan Peter Bailey - *Goldman Sachs Group Inc., Research Division - Associate*

This is actually Ryan Bailey filling in for Alex. This is a bit of a multi-part question. But over the next 12 months, when you think about some of your uses of capital, can you give us a sense of what, if any, contractual direct investments or equity stake increases you'll be making? And in which types of Affiliates those would be in? And then would there be any incremental discretionary equity stake purchases on top of this?

Thomas M. Wojcik - *Affiliated Managers Group, Inc. - CFO*

Thanks for your question. So let me kind of take that at a high level, and then I'll try and address some of the specifics as well. Everything that you've asked about really fits squarely in the center of our overall capital allocation strategy. And our capital allocation strategy is ultimately what's fueling our overall growth strategy.

So I think, first and foremost, we're focused on investing for the future growth of our business, and then efficiently returning excess capital to our shareholders. As we mentioned on the call in our remarks earlier, there are really 3 primary areas: first, through new investments, that enable us to gain exposure to the fastest-growing segments of the market where we think we're going to see both earnings accretion as well as organic growth accretion. And we do firmly believe that new investments when priced and structured appropriately, represent the highest and best use of our capital. And Jay gave you a lot of color on that earlier.

With respect to existing Affiliates, at these firms, we're looking to help them evolve their businesses to capitalize on client demand trends. We're investing in them through seed and co-investments. We're providing expertise on lift-outs and product development. And to your point, in line with some of our past investments, we're also investing in the equity of these businesses, and we are in the succession business, and we're working through that as well.

And then lastly, we're investing in some of the high-value centralized capabilities that exist at AMG and looking to reallocate our resources there to try and deliver that expertise in the best way we can to our Affiliates to drive returns. After we make those investments in future growth, we will continue to return excess capital to our shareholders through a combination of repurchases and dividends as we have historically.

I guess I'd just end by saying, look, we take a very focused and disciplined approach to allocating our capital. Every dollar we spend needs to generate an appropriate risk-adjusted return. And we're going to continue to focus on allocating capital to the highest growth areas that we have, where there are significant return opportunities, and we'll hold ourselves to a very high standard when we make those investments.

Jay C. Horgen - *Affiliated Managers Group, Inc. - CEO, President & Director*

Let me just add two points, and I'll try to get specifically to your question. The first, though, at the highest level, we're managing our business for growth over the long term. We obviously maintain a capital structure in doing that. We want to be prudent in that capital structure as well. So we've historically [operated at a] (corrected by company after the call) 2x debt to EBITDA, which is kind of where we are today. So we're not overlevered or underlevered, but it's appropriate and prudent. We want to make sure that you realize that the goal is to allocate our capital that comes from our business into these highest growth areas, both growth and return. And if we find those growth opportunities in our business, we will invest in them. And then we'll deliver capital to shareholders through repurchases, as Tom said.

As it relates specifically to your question, with some Affiliates as part of the original agreement, we do have repurchase obligations over time. With that, we actually get cash flow. It looks a lot like a repurchase of equity, similarly priced to where the equity is today. Those hang off of long-duration incentive structures, typically 15 years. We tend to own more of our winners, which is the right way to think about it, as they grow and, obviously, over the longest term, we have to make sure that the incentives in the business are refreshed and aligned. But we do so, as Tom said, underneath our discipline of capital allocation.

Operator

Our final question is a follow-up from Bill Katz with Citi.

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

Okay. Just a couple, if you don't mind. So first one, just want to make sure, on the EBITDA guidance, the $215 million to $225 million range is pre-performance fees, which I think is the case. And then just sort of stepping back, Jay, it's sort of a question for you as you sort of reposition the footprint and more focus on things such as illiquids, what is your appetite to migrate to a DE type of earnings release, type of methodology similar to like a Blackstone or KKR, et cetera? And is it possible to give us what the net accrued carry was at the end of the year versus maybe a year ago? Just trying to size what the performance fees might be for this year?

Jay C. Horgen - *Affiliated Managers Group, Inc. - CEO, President & Director*

You want to take the first part of that?

Thomas M. Wojcik - *Affiliated Managers Group, Inc. - CFO*

Sure. There's a few questions in there. Thank you, Bill. So Bill, on the EBITDA piece, the $215 million to $225 million does include performance fees. So it is inclusive of performance fees.

Jay C. Horgen - *Affiliated Managers Group, Inc. - CEO, President & Director*

Yes. And then you're right, we are positioning our business for growth. And certainly, the growth comes from additional new investments, but also the growth of our existing Affiliates, and as we've established on this call, the pieces of our business that are growing, perhaps the fastest are the private markets and the wealth management areas, but also certain of our alternatives like relative value fixed income and other parts of our business. So there are a number of growth areas. We like to think that the diversification across all these asset classes, both the secular demand trends, and also the cyclicality of these businesses is really a valuable aspect of why you're investing in AMG. We are diversified investment in active; structured appropriately for shareholder value. There may come a time where the world migrates to all private markets. And at that point, clearly, we have to think about the disclosure looking probably more like our PE competitors. I think we can selectively consider over time, some of these disclosure items that you mentioned, and think that, that's helpful as an increase in magnitude in our business. But for today, we are a diversified group of Affiliates with lots of opportunities across all of our Affiliates, and including even the systematic businesses, which are going through a cyclical moment at this point. So that is a valuable aspect of our business.

On the carry opportunity, it is increasing. It is up year-over-year. We do report on method one. And as you know, we have a number of Affiliates that are delayed reporting by one quarter. So we do have some visibility on this, which gives us some confidence as we look out each quarter and give you that guidance.

I think we're not ready to produce the accrued but not realized carry number, but that's something we will consider in the future.

Operator

We have reached the end of our question-and-answer session. I'd like to turn the call back over to Mr. Horgen for any closing remarks.

Jay C. Horgen - *Affiliated Managers Group, Inc. - CEO, President & Director*

Thank you all again for joining us this morning. As you heard, we are focused on our growth opportunities as we execute on our strategy, and at all times, we'll maintain discipline in allocating our capital to maximize shareholder returns over the long term. We look forward to speaking with you next quarter.

Operator

Thank you. This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation, and have a wonderful day.