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AMG - Q2 2018 Affiliated Managers Group Inc Earnings Call

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OVERVIEW:

Co. reported 2Q18 economic net income of $195.6m, GAAP EPS of $2.16 and economic EPS of $3.61.

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PRESENTATION

Operator

Greetings, and welcome to the AMG Second Quarter 2018 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Ms. Selene Oh, Vice President, Investor Relations for AMG. Thank you, you may begin.

Selene Oh

Thank you for joining AMG to discuss the results for the second quarter of 2018. In this conference call, certain matters discussed will constitute forward-looking statements. Actual results could differ materially from those projected due to a number of factors, including, but not limited to those referenced in the company's Form 10-K and other filings we make with the SEC from time to time. We assume no obligation to update any forward-looking statements made during the call.

AMG will provide on the Investor Relations section of its website, at www.amg.com. A replay of the call and a copy of our announcement of our results for the quarter as well as a reconciliation of any non-GAAP financial measures to the most directly comparable GAAP financial measures, including a reconciliation of any estimates of the company's Economic earnings per share for future periods that are announced on this call.

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

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

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

Thanks, Selene, good morning, everyone. AMG generated strong results in the second quarter with positive net client cash flow of $4.3 billion and a year-over-year growth of 8% in Economic earnings per share.

Our results reflect the strength of our strategic position in attractive areas of alternatives and active global equities and ongoing significant client demand for our Affiliates' broad range of distinctive return streams, especially in these areas.

At the highest level, we are pleased with our organic growth as we generated continued strong gross sales and returned to an overall more normal level of redemptions. While still early in the third quarter, we are off to a good start so far with positive flows and the level of activity at all stages of the sale cycle remains very high across AMG's and our Affiliates' business development teams. We are seeing this across won-but-unfunded mandates, finals and RFPs.

In terms of second quarter flows across our product categories, we saw continued strong demand for alternatives with $2.6 billion in positive net flows. We generated record sales in global equities during the quarter, resulting in $1.9 billion in net flows, while U.S. equities had one of its best quarters in years on a net basis with only modest outflows. Finally, we continued to see positive flows in our multi-asset and other category as some newer products are starting to gain traction.

Turning to our quarterly flows by distribution channel, we sawsignificant strength within institutional, producing our best quarter in the last three years with $5.3 billion in net flows and sales well-diversified across product categories.

Our institutional flows were also well diversified by geography with sales in each of our coverage regions. In the retail channel, we reported net outflows of $0.5 billion, and while we saw weakness in our liquid alternatives, this was mostly offset by strong sales in global equities. In terms of subcategories within the retail channel, we had good traction in the sub-advisory and certain non-U. S. regions.

Finally, in the high-net-worth channel, we reported modest outflows of $0.5 billion, which we believe were driven primarily by a few SMA model changes, but otherwise the underlying demand trends remain in place.

One final point relative to flows in the quarter. We were pleased to see a very diverse group of product types in Affiliates contributing significantly, as we saw strong sales across AQR, Capula, EIG, Pantheon, and Systematica within our alternatives segment; while Artemis, Harding Loevner, TimesSquare and Veritas were notable contributors within our global equity segment.

As I said, we're off to a strong start for the second half of the year and now let me also spend a minute on why we are very confident about our long-term organic growth prospects.

First and most importantly, it begins with our Affiliates' outstanding long-term track records of investment performance in areas where we continue to see secular client demand trends, including global equities and liquid and illiquid alternatives. Fundamentally, many of our Affiliates' largest and most significant products continue to build on excellent and distinctive track records.

Second, we and our Affiliates are innovating and developing new products, which is, of course, critically important to match evolving client needs. Examples are many and diverse, and would include AQR beginning to build a fixed income franchise or a U.S. equity manager such as TimesSquare launching an international and now emerging markets franchise, or GW&K's evolving from a great muni bond manager to a successful U.S. and now an international equity manager. Artemis in particular has a very successful model of leveraging their U.K. retail brand across a series of new products -- homegrown and through lift outs.

Third, we have a unique distribution strategy that combines the focused distribution resources at each of our Affiliates with the leverageable scope and scale of AMG's global distribution platforms -- and our continuous evolution and improvement of those platforms. This includes coverage of geographies and channels, but also product packaging and operational expertise.

As you have heard us say, this distribution strategy is increasingly effective as leading clients worldwide and the intermediaries who serve them are consolidating their relationships with external managers and looking for more effective relationships and even partnerships with a smaller universe of investment management firms.

One product area we have highlighted recently that pulls all three of these elements together is our growing franchise in illiquid alternatives across Affiliates such as Baring Asia, EIG and Pantheon. First, each of these Affiliates produces distinctive return streams in their flagship products. Second, we and they have been working to innovate and develop additional products such as the infrastructure, real asset, and credit strategies at Pantheon; the Asia credit and real estate products at Baring Asia; and credit, direct lending, and operating energy capabilities at EIG. Third, we and they have been working together to diversify their distribution opportunities and bring their expanding product sets to the most appropriate pools of capital worldwide.

Expanding on that last point about distribution capabilities, we continue to leverage AMG's scale in working with our Affiliates to bring their differentiated strategies to sophisticated clients and intermediaries around the world. As you know, we have been successful in strategically and deliberately building out our global distribution capabilities over the past dozen years -- first in Australia, then expanding to the Middle East, Europe and parts of Asia -- and offering clients an array of distinctive return streams, managed by best-in-class boutique firms. As we mentioned on recent calls, we are extending our Asian coverage to Japan. We are opening our office in close cooperation with Pantheon, which recently opened their Tokyo office and we are in the planning stages with certain other Affiliates.

Given the array of relationships we and our Affiliates have been establishing with some the largest and most important clients and intermediaries in Japan, we see tremendous growth opportunities building on our early wins and we look forward to updating you more in the quarters to come.

Putting together the three elements I highlighted earlier, first, Affiliate investment performance, second, continued innovation and product development and third, a unique collaborative distribution strategy -- our growth prospects look very good and that is just speaking about our existing Affiliates.

In addition, AMG's business strategy provides a unique opportunity to generate incremental earnings growth, and product diversification, through accretive investments in new Affiliates. Given our outstanding track record spanning more than two decades, AMG is the partner of choice for boutique firms around the world, both traditional and alternative, which seek a permanent strategic partner.

We have an outstanding secular opportunity here, and while the pace of activity is inherently based on the dynamics of each prospective Affiliate, we continue to make good progress across a range of potential new investments. As always, we remain very disciplined and highly selective.

Given the scale of our recurring free cash flow generation, we are able to execute this element of our growth strategy while also consistently returning capital to shareholders, through both our regular cash dividends as well as ongoing and increasing share repurchases, as our earnings grow. As Jay will discuss further in a moment, we demonstrated the disciplined approach to capital again last quarter.

Looking ahead, we are very confident in our ability to continue to enhance the quality, diversity and earnings power of our business and generate outstanding long-term shareholder value. Through our unique business model, we offer the focused expertise of specialist managers along with the scale and resources of a global asset management franchise. Combined with a 25 year track record of deploying the cash flow generated by our business to create shareholder value.

And with that, I'll turn it to Jay to discuss our results in more detail.

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

Thank you, Nate, and good morning. AMG generated strong organic growth for the second quarter with $4.3 billion in net client cash flows across a broad array of alternative and active global equity strategy.

As Nate described, we feel good about our improving organic growth profile and looking forward, we are off to a good start in the second half of the year with positive flows in July-to-date and a strong pipeline of won but unfunded mandates.

Now turning to the details for the quarter, I am going to describe our business trends within each product category with a focus on both flows and market performance through June, and given that this is the first time for me to review our business trends, the flow and format may be a little different and will evolve over time. I look forward to your feedback, as we continue to enhance our disclosure.

Starting with alternatives, which account for 39% of our AUM, we had another good quarter of organic growth and saw meaningful positive contributions from both our liquid and illiquid products set totaling $2.6 billion in net flows for the quarter. Focusing on illiquids for a moment, we had a solid level of fundings in the second quarter, but in July, we generated more commitments in this category than all of the second quarter.

Beyond illiquids, consistent with recent trends, the systematic diversified category continues to be challenged; however, we have experienced good flows within multi-strat as well as the fixed income and equity relative value categories.

Now turning to our selected benchmarks by alternative category. Within systematic diversified, which accounts for 5% of our AUM, our selected industry benchmark continued to move lower with the SG Trend Index down -1.3% for the quarter and -5.2% year-to-date. However, most of our products in this category maintained good relative performance.

Within fixed income and equity relative value, which accounts for 9% of our AUM, our selected industry benchmarks were modestly positive with HFRI Relative Value up 1.1% for the quarter and 1.5% year-to-date and HFRI Equity Hedge up 0.9% for the quarter and 1.2% year-to-date. And finally, the HFRI Activist Index was up 4.8% for the quarter and 2.4% year-to-date. While our benchmarks remain modestly positive, generally, we have seen mixed relative performance in this category; however, we have seen strong relative performance from our Event driven strategies.

Now turning to multi-strat and other, which accounts for 15% of our AUM, our selected industry benchmark was modestly positive with the HFRI Fund Weighted Composite up 0.8% for both the second quarter and year-to-date. Against this backdrop, our performance has been mixed for both the quarter and year-to-date.

Next, turning to our private equity and real assets category which accounts for 10% of our AUM and includes strategies such as global and regional private equity, co-investments, credit, real assets, infrastructure and real estate. Our Affiliates maintain strong, long-term track records and the pace of product innovation and extensions in this category has led to even greater growth in our business.

Next, turning to global equities, which account for 34% of our AUM, we saw net inflows of $1.9 billion in the quarter, driven by retail sales, including a number of sub-advisory wins as well as strong momentum in institutional sales with a significant improvement in redemption levels. Selected industry benchmarks in the category were mixed with the MSCI World up 1.9% for the quarter and 0.8% year-to-date. While the MSCI EAFE was down 1% for the quarter and 2.4% year-to-date and MSCI Emerging Markets was down 7.9% for the quarter and 6.5% year-to-date.

In U.S. equities, which account for 14% of our AUM, we reported outflows of $400 million, and while negative overall, we had a good institutional flow quarter with a number of wins and continue to see pockets of ongoing opportunity.

While industry trends continue to be challenged in U.S. equities, our overall redemptions have been improving over time. Selected industry benchmarks were positive with the S&P 500 up 3.4% for the quarter and 2.6% year-to-date and the Russell 2000 up 7.8% for the quarter and 7.7% year-to-date.

Finally, in multi-asset and other, which account for 13% of our AUM and encompasses multi-asset and balanced mandates within our wealth management business, as well as a number of specialty fixed income and multi-asset products, we had a slightly positive quarter producing net flows of $200 million. While we saw some weakness with our legacy fixed income products, our wealth management Affiliates continued to generate positive flows and we are seeing good momentum in new products including systematic fixed income.

Before turning to the financials, I wanted to reiterate that we are pleased with our improving organic growth profile as we and our Affiliates are realizing the benefits of new products, new packaging, and new geographies.

Now turning to our financials. As you saw in the release, we reported Economic earnings per share of $3.61 for the second quarter, which included net performance fees of $0.10. On a GAAP basis, we reported earnings per share of $2.16.

For the second quarter, aggregate fees grew 5% to $1.3 billion from a year ago, driven by positive markets and organic growth in alternatives. The ratio of aggregate fees to average assets under management declined modestly year-over-year from 64 basis points to 62 basis points, which was driven in part by timing differences between AUM and revenue recognition as well as changes in the composition of our AUM.

Adjusted EBITDA decreased 3% to $246.2 million from a year ago reflecting lower at "other income" from realized and unrealized gains, modestly lower net performance fees, and the impact of investments, which position our business for long-term growth.

Economic net income grew 4% to $195.6 million from a year ago, reflecting lower interest expense and a lower tax rate; while Economic earnings per share grew 8% to $3.61 given lower year-over-year share count due to repurchase activity.

Turning to more specific modeling items, for the second quarter, the ratio of adjusted EBITDA to average assets under management was 11.9 basis points or 11.5 basis points excluding performance fees.

Looking ahead, we expect adjusted EBITDA to average assets under management to be approximately 11.3 basis points in the third quarter, reflecting seasonally lower performance fees and continued investment in product development and distribution capabilities.

Our share of interest expense was $21.4 million for the second quarter. In the third quarter, we expect our share of interest expense to remain at approximately $21 million.

Our share of reported amortization and impairments was $74.4 million for the second quarter including $56.8 million from Affiliates accounted for under the "equity method" which was elevated primarily due to a non-cash impairment charge of $33 million related to Ivory. While this non-cash charge reduced our carrying value to zero, the economic impact was far less at roughly $1 million in EBITDA per quarter. Looking ahead to the third quarter, we expect our share of reported amortization to return to a normalized level of $41 million.

Turning to our taxes. With regard to our tax rate in the second quarter, our effective GAAP tax rate was 21.3% and our cash tax rate was 18.1%, which was lower due to adjustments related to U.S. tax reform and we expect these rates to normalize on a full year basis. Looking forward, we expect our GAAP tax rate to be approximately 25% and our cash tax rate to be approximately 20%.

Intangible related deferred taxes were $4.7 million, which was lower in the quarter given the level of amortization and impairments. For the third quarter, we expect intangible related deferred taxes to return to approximately $12 million, as our amortization normalizes.

Other economic items were negative $0.5 million for the second quarter, for modeling purposes, we expect our other economic items to be approximately $1 million per quarter.

Our adjusted weighted average share count for the second quarter was 54.2 million and we expect it to be approximately 53.5 million for the third quarter, reflecting a continued level of repurchases, and we now expect our adjusted weighted average share count for the full year to be approximately 53.9 million.

Turning to our balance sheet in the second quarter, we paid a $0.30 dividend per share and we repurchased $150 million in shares. Looking to the second half of the year, we expect to repurchase between $200 million and $300 million depending on the level of new investment activity.

Looking ahead, we are confident in our ability to generate outstanding long-term shareholder value through both the organic growth of our global asset management business as well as the deployment of capital into accretive investments and outstanding new Affiliates, while also consistently returning capital to shareholders.

Now we'll be happy to answer your questions.

QUESTIONS AND ANSWERS

Operator

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

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

So just coming back to flows for a moment, it's a bit of a differentiated update versus some of your peers that were out last week. How much of this might be cyclical in terms of some of the product gains, that you've been out there on the alternative side? And how much of it do you think is a little more structural, just given it sort of ended with new products, expanded opportunity, expanded geographies et cetera? And how do you, sort of, think about that beyond the third quarter, just looking at maybe the second half of the year and even 2019?

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

Simply put, much of it is using the framework you set up, so I think much of it is structural and therefore, sustainable. And on some level, there is really nothing all that different or new from the way we have been talking about overall levels of gross sales. If you look over the last 1-1.5 years, our gross sales have been pretty good. And then, the question then is, well okay, so why? And we covered much of this in our prepared remarks, but as I said, it starts with the distinctive track records that our Affiliates are producing and these are great institutional brands, these Affiliates. I think of things in global equities like Harding Loevner or Veritas, and in liquid alternatives we're talking about brands like AQR or Capula or Winton and in the illiquids, which we highlighted in the prepared remarks, it's brands like Pantheon, Baring and EIG. And I use that word brand because, as we talked about, these are franchises that are growing and expanding, and we talk about it as product innovation but it's really doing a better and better job matching the capabilities of the firms with the evolving client needs across channels and geographies. And so, a layer down if youstep back, we had sales in something like 400 products in the quarter and a bunch of those are products we didn't have 5 years ago --and that includes some of the fastest-growing ones. Now, as you said, some of that will have cycles to it, especially where there is something that's got a fundraising cycle to it or where there is a product that is exploiting a specific opportunity that one of our Affiliates sees, but in the main, that overall wave of product development and evolution is the most important theme. And then again, just to make sure everybody's tracking, for us, product development happens some at the Affiliate, of course just Affiliates alone, it also happens us jointly with Affiliates -- and this is something that we are still at the early stages of because we are getting better and better at bringing the market knowledge that we have back to the Affiliates. Back to leveraging our scope and scale, as we always have, we have this unique ability to add proven, well-performing products, distinctive products through our new investment efforts. So we have all of those product development engines. As we said in our prepared remarks, it's not just product development that way and innovation but it's also the packaging and distribution capabilities, extensions and wrappers, and some of it is simply bringing products to new geographies and channels. While we talked about the opening of Tokyo here, it is important to note that over the last couple of years, we've been adding resources in Europe, a little bit in the Middle East and a little bit in Asia, as we're doing some channel extensions in places like that. We've also been making some modest investments in packaging capabilities and here, I would highlight things like the Pantheon 40 Act fund which is something that is public and so we can talk about it. When we put all of these together, the performance, the brands, the innovation and this distribution strategy, absolutely, we think those are the things that have been showing up in gross sales and will continue to drive gross sales going forward.

Operator

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

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

I guess Jay, could you kind of update us on the outlook as we think about performance fees into the back half of the year? And just kind of the benchmarks versus your guidance from earlier in the year in terms of where we sit?

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

Yes. I'll take this in 2 pieces. I'll talk about the third quarter and then the rest of the year. First, as I said in the prepared remarks, we're off to a good start, we've seen positive markets and positive flows in July so far. Our current blend across all categories is up 1.5%, that includes FX as well. That's from a base of $824 billion, which you can see in the June 30 numbers, so we're up in July, which should give us a little bit of a lift in the quarter and for the year. When we turned to the third quarter, I gave some guidance in the call around our EBITDA at average AUM of 11.3 basis points, which is slightly lower than where we came in this quarter. And I just want to remind everyone, our third quarter is a typically seasonally low point for us, both EBITDA and earnings, primarily given the population of performance fee contracts that crystallize in the third quarter, they're very low, that population. As a result, we're only expecting $0.01 or $0.02 in the third quarter. So that's in there, obviously we continued, as you heard from Nate to make investments in the business, including new products and new capabilities, that's all reflected in the 11.3 basis points. And then looking beyond the third quarter to the fourth and staying on performance fees for a moment -- and I'll just maybe take the perspective of a full year and then I'll narrow it to the fourth quarter. Given the benchmarks that I've mentioned in my prepared remarks in the alternative category primarily, most of those benchmarks are modestly positive, so really, the comment I'm about to make is more about the overall benchmarks because our relative performance is pretty good with the exception of the continuing, challenging environment for systematic diversified. So really, relative performance is good, benchmarks are modest and I think when you factor all of that together and you think about where we are in the year, we are now tracking closer to about $1.30 for the whole year in performance fees, and of course there's a range around that. We've already booked $0.50 in the first half, I mentioned $0.01 or $0.02 in the third quarter, so that leaves about $0.80 in the fourth quarter. This is a conservative estimate and we're just in July -- we've had many environments where the third and fourth quarter bring about lots of performance fees. So I just wanted to point that out. Still feeling pretty good about the prospects for performance fees beyond '18, just given the relative long-term performance of our alternative products. Then finally on capital deployment and maybe I'll even touch a little bit on '19 here. As you think about what we've said, we continue to repurchase shares at a reasonably high level, $200 million to $300 million in the second half of the year. We've already done $300 million in the first half. That's brought our weighted average share count down quite a bit. We expect the weighted average share count for the year to breakthrough 54 million and when we look at the year-end share count, we're seeing it below 53 million, just a touch below 53 million. So that is a pretty good setup, going into next year because we started this year at 57 million and we're ending at 53 million. So looking forward to '19, together with an improving organic growth profile, a lower share count, and some good things going on in our business, we're looking forward to that.

Operator

Our next question comes from the line of Patrick Davitt with Autonomous Research.

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

The last couple of quarters you talked about some big wins in the pipeline getting delayed. Did that help 2Q? Or are you still waiting for some of those to come through? And Jay, your comments about July commitments in alts being more than all of 2Q, is that actual inflow or is that just adding to the pipeline?

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

Let me start and then maybe Jay can pick up on that last bit. As we've talked about, we have in both composition, meaning the product mix as well as kind of the combination of channel geography, been pursuing some more complicated mandates. Some of that absolutely did start to materialize in the second quarter, but in terms of pipeline overall, the overall pipeline, that's all been replenished and so it's not like 'hey, that this was just kind of a one-time thing' -- those kinds of mandates I think are part of two overall trends, one is a trend in the marketplace, which is the behavior of pools of capital and the larger intermediaries and how they're narrowing and you've heard lots of folks talk about that. And the other is again on our side, which is the evolving capabilities that we and our Affiliates have to do an increasingly good job -- and again to be clear, there's lots more that we can do -- an increasingly good job facing off against that trend. So we are seeing some of that pull-through, but we're also just seeing that opportunity as a long and growing opportunity.

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

Yes. Patrick, just maybe starting with the second quarter, I mentioned in my prepared remarks, we fell $2.6 billion in net flows for this second quarter and I also mentioned that we saw net flows in both the liquid and illiquid books. So if you imagine, something in the neighborhood of an equal weighting, we had good flows in both. I would say that going into July, we are seeing a number of our private equity, real assets, and illiquid managers starting to close on a number of funds that have been in the market without going into any more detail there because I can't. Some of those have made the news, some of them haven't. But we're seeing that number being quite a bit more than what we saw net in the second quarter.

Operator

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

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

Kind of a 2 part question. First for Jay, starting on EBITDA, you mentioned down year-over-year, I think you mentioned the other income, performance fees and investments. I guess just on the investments, like how much is that, maybe weighing on it? And then, in terms of the investment time horizon and how we should think about the return on those investments? Then I guess just bigger picture, like if I look at how you guys are positioned on the -- you mentioned the structural allocation that makes sense, the investments you're making, they make sense. On the other side, the alts, it seems like the performance as a whole, I mean for the industry has been more muted and then you had the impairment with Ivory. So I just wanted to understand when you look across all the Affiliates, do you have any stats on how many are outperforming the benchmarks even if it's a longer term, like 3 to 5 years? Or out of all of the Affiliates, how many are having, inflows versus outflows, on maybe a trailing 12 months. Just something to get a little bit of color because the flows are obviously good for the quarter but just to get a little bit more color on the sustainability of that?

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

I'll start with the back half and then turn to Jay. So, appreciate the comment and there is a couple of different themes that we have to work together here. So one is short term performance themes. Honestly, on a lot of levels, on the short-term kinds of performance themes, I think we have to look through those. You've heard us talk about some specific areas where they have been good, now we have to look through those. I think there are questions. I would start with, where do we see -- and we will think about the ways that we can get better, meaningful data out -- but where are the ways we can see, where are the places we can see significant opportunities in part for specific products, but really for capabilities, right? And I don't think that's just specifically in alts but you can use alternatives as an example of a place to start that. We think there is a long-term opportunity for the capabilities that our Affiliates have. Some products absolutely underperforming, some products absolutely outperforming in the main, the alternative products -- if you think about it across the whole, in the main, our alternative products are performing better than peers. That's probably the right way to think about it, once you've gone from category to category -- because there are demand characteristics of the categories and then, which are the better performing products and capabilities within that. So in the main, our Affiliates are performing better than peers, we'll figure out ways to get that. So it's demand characteristics versus capabilities. Within alts specifically, we've talked about it on these 2 dimensions, which is liquid and illiquid, we've put down somewhat artificial stakes around those two definitions, but on stakes around those definitions, if you do it that way, the illiquid book and the illiquid opportunity set is behaving, as good as the liquid is, the illiquid opportunity set is even better -- and there is just an incredible amount of demand for both the existing capabilities and also reasonably easy to see extensions of what our Affiliates are doing. And to the extent that these businesses are ultimately -- and you heard us talk about this a little in our prepared remarks, these businesses are behaving more like platforms as we look at the way they can extend their products consistently under their brands. Jay if you want to add to that or also take the second part?

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

Yes, so let me take the second part. There's a lot I could say here, so I'll try to just be brief. Just on the earnings, the EBITDA and kind of where we are, you noted -- our business is seasonal, so I want to make sure that we note that. We have higher-level performance fees in the first and the fourth quarters, seasonably low in the second and third and to some extent, that's affecting our EBITDA in the second to third. So if you look at it, there's a first half, second half business, you'll take into account the spreading of those performance fees. The other point that I made in the prepared remarks is other income clearly was down. You could see it was down $4.5 million on the line item, the financial statement line item, but actually we had last year, a bit more realized gains than we do this year, so it's really more down like $6 million, not $4.5 million -- so that obviously impacted. And those are gains from investments that we've made, typically seed or GP investments and that's part of our business. So we leave that in our earnings and we expect them to go up over time. So that is something that we usually have a contribution from, almost every quarter, but just down this quarter. There is a little bit of Ivory in there, as I mentioned, there is a non-cash element to Ivory and then there is about $1.25 million, which we would take out, if you reconcile that's about a $10 million spread that we did not see recurring in this quarter year-over-year. And then as I mentioned in my remarks, the investments that we have and will make in the business, that's included in the guidance of the 11.3 basis points. I would say and just to dimensionalize it a little bit, I think if you think about our history of expanding geographies in front of both the significant demand and participation by all of our Affiliates, you think about Japan as an example and I'll make the comment that, just like Australia, Middle East et cetera before that, we do have a bit of a startup expense initially, and in Japan, to contextualize it, it's even a more robust statement because not only have we moved to open up a Japanese office and work in Japan, we helped some of our Affiliates do the same. So if you think about Pantheon, we've worked side-by-side with Pantheon and in a way to get that startup cost through and so when you see that come through our numbers, sure, we've had a little bit of that, it's in the forward projections and we do expect a return coming through as AUM is accumulated in those regions, and that's been our history.

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

Let me maybe just add a touch to that last point, which is as Jay said, we've been looking at Japan for a while and we're now in a place where we see enough demand, that we and our Affiliates are going to go after it in an on-the-ground, kind of way. So there's a little bit of startup cost as I said, and that's true everywhere as we invest and then start to experience the growth curve. I will this say to be clear, most of the time when we're entering a market we have much less traction than we already have in Japan and we've really had quite a good experience. Some of which has already come through but much of which obviously hasn't, but we're really seeing good traction there. And then the only other small point I'll add is, we have had to stop the process to open the Dublin office and we had conditions in place, but we're having to execute on them. So, not a lot of money but, obviously, and the ultimate shape of it will depend on Brexit obviously and our conversation with the regulators, but we are having to stand that up.

Operator

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

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

Maybe, I guess my first question -- well, I'll ask a two parter. First one is just on M&A, I know you guys are obviously trying to stay disciplined, but you have seen the fair amount of activity in the market, some competitors acquiring stakes and some of these kind of "permanent capital vehicles", whether it's Dyal or Blackstone's platform. Can you maybe talk a little bit about beyond the -- looking for a permanent partner but how you kind of perceive maybe your strategy? Or what you're looking to invest in compared to what you're kind of seeing happening in the marketplace, as it relates at least to minority stakes in alt managers? And then I guess maybe just as a second part. In the alts business, you talked about a lot of commitments coming on board in July, I guess a lot of fund closing. I'm assuming that, that's not going to necessarily going to flow into AUM, all of that, if they haven't turned on fees. So is there any sense of getting a sense of what your kind of dry powder pipeline maybe like of commitments that you're Affiliates have received, but we're not seeing yet in AUM or that haven't been turned on?

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

Let me start on the first part and then I'll ask Jay to the second. So i think you framed it, look you understand us I think really well and framed it well. So just to level, stepping back, we do have a differentiated model of approach and we've been kind of running and evolving this model for now nearly 25 years. Our approach is very attractive to our target universe, which is prospective Affiliates that are looking for a permanent institutional partner and I would underline the word permanent there, and at the highest level, we're helping solve a demographically driven management ownership and succession problem for these firms, and we have a solution that preserves and protects their unique entrepreneurial cultures across successive generations of management. That's why that kind of permanent underline is so important. And then in terms of how we pursue it, we have this propriety calling out for, we've been out building relationships with the best firms for many years and that activity continues apace. And you've heard us say, those kind of firms that we're pursuing generally don't have to do anything, at least not at a specific point in time -- so what's driving the transactions of those firms is generally us building the relationships and the firms deciding that now, whatever the "now" is, is the right time to address that long-term demographic issue. So that's at universal firms, where we have a unique solution, I think, we are uniquely attractive. Now in terms of your comments about the current environment. Absolutely, this has been an elevated period of M&A activity in the industry and you should assume alongside our proprietary calling effort, we're looking at all of the opportunities in the market. And then you should also assume and expect, as you sort of led your question with, when we're looking at an investment, we're very disciplined. And that's across multiple dimensions, that's discipline around business quality, that's discipline around the long-term alignment structures that we talked about, and of course, that's discipline around pricing. And then I guess, the last point I'd make is, that when we talk about this discipline, we're also always measuring the opportunities we have, against reinvesting in our business, through share repurchases and we have a very high quality diverse business in place. So we're always looking at it against that backdrop as well. Put all of that together, we have this outstanding secular opportunity to partner with the best boutique firms and while the timing of any one is to be driven by those dynamics I described, we continue to be really busy and make good progress across the range of new investments.

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

Yes, and I was just going to add one thing and I'll talk about the illiquid AUM in a moment. But just, the thing I would add is one of the major advantages that we have in the market is our reputation for being a supportive partner over 25 years and our permanence in the model, the AMG model that is what people know to be the succession planning model to ensure that permanence for both us and the Affiliates and really alignment is posited in that. That is still highly valued in the market. It's not for everyone and when you look at some of these stake buyers, whether it's pricing or other elements, in some cases, we have just decided that it's not a situation where we want to chase because pricing can be too high in those environments. So we have stuck to that 8x to 10x EBITDA discipline, but where we really are attractive to partners is where they value the permanence, they value the reputation and the model. And then as it relates to the AUM policy, you did say one thing I wanted to clarify, our policy is actually to take assets in under and account for them when they come under supervisory, really when we start to manage those assets. Generally speaking, fees are tied very closely to that timing, but I would say and I mentioned it in my prepared remarks, even this quarter, we saw our aggregate fees to AUM tick down a little bit, mainly because of this timing issue. We have taken in some AUM before the fees were turned on, that's usually days or months or a quarter but it's not usually that long. And I think you will see us book again in the third quarter some AUM right at the onset of fees, so we could have a little noise in the third quarter. But in general, we are taking that AUM as we start to manage it.

Operator

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

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

Just trying to come back to the EBITDA and the investments in the business. Clearly, obviously, a lot of good promising organic growth opportunities that we would naturally think you would want to invest in. But as you talked about the Japan office and that opportunity and then the Dublin office also. Should we be thinking of these investments as sort of -- I don't want to say one time, but sort of brief? And then you guys coming back to realization rate closer to that 12 basis points ex-performance fees or rather do you see enough organic growth opportunities, that you wanted to really continue that into the future?

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

Let me start and then I'll hand it to Jay. So I -- look, the last part of the question, sitting here today, we think there are a lot of opportunities for us to improve, how we're bringing these distinctive return streams to market. I think our method and our approach will be pretty consistent. You've seen us be quite disciplined as we've built distribution over the last 12 years. I think you'll see us pursue in a deliberative fashion. Part of the question is what's the pace and how do we do it in our way, which is partnering with Affiliates and pursuing things that we think are the highest return opportunity at any point in time? And so I think you'll see us pursue it in sort of the same disciplined way we always have. I think there are definitely included things that are short-term in nature, right? So the startup cost for a geography or the startup costs for a channel within a geography. The Dublin office -- the question is highly dependent on how Brexit unfolds, but we very much hope that it is a temporary thing. I think there's absolutely a category to go that way. But, in my mind the most important part of the question is where you ended -- which is, sitting here today, we do see opportunities but we'll continue to pursue them in that disciplined way. And then the other thing I'll say is that, it's working, we are seeing returns on those investments coming through as gross on the sales line.

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

Yes, in our AUM realization rates, obviously they have a lot to do with the level of performance fees in addition to asset-based fees. So when you think about over the course of the year, if I go back to my first half, second half nomenclature, if you're averaging the first quarter with the second quarter and the third quarter with the fourth quarter, you'll see the realization being higher, just by virtue of that normalizes our performance fee opportunity. So you really have to think about those altogether. The last thing I would say is, on that ratio, we continue to see faster growth amongst our equity method Affiliates, primarily because those are in the alternative space and that's where most of our illiquid managers are, although Pantheon is a consolidated Affiliate. So we are seeing more growth there, which we obviously own a bit less, and that will change that ratio just from a composition perspective over time.

Operator

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

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

So a couple on the pipeline. I think this first one is kind of touching on the points you were just making, Jay. But looking at the pipeline and where you're going over the next couple of years, can you give us a sense of where you think the revenue yield and the EBITDA yield on the inflows will be compared to the yield on the outflows at least in the near-term there? And then on new Affiliate investments, I know you've made -- you've been talking about focusing more on larger, more diverse prospects, so within that context, in your conversations with prospects in the near term part of the pipeline is, is distribution still as much of a selling point of the AMG model?

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

Yes, let me start with that last question. I think the way we talk about it is, we're looking for the highest-quality boutiques. And I do think that the dimensions of the highest-quality boutiques more require either products that are more leverageable through distribution or otherwise or firms that themselves have investment processes and disciplines and an orientation to need to continue to grow and expand their business. I think it can be both, a firms doesn't have to necessarily be larger right away, but it has to include those things, which is a process that can evolve and grow as well as better orientation. But absolutely, we're looking at larger firms and more diverse firms as well. In terms of the attract, the relative importance or attractiveness of AMG, especially, it is one of the things, we're looking at firms that are themselves already complete firms. And so therefore, have proven distribution capabilities, generally in at least 1 or 2 geographies and 1 or 2 channels. So those are the firms we're attracted to. Our distribution, the distribution we've been building over this dozen years that we talk about, is designed to knit to the distribution capabilities of our Affiliates, which includes some obviously, very large successful, diverse firms. So we are very used to working with, and continuing, and partnering with, and enhancing, and diversifying, the asset bases of very successful large, diverse growing firms. That's actually -- not that easy, but that is something that we've really done, we've put a lot of effort behind it and are doing an increasingly good job at. So, it's not so much that they specifically need it, but I think we have built a unique distribution set of platforms, that as I said, can sort of knit to the distribution of boutiques and enhance them. And that's something that we've been investing over the past decade. So I'm not sure it's necessarily specifically important to each of them, but I think as we go through these conversations with them, I think they'll get it. I want to pick up on a point that Jay made before, which is a huge asset that we have is this track record of partnership with these firms. And so all of the things we described about, the ability of the distribution platform to work with, very successful large-scale diverse and growing boutiques is highly referenceable. So they can just call and speak with any number of our Affiliates about how we work with them in ways that are highly customized to those businesses. So we do think that what we're building is additive, and again we're building it, not just any of the virtual circle we've talked about, much of it because it's helpful to these new boutiques and additive to that new investment process, but it's also, absolutely, today additive to even our largest, most diverse Affiliates and we saw that again this quarter and come to a close.

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

Yes. And then Chris, just on the yield point. So look, it's a fee rate comment, it's also an ownership comment for us, but just at the fee rate level, you've seen us and you've heard us say that our fee rates have been holding relatively stable at the highest level, we're at about 52 basis points with some performance fees, so we're in that 59, 58 kind of range without performance fees. That level, when you think about it, you could say it's been holding relatively stable. Interesting thing is, we've probably seen everything underneath that. We have some places where we're seeing our mix shift to higher fees, we're seeing places where we see the mix shift to lower fees, we're seeing differences between Affiliates. We're seeing it all because when you have $824 billion in AUM and as many Affiliates as we have -- we're seeing it all, but we're seeing the composition remain relatively static at the highest level. Why is that? Because we continue to grow in alternatives, just sort of plain and simple. And then within alternatives, the illiquids tend to have higher fees and frankly, longer duration. So I think that's a good phenomenon of structural phenomena that's actually happening in our business today and that's keeping our yield on the assets higher and its attractive mix shift, if I had to say it that way. On the ownership side, we do have the comments I made earlier about EBITDA to AUM. We are seeing good growth in those alternative businesses, but we're also seeing good growth in some of our global equity managers like Harding Loevner and Pantheon, who is a consolidated Affiliate. So, we are keeping up on an ownership basis, but from quarter-to-quarter, over time, those changes can be modest, but you have to stay focused on the EBITDA line that should be growing over time.

Operator

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

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

Was hoping you guys give us a couple of specific answers around the systematic performance. I guess one topic but a couple of questions there. I guess, a, will be helpful to get an update on how different strategies have done year-to-date, kind of, on an absolute basis? Obviously, we could all see the public sleeves, manage feature as long, short et cetera, but it will be helpful to get a sense of where the others are. And I guess more importantly, given sort of the year-to-date challenges in that bucket. Can you give us a sense of how critical it is going to be for flows in the next 6 months from an institutional perspective? And ultimately, kind of what do clients care about? Is it absolute or relative performance in that category?

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

Let me start. There's a bunch of pieces in there. So I think the clients in that category are divided into a couple of different groups. I think there's clearly clients who understand the product, and are investing in it because of the diversifying characteristics of it -- making an observation here, which is the large drawdowns in traditional portfolios tend to be more severe than the drawdown of trend managers, both now in this environment and historically. I think the core of the investors, especially, the core of the institutional investors understand the reason they are investing in these strategies and how these strategies should behave as a diversifier in their overall portfolio. I think that's true,and I think that while this is a challenging period for the category, it's not an unheard of period. So those comments are really important for a significant portion, I'd say the most significant portion of the asset base for us in the category. Now there is also absolutely, people who are investing in this strategy in a way that was following performance and being driven by performance, and the performance of the category has not been good, and that has been reflected in flows and you're seeing that in the retail flows that you mentioned. And I think you can look that asset base as long as performance continues this way, some portion of it will behave that way. We at the highest level, we believe in the category. As part of our diverse business, I think it's an important part of the business. For us, that's the most important point to make, which is we have a large diverse business, with significant participation in areas that we think have long term secular demand terms behind them. Any one piece of the product set within those secular demand trends will not be performing well at any one given point in time and that's okay, in fact, that actually also provides some opportunity. So I think that's how I would had answered at the highest level.

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

Yes. And I wanted to pick up on the thread that Nate mentioned in his prepared remarks as well. I mean with systematic diversified being 5% of our business today and on an AUM basis, it really speaks of the diversity and the power of the diversity of our business because as you saw in the public data, I'm sure all of you saw on the public data that it looked like we were going to have negative flows, when in fact, we had demonstrably positive flows this quarter. And it just shows you that we do have tremendous diversity in this business and even though systematic diversified is challenged at the moment, as Nate said, it is an opportunity for the future. And again, within the context of the diversified business, you're always going to have those pockets and we're completely confident that over time that, that segment will provide us some growth in the future period.

Operator

At this time, this includes our time for questions. I'll turn the floor back to Mr. Dalton for any final comments.

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

Thank you again for joining us this morning. We are pleased by our results for the quarter and we are confident in our ability to continue to create long-term shareholder value. We look forward to speaking with you again in October. Thank you very much.

Operator

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