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Athene Holding (ATH)

Q4 Earnings Call

Corporate Participants

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Chairman, CEO and Chief Investment Officer, Athene Holding

William Wheeler
President, Athene Holding

Martin Klein
Chief Financial Officer, Athene Holding

Noah Gunn
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Other Participants

Andrew Kligerman
Analyst, Credit Suisse

Ryan Krueger
Analyst, KBW

Mike Ward
Analyst, UBS

Tom Gallagher
Analyst, Evercore ISI

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Analyst, Goldman Sachs

John Barnidge
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ATHENE HOLDING LTD.
Q4 2019 Earnings Call
Moderator: Noah Gunn
February 18, 2020
10:00 AM ET

Operator:
Good morning. My name is Thea and I will be your conference operator today. At this time, I would like to welcome everyone to the Athene Fourth Quarter and Full Year 2019 Earnings Conference Call and Webcast. All participant’s lines have been placed on listen-only mode to prevent any background noise. After the speaker’s remarks, there will be a question and answer session. If you would like to ask a question at that time, please press star one on your telephone keypad. If you should need operator assistance, please press star zero. Thank you. I will now turn the call over to Noah Gunn, Head of Investor Relations. Please go ahead.

Noah Gunn, Head of Investor Relations:
Thanks, Thea, and welcome to our fourth quarter and full year 2019 earnings call. Joining me this morning are Jim Belardi, Chairman and CEO; Bill Wheeler, President; and Marty Klein, our Chief Financial Officer.

As a reminder, this call may include forward-looking statements and projections, which do not guarantee future events or performance. We do not revise or update such statements to reflect new information, subsequent events or changes in strategy. Please refer to our most recent quarterly and annual reports, and other SEC filings for a discussion of the factors that could cause actual results to differ materially from those expressed or implied.

We'll be discussing certain non-GAAP measures on this call, which we believe are relevant in assessing the financial performance of the business. Reconciliations of these non-GAAP measures can be found in our earnings presentation and financial supplement, which are available at ir.athene.com. I will now turn the call over to Jim Belardi.

Jim Belardi, Chairman, CEO and Chief Investment Officer:
Thanks, Noah, and good morning, everyone. Our robust fourth quarter results capped a year of record adjusted operating earnings and record organic growth for Athene. Strong operating performance combined with our focus on effective capital allocation is a powerful tandem in driving long-term shareholder value. 2019 featured numerous accomplishments worth highlighting.

First, our strong financial results drove 18% year-over-year growth in adjusted book value to $54 per share, exceeding our historical compound annual growth rate of 17% since inception. This translated to a consolidated adjusted operating ROE of 14% for the full year, achieving our target of at least mid-teen returns despite our excess equity capital and the challenging macro environment.

Second, we demonstrated the strength of our multi-channel distribution model generating record organic deposits of $18 billion at very attractive returns that were above our historical average. While retail sales were impacted by low interest rates, we more than made up for it with record deposits across our pension risk transfer and flow reinsurance channels and re-emerging activity in funding agreements.

On the inorganic side, we remained disciplined in evaluating various opportunities. And while there weren't any new deal announcements in 2019, we acted strategically by laying the groundwork for potentially larger and more numerous transactions through the creation of ACRA. As we have demonstrated in the past, Athene's model has great potential for transformative growth when we are able to combine organic and inorganic growth simultaneously.

Third, we continued our track record of top tier investment performance and yield generation. Even in a low interest rate environment, we continued to achieve fixed income yields at a premium to the broader market. Consistent with our philosophy as active asset managers, the yield on our fixed income purchases in the year was 35 basis points higher, net of fees, than the BBB corporate index. Over the course of the year, we invested more than $32 billion of flows, the most we've ever done.

One of the most important areas of focus at Athene today is working with our partners at Apollo to build out senior secured direct origination capabilities that generate attractive net investment spreads without assuming incremental credit risk.

The latest example of the progress we've made is the acquisition of a large aircraft lease portfolio from PK AirFinance, which closed in December. In total, we invested nearly $3.5 billion or 11% of our aggregate deployment in directly originated senior secured assets in 2019 and we expect to bolster our origination capabilities to do significantly more volume in this area in 2020.

Finally, we took two important steps to bridge the gap between our superior operating performance and our discounted share price. First, we worked with our partners at Apollo to eliminate Athene's multi-class share structure. Over the past few months, the market appears to have rewarded us for taking this important step, with both companies experiencing appreciation since the deal was announced.

We recently received shareholder approval for the proposed transaction, and upon closing, which is expected to occur in the coming weeks, Athene will be fully eligible for inclusion in a major S&P index, such as the S&P 500. Importantly, this transaction will broaden our appeal to a wider range of both active and passive investors. We view our investment in Apollo as strategic in nature and look forward to participating in Apollo's robust growth, profitability and yield characteristics.

Second, we judiciously allocated more than $900 million of capital for share repurchases, including nearly $300 million in the fourth quarter alone, which allowed us to opportunistically secure high teens returns with virtually no execution risk.

Across our primary uses of capital today, we believe our undervalued stock is one of the best investments we can make, and so we expect to restart our activity tomorrow when our trading window opens. Of course, we will continue to evaluate our pace on an opportunistic basis, balancing other deployment opportunities along the way such as accretive inorganic transactions.

When stepping back and reflecting on the environment in which we've been operating recently, our achievements in 2019 are even more significant. As an operator who drives profitability for manufacturing spread, one might say our business is easier to execute in a higher interest rate environment.

However, Athene's resilient business model is ideally positioned to thrive in a variety of interest rate and economic environments. We do not require higher rates to deliver compelling earnings and book value growth, and our performance over the past few years is a prime example.

In 2019, the average yield on 10-year treasuries was approximately 20 basis points lower than it was in 2017. Although there have been relative peaks and troughs in rates during that time, overall yield levels have declined. Some may have expected our business to contract in this type of environment, but in fact the opposite is true, as we employed our discipline strategy, grew profitably, and reached new heights.

Since 2017, adjusted operating EPS has compounded at nearly 14%, adjusted book value per share has compounded at 19%, average net investment assets have compounded at 23% and we've generated record annual gross organic deposit activity and closed two inorganic transactions. These results demonstrate the fact that our ability to execute and thrive are not dependent on a higher rate environment.

I'd like to close my prepared remarks by quickly reflecting on how far we've come in creating significant value for all our stakeholders. As you may know, Athene celebrated its 10-year anniversary as a company in 2019. In just a decade, we've grown from a grand total of seven employees with no clients to a public company with more than 1,300 employees, hundreds of thousands of customers and managing $120 billion of net invested assets, which have driven leading adjusted book value growth and returns.

Of course, none of this would be possible without our unwavering commitment to our shareholders, employees and the communities in which we operate, which is at the core of everything we do. As a recent example, in January, we published our inaugural Corporate Responsibility Report, which highlights the many ways Athene is making an impact in the communities in which we work and live.

I'm very pleased that our mantra, “Driven to do more”, is deeply embedded in our culture. That is why when it comes to corporate responsibility, our team consistently strives to make a difference through volunteer service, philanthropic giving and community outreach, which speaks volumes about who we are. I encourage everyone to read the report, which is available on our website, and we look forward to making continued progress in this important area.

With that, I'll turn the call over to Bill to provide comments around liability origination activities and outlook.

Bill Wheeler, President:
Thanks Jim. Our fourth quarter results capped a strong year of organic growth for Athene, demonstrating the strength of our multi-channel liability origination model. As Jim mentioned, we generated gross organic deposits of $18 billion, a record level, and 37% higher than 2018 driven by healthy activity across all our channels. Importantly, we did not sacrifice profitability to achieve record volume.

We continued to price new business in line with our historical mid to high teens return targets, and in the end, we were awarded for our discipline as the outcome was even better than our initial pricing indicated, as we posted a record blended return on organic origination. To provide you with some context on this activity, as well as some insight on our outlook, I’d like to share some detail by business channel.

Our retail business drove nearly $7 billion or close to 40% of our aggregate deposits in 2019 at our targeted mid-teens returns although this was approximately 10% below the level we saw in the prior year. The primary driver of lower sales was the result of more muted overall sales activity in the industry in a lower rate backdrop coupled with a slowdown in less profitable MYGA sales amid rising competition.

It's worth noting that in FIA products, which are our core strength and account for 90% of our retail business, sales for the year were down only modestly, while we maintained discipline on pricing. As we previewed on our prior call, retail sales moderated in the fourth quarter due to prudent pricing actions we made in the third quarter when interest rates dipped and the impact of the lag effect of the associated slowdown in new policy applications.

Looking ahead to 2020, we expect retail sales could continue to face near-term pressure as we maintain our pricing discipline in a competitive market. However, we are cautiously optimistic that recent favorable pricing adjustments made in February will benefit retail volumes in the back half of the first quarter with further room to improve as the year progresses. Importantly, we continue to expand our product distribution footprint, particularly among financial institutions.

For example, we signed 24 new broker-dealer and bank relationships and onboarded 19 during the year. This included household names like PNC Bank, BB&T Bank and LPL Financial more

recently. Financial institutions now comprise more than a quarter of our retail sales and we anticipate this channel could continue to grow with stronger near-term growth likely to come from broker-dealers.

Additionally, we are actively enhancing our product set. As an example, we recently bolstered our fixed-indexed annuity product offering with the addition of a NASDAQ Index, which uses patent-pending, intra-day balancing for increased efficiency and performance, as well as a US Equity Index which is powered by IBM's Watson artificial intelligence capabilities to identify investments that are poised for growth within a broader large cap equity strategy.

This new first-to-market feature is a good example of the constant product innovation taking place at Athene. We expect the addition of technology-forward index designs to further strengthen our market leading FIA franchise. Overall, we remain confident in the fundamental strength of our retail business and expect to retain our position as an industry leader in the fixed-indexed annuity market.

Turning to our PRT channel, we had a record year of pension closeouts, solidifying our position as a market leader, while generating attractive returns. For the year, we closed $6 billion of transactions, more than doubling the volumes in 2018 and significantly expanding our market share.

Importantly, in the fourth quarter, we announced our inaugural PRT transaction in the UK, closing 2019 on a high note. We are pleased with the completion of this initial step and we remain optimistic that the UK PRT market could be an attractive long-term growth opportunity for Athene, particularly given that the UK market is currently transacting more annual volumes than the US.

Looking ahead, we expect overall PRT growth to remain healthy, although 2020 results could face a tough year-over-year comparable, given the large Bristol-Myers transaction and elevated overall industry volumes in 2019. While it is too early to predict the deal volume for the year, the pipeline currently looks to be in decent shape. Most importantly, we will maintain our pricing discipline despite a competitive market environment.

In our third-party flow reinsurance channel, we generated approximately $4 billion of volume for the year, up more than 60% year-over-year. As we expected, the fourth quarter result of $1.2 billion rebounded substantially quarter-over-quarter and returned to the strong levels we saw in the first half of 2019. This was in response to favorable pricing adjustments we made in the third quarter and stronger volumes with key partnerships established within the past 18 months.

That said, we anticipate our go-forward flow reinsurance volumes will likely moderate from the particularly strong fourth quarter results, as some partners adjust their quota share levels. On a positive note, we are in the midst of several negotiations for potential new partnerships, which may provide upside in the back half of 2020 and beyond.

With respect to funding agreements, we issued a total of $1.3 billion in 2019, reflecting an improving spread environment that had not been in our favor for most of 2018. Notably, we issued our first 7-year funding agreement backed note during the fourth quarter, which totaled $500 million. In general, the FABNs we've done were the more common 5-year maturity notes and so we were encouraged by the investor receptivity for a longer-dated product, which pairs nicely with our longer-term approach in managing our asset portfolio.

We are optimistic on the issuance pipeline for funding agreements and we have already begun to execute by closing a $625 million issuance in January. We anticipate 2020 volumes could meaningfully exceed 2019, partially driven by a likely expansion into non-US dollar denominated deals.

In summary, we anticipate healthy organic activity to continue in 2020 and be underwritten to targeted mid-teens returns with our mix likely more balanced across channels.

On the inorganic side, we continue to see opportunities to deploy our excess capital at attractive returns. While we did not announce any inorganic transactions during the year, we actively evaluated numerous opportunities, some of which we're continuing to evaluate now. Since we are unable to control the speed of M&A processes and the willingness of counterparties to transact, it's difficult to determine the likelihood and timing of transactions that might be consummated. That said, we are optimistic on the current pipeline and we believe we are well positioned as a preferred solutions provider.

In an industry that continues to go through significant restructuring, as evidenced by several announced transactions in just the last few months, we differentiate ourselves with our deep expertise, swift execution capabilities and unmatched deployable capital position. To date, ADIP has closed on $3.2 billion of third-party capital commitments for investment into ACRA and we anticipate additional commitments to be signed within the next couple of months.

Combining Athene's standalone excess capital and debt capacity with third-party ADIP capital, as well as the pro forma excess capital we expect to generate from the strategic transaction with Apollo, we estimate that total deployable capital of approximately $8 billion could support nearly $100 billion of acquired liabilities, which we would expect to generate significant incremental run rate earnings power.

Now, I'd like to turn the call over to Marty, who will discuss our financial results.

Marty Klein, Chief Financial Officer:
Thanks, Bill, and good morning, everybody. We delivered strong performance in the fourth quarter, including record adjusted operating income closing out a strong year for Athene. This morning, I'll walk you through our fourth quarter results and discuss how we view our forward earnings power, including some perspectives on 2020.

Before getting into the details, as a reminder on October 1st, we closed the sale of 67% of ACRA to the third-party investors in the ADIP fund, which resulted in $575 million of capital being transferred to Athene in exchange for the economic interest in approximately $6.1 billion of reserves, for which Athene began earning fees as the manager of ACRA. Our GAAP financials now include this non-controlling interest, while our management view results focus on results for Athene on a net basis.

For example, you'll see that our disclosure now includes reference to items such as gross invested assets, including the piece of ACRA attributable to third-party investors and net invested assets, which aligns with Athene's ownership on a standalone basis. Importantly, the moving pieces in the quarter had a relatively modest net reduction of roughly $0.05 per share on our earnings results, which was mostly offset by share repurchase accretion.

Turning to our results for the quarter, we reported GAAP net income of $432 million or $2.42 per diluted share. Our adjusted operating income available to common shareholders for the quarter was a record $389 million or $2.21 per share, which drove a strong adjusted operating ROE of 16.7%.

Notable items totaled $47 million pre-tax in the quarter, including $25 million of equity market impacts and $22 million of favorable actuarial updates. Excluding notable items, total adjusted operating income was $346 million or $1.97 per share.

Our consolidated net investment earned rate or NIER in the quarter was 4.62%, which rebounded significantly from 4.35% in the third quarter. As you may recall, the prior quarter was impacted by declining floating rate investment income as well as lower than expected discount accretion in our RMBS portfolio from lower prepayments.

In the fourth quarter, we updated our RMBS model to adjust for prepayment speeds and improvement in the underlying credit profile, which we expect will lead to additional investment income on that portfolio over time. These adjustments benefited our fixed income earned rate in the quarter, as did higher bond call and bank loan income. The tailwinds collectively amounted to 15 basis points, including about 8 to 10 basis points, which we view as quite favorable in nature.

Lower floating rate investment income was a 5-basis point drag on the fixed income NIER in the quarter, principally driven by a 37 and 25 basis points sequential decline in average 1-month and 3-month LIBOR rates respectively, which have trended down a bit more since year-end.

As a reminder, 18% of our portfolio is in floating rate securities, mostly in CLO and RMBS assets, which have been meaningfully accretive to our investment spread over time. We anticipate quarterly upticks and downticks of investment income depending on movements in rates, while corresponding impacts to crediting rates play out over several quarters.

Turning to our alternatives portfolio, we generated strong annualized returns of roughly 11% with particular strength in Venerable, the private variable annuity company established as part of the Voya transaction, as well as OneMain Financial and various real asset investments. Robust returns from Venerable were driven in part by the payment of a dividend significantly ahead of expectations as a result of solid business performance. Our alternative strategy remains differentiated in its makeup and has generated strong returns historically, although quarterly results vary.

Moving to the liability side, our total cost of funds for the fourth quarter was 2.73% of average invested assets in retirement services. This reflects a 45-basis point decrease from the prior quarter, which was elevated due to an unfavorable impact from our annual actuarial assumption unlocking.

Within total cost of funds, our cost of crediting decreased 13 basis points quarter-over-quarter, which was primarily driven by an approximately 8 basis point reduction from a non-recurring favorable actuarial update to reserves in our PRT business. Our deferred annuity cost of crediting also decreased 3 basis points sequentially, driven primarily by rate actions on in-force renewals and run-off of higher rate business.

In other liability costs, the rate decreased 32 basis points quarter-over-quarter, primarily reflecting a normalization from the third quarter result, which was impacted by our annual unlocking process. As a reminder, last quarter, we revised our long-term interest rate assumption to a rate which is now about 100 basis points below the levels generally assumed in the life insurance industry. This reflects our prudent and disciplined approach to underwriting and balance sheet management.

So if we were to bring our assumptions in line with the industry, there would be a very significant favorable impact on earnings measured in the hundreds of millions of dollars. Other liability costs also benefited from favorable rider reserves and DAC amortization as a result of strong equity market performance with the S&P 500 up 8.5% in the quarter.

Moving to operating expenses, the operating expense ratio in the fourth quarter was 30 basis points, up 3 basis points quarter-over-quarter primarily due to the timing of expenses and a decrease in average invested assets related to ACRA. Despite the uptick in operating expenses as measured by dollars in the fourth quarter, the full year 2019 expense ratio of 29 basis points declined 4 basis points year-over-year amounting to approximately $46 million of savings.

Lastly, as expected, our tax rate in the quarter increased from the particularly low level in the third quarter. The fourth quarter adjusted operating tax rate of 11% was primarily driven by higher taxable income from a non-recurring item as well as from the mix of our onshore/offshore business, which can fluctuate in any given quarter.

Turning to capital, our capital ratios remained strong at the end of the year with ALRe estimated RBC ratio of 443% and the US estimated RBC ratio of 429%. We ended the quarter

with approximately $2 billion of excess capital and $2.5 billion of untapped debt capacity. Our untapped debt capacity assumes repayment in the second quarter of approximately $475 million in short-term financing we drew down related to closing PK AirFinance.

Summing up our results, 2019 was a year where we continued to execute on our core strategy of profitable growth as our earnings power and access to capital reached new heights. When you consider the substantial size of our in-force block, the ongoing benefits of our organic growth engine, the opportunity for inorganic deals now further enhanced by ACRA, as well as accretion from opportunistic share repurchases, we expect to generate solid earnings and book value growth in the year ahead.

Our current outlook for 2020 incorporates the following;

We expect our baseline fixed income NIER in the first quarter to normalize to a level which excludes the 8 to 10 basis points of favorable fourth quarter items I mentioned earlier, as well as some additional drag of a couple of basis points from floaters, given year-to-date declines.

Further, we expect alternative returns of approximately 10% to 11% in 2020, excluding the performance of our investment in Apollo. Given the favorable market conditions in the fourth quarter, we expect our alternative investments which report on a lag to drive a stronger than usual first quarter.

On the deposit front, we expect organic volumes to be roughly similar to 2019 levels, excluding the outsized $2.6 billion Bristol-Myers deal as we maintain our pricing discipline in a low interest rate environment. We also expect in-force decrements of approximately 9-10%, consistent with recent trends.

Moving to cost of funds, we would anticipate the cost of crediting on deferred annuities to remain fairly stable to slightly lower, with flexibility to move down further if there is continued pressure on interest rates. For the institutional crediting rate, we would expect the rate to normalize in the near-term from an abnormally low fourth quarter to a level around the prior run rate of approximately 370 basis points on the existing business.

On other liability costs, we continue to view 100 basis points as a good quarterly run rate, although the result can fluctuate quarter-to-quarter depending on a variety of factors, including the level of gross profitability, equity market performance, and other actuarial experience updates and unlocking.

Regarding expenses, while we expect to benefit from our highly scalable platform over time, our expense ratio in 2020 may remain roughly stable given the timing of the capitalization of certain expenses from prior years, costs related to accounting standard implementations such as CECL and LDTI, as well as ongoing investments in process automation and other elements of infrastructure that we expected to drive additional efficiencies over time.

We expect a tax rate of roughly 9% on the core business, although the actual results could vary significantly by quarter depending on the mix of business ultimately generating profits.

Finally, overall, we expect these components to drive an adjusted return on assets of 110 to 120 basis points, in addition to continued opportunistic share repurchase activity.

Finally, as Jim noted, we announced the strategic transaction with Apollo to close in the coming weeks. In terms of near-term financial impact, we anticipate that any gain or loss on our acquired Apollo shares between announcement and closing will go directly into GAAP equity with subsequent Apollo share price changes to dividends reflected in investment income, net of appropriate liquidity discounts and taxes. We will be holding the non-listed Apollo Operating Group or AOG units, so we currently expect to apply a liquidity discount on our quarterly valuation.

In addition, as an AOG equity holder in the underlying cash flows of the various Apollo partnership entities, we currently anticipate that any appreciation of dividend income from Apollo will have an associated tax rate of approximately 20%, which will vary depending on the mix of results among the entities. We expect the dividends and quarterly valuation changes on our strategic Apollo investment to be reflected in our Corporate and Other segment.

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

Operator:
At this time, if you would like to ask a question, please press star one on your telephone keypad. If you wish to remove yourself from the queue, you may do so by pressing the pound key. We remind you to please unmute your line when introduced and if possible, pick up your handset for optimal sound quality. We appreciate all of your interest in questions in order to ensure every one receives a turn, we ask that you please limit yourself to one question on the first go round and hop back in the queue if you would like to ask a follow up. The first question is from Andrew Kligerman with Credit Suisse.

Andrew Kligerman, Credit Suisse:
Good morning. So the first question is around run rate crediting rate. On institutional, Marty, I think you said the run rate would be 370 normalized. We thought the normalized might have been 353 if we backed out actuarial updates. So on the institutional, I'd just like to get a sense of - just a little clarification on the 370 and why you think that will be the level number. And then it looked like retail crediting interest dropped off 3 bps in the quarter and I'm thinking going forward 1 to 2 basis points a quarter, would that be right?

Marty Klein, Chief Financial Officer:
Andrew, it's Marty. Yes, so on the institutional side, it does move around. I'd remind you that in institutional cost of crediting, it really kind of impacts everything that's in there. So for funding agreements, it's basically the interest we pay on funding agreements. For our PRT business, it also includes that kind of implied investment credit rate on the reserves we have and any other

reserve changes - and any mortality fluctuations that we may have quarter-to-quarter, remember there is a little bit of longevity risk, not a lot but a little bit in PRT.

So yeah, I'd say that it bounces around a little bit, a few basis points quarter-to-quarter in the PRT line in particular and it could be in a normal quarter anywhere from 350, 355 basis points to 370, 375 basis points. We think 370 is probably a decent run rate with a few basis points of volatility on either side of that.

On the deferred annuity side, I think if rates held where they were right now, we might expect the overall cost of crediting in deferred annuities to maybe go down like a basis point or so. Obviously, if rates continue to drop through the year from these levels, we'd expect, probably to your point, another couple of basis points of lift and maybe as much as getting that per quarter if rates kept going down from a combination of rate resets downward on business coming up for renewal, as well as potentially lower hedging costs. Does that help?

Andrew Kligerman, Credit Suisse:
Very helpful, and then just on share repurchases. So, I think Bill called out at the end that you've got $8 billion in deployable capital capacity. So, as I think about the $640 million authorization, it seems like an amount that you would likely be inclined to utilize, regardless of transaction activity. So maybe you could talk about your inclination to deploy that, and if possible potential timing.

Jim Belardi, Chairman, CEO and Chief Investment Officer:
Yes, look, repurchasing our shares is one of the highest and best uses of capital at these share prices. I mentioned on the call that we plan to be back in the market tomorrow, but it's all about the returns that we can achieve by buying back these shares. We've been very successful in what we've done in the past, but we expect to judiciously allocate capital across our share repurchases, supporting organic growth and holding capital for ratings upgrades as we've said in the past with the inorganic capital kind of two-thirds from our ADIP third-party money, but one-third of it has to come from us as well. So yeah, we expect to be in the market repurchasing our shares going forward.

Andrew Kligerman, Credit Suisse:
And the $640 million you think you could deploy that this year?

Jim Belardi, Chairman, CEO and Chief Investment Officer:
All depends on the price, which correlates to the return that we could generate. So, we're not going to give you - we have that much authorized. That is correct.

Andrew Kligerman, Credit Suisse:
And you consider the current share price well?

Marty Klein, Chief Financial Officer:
Well, it's been moving around. Still low, but it’s less low than it was a day or two ago.

Jim Belardi, Chairman, CEO and Chief Investment Officer:
Well, no, I said, look, we see what the stock is doing today and we expect to be in the market tomorrow buying shares.

Operator:
Ladies and gentlemen, as a friendly reminder, please limit yourself to one question. The next question will come from Ryan Krueger with KBW. Please go ahead.

Ryan Krueger, KBW:
As we're now in 2020, can you give us an update on your expected capital generation as you have, I guess, did in the past for 2019?

Marty Klein, Chief Financial Officer:
Yes, it's Marty. I think I would expect that in 2020, we'd have roughly another close to $2 billion of earnings coming off the in-force, the combination of statutory earnings and capital released on the run-off and then - we've been typically investing about a $1 billion of that into organic, so I would expect year-over-year we'd have kind of a net increase, maybe a $1 billion. We also may ramp up alternatives a little bit, which uses up a little bit of that excess capital.

But I'd expect excess capital, away from doing inorganic deals and away from share repurchases, to grow maybe a $0.5 billion, maybe a little bit more. One thing I'd note is that in 2019, our full year statutory earnings on kind of a normalized basis were about $1.4 billion. So that's a really strong statutory earnings number, considering how quickly we're growing, we continue to print very strong statutory results.

Ryan Krueger, KBW:
So, the net would be about $1 billion, but then there's some other impacts, some alts that…

Marty Klein, Chief Financial Officer:
Maybe a little bit less - yes, maybe a $0.5 billion to a $1 billion from the activity we see on organic growth and investments, somewhere in that neighborhood.

Operator:
Our next question will come from Brian Meredith with UBS. Please go ahead.

Mike Ward, UBS:
This is Mike Ward on for Brian Meredith. I just had a question on retail sales. They were a little softer in 4Q, which makes sense, given those pricing actions. And I think we can see the benefit kind of flowing through cost of funds. But just wondering for how long you would expect those sales to be a little bit pressured in the retail channel? I know you've mentioned you expected the actions could help in the back half of, I think, 1Q, but would you say kind of this 4Q level is a good run rate going in the near-term?

Bill Wheeler, President:
Mike, it's Bill. I actually think we will probably do better than the 4Q run rate. It's just how much better. Our expectation is that best case, sales will probably be flat year-over-year, which means the fourth quarter run rate would have to improve, and I do expect that. Remember, a couple of things happened. We don't have industry data yet for FIA sales, but the anecdotal information is that it was a soft quarter, which it often is when the stock market does really well. You sort of see a link to lower FIA sales and when the market gets choppier, FIA sales tend to improve when consumers remember that they can actually lose money and they might want their principal protected.

So I think you'll see some improvement both in the overall macro environment for FIAs and then, obviously, I think our results are going to look a little better too because of these relationships that we've sort of just implemented with some key distributors and also because we took some pricing action here in February.

Mike Ward, UBS:
And then just a quick follow-up. Just wondering if you could provide an update on the M&A pipeline, I know you guys are always out there and evaluating potential deals, but just curious how maybe the macro environment is impacting valuations or how the pipeline looks relative to the last few quarters? Thank you.

Bill Wheeler, President:
Sure. Well, to some extent, lower interest rates, obviously, lower valuations, which probably doesn't help sellers too much, but the reality is if you look at what we're working on and look at our visible pipeline, we're quite busy. And so there is still a lot of people who for oftentimes unique motives want to restructure their company, want to get ahead of LDTI are looking to generate capital, so that they can do buybacks when valuations are low. So, there's reasons why people are still out there considering transactions and those are the motives that people were looking at. So I would say, the pipeline is good.

Marty Klein, Chief Financial Officer:
Mike, it's Marty. One thing I might offer on your first question is that Bill commented on the rate pressures, the impact on retail, but the flip side of that is that same environment, which may reduce volumes to some extent in our annuity business tends to be beneficial to the funding agreements because a low spread type rate environment means funding agreements become a

very attractive source of funds and we can actually write pretty profitable funding agreement notes in that environment.

So, if there is any kind of pressure on retail sales and we don't know if there will be or not this early, but a good chunk of that would be offset in funding agreements we would expect.

Operator:
The next question will come from Tom Gallagher with Evercore ISI. Please go ahead.

Tom Gallagher, Evercore ISI:
Bill, just a follow-up on your M&A comments. Is it still fair to assume that you'd be looking to deploy most of your excess into one big deal or would you say it's a possibility you might do multiple mid-sized deals?

Bill Wheeler, President:
I think what makes us a little unique in the M&A market because we're not the only people who are chasing these types of liabilities, is we have the ability to do large transactions when almost - we don't have - we probably don't have zero competition for large transactions, but it's close. So I would say, given that I think it's just as hard to do a mid-sized deal as a big deal, I think there's a good chance that we may very well do a big deal and we should be able to do it at an attractive rate of return because I think the competitive environment isn't that frothy at the high end. So, I think the opportunity is clearly there for large transactions.

Operator:
The next question will come from Alex Scott with Goldman Sachs.

Russell Haug, Goldman Sachs:
This is Russell Haug on for Alex. Just a question on capital generation. If I just think about the delta between the $2 billion of excess capital this quarter and $1.8 billion last quarter, after considering the $575 million generated from ACRA and about $280 million of share repurchases, that kind of points still like a $100 million of net capital consumption from organic growth net of run-off and stat earnings. But I think there might have been some other moving pieces there. If you could just provide some detail on the moving pieces that bridge that delta?

Marty Klein, Chief Financial Officer:
Sure. A couple of other moving pieces was we had very strong statutory results in the fourth quarter, a little stronger than usual and that kind of helped the $1.4 billion that we had normalized overall. So that was probably close to $500 million in the quarter. And then we also had a little bit of an offset as we closed out PK AirFinance.

So we had the usual puts and takes with putting business to work in inorganic and capital released on run-off, but a particularly strong stat earnings quarter and we had ACRA and the check from ADIP that we got for that and then the other, not typical thing, although we hope it becomes much more typical and expect it will, is closing on things like PK AirFinance.

Operator:
The next question is from John Barnidge with Piper Sandler. Please go ahead.

John Barnidge, Piper Sandler:
Can you talk about the PRT market in the UK, you closed the inaugural transaction and maybe how you see it developing?

Bill Wheeler, President:
Sure, John. So just to remind everybody, the pension closeout market or pension risk transfer in the UK is actually bigger market than it is in the US. There is a fairly limited number of players in that market. They're challenged by how much capital they really have available to handle the volumes. So, we've had conversations with everybody who participates in that market and I would say that the consistent message is, we sure would like some other additional sources of capital via reinsurance so that we can do more business volume and get good returns.

And so, that's how we're participating. We're having discussions with all of these players in the UK market about how we can partner with them and bring in new pension volume, as well as deal with other existing pensions. The transaction we just did was slightly different than that, but very similar where it was again a reinsurance transaction to Bermuda.

I would say what's interesting about this market is while the US market feels very competitive right now, and because I think everybody has woken up and realized this is a good market to be in, the UK market doesn't feel as crowded or competitive, and it also sort of feels like a market where we can earn very good returns. So, kind of back to Marty's point, I'll just use this opportunity to say, please don't think of Athene as a fixed annuity company and that’s it. We have multi-channel distribution and different product categories, different end markets.

And I view the two markets that are really going to help us this year are both funding agreement backed notes and the UK PRT business. So, I expect significant volumes there, I expect significant volumes at attractive returns. So, that's exciting.

Operator:
The next question is from Erik Bass with Autonomous Research. Please go ahead.

Erik Bass, Autonomous Research:
Marty, when you're talking about the 110 to 120 basis points ROA, what are you assuming for the return on Apollo shares as part of that?

Marty Klein, Chief Financial Officer:
We should really leave it to Apollo to kind of give guidance on how they think the results will do, but we've kind of assumed sort of a long-term return that's in line, maybe somewhat better, but in line with our alternative results. And then at this point, as I said earlier, we expect a tax rate that's probably going to be around 20%, although that could be a little volatile as well as some discount that we're likely to apply.

But it was certainly a return that, if I had to ballpark it in our long-term assumptions, it's probably on a pre-tax basis close to 12% pre-tax, pre-discount. And that's the combination of dividends as well as stock price change and obviously stock price changes are very hard to predict and can be somewhat volatile.

Operator:
The next question is from Jimmy Bhullar with JP Morgan. Please go ahead.

Jimmy Bhullar, JP Morgan:
So, I had a question just first on this competition for - in the retail sales market. If you could talk about what you've done in terms of crediting rates for retail annuity sales, given the decline in interest rates? And are you seeing competitors reduce crediting rates as well, given the drop in rates?

Bill Wheeler, President:
Sure, Jimmy. So with regard to MYGAs, our MYGA crediting rates now are so low, they are not very attractive. And so our retail sales of MYGAs are approaching zero. And so, there - now, indexed annuity business is different, right, it - between new products and some new pricing actions in recent quarters. Remember, I think on my last call, I said if anything we've probably overdone the pricing and we've sort of reversed some of that as sort of the - as the tenor has calmed down, its still low but it’s calmed down.

Others have finally followed suit in terms of crediting rates. And so I think there - the playing field feels a little more level than it maybe did couple of months ago. That said, it's hard to tell what's going on because it's clear that industry sales were lower in the fourth quarter. And so we'll have to see how 2020 shakes out from a macro perspective.

Operator:
The next question is from Humphrey Lee with Dowling & Partners. Please go ahead.

Humphrey Lee, Dowling & Partners:
I appreciate the color in terms of the NIER outlook and some of the moving pieces. But if I drew down a little bit further looking at different asset classes, there is notable improvement quarter-over-quarter specifically for CMBS. So you talked about some of the changes for RMBS, but I was just wondering, is there something kind of different for CMBS this quarter in terms of the asset class earned rates?

Marty Klein, Chief Financial Officer:
Yes. Humphrey, it's Marty. What you see in that CMBS rates that you're looking at is some of the bond call income that we had, which was a little more favorable than we might typically expect, some of that came through in CMBS redemptions and so that kind of popped up the NIER in CMBS in the fourth quarter. So as I said, that's kind of a tailwind that we wouldn't expect to continue quite as much as part of the overall 8 to 10 basis points of favorability that probably won't repeat necessarily.

Operator:
The next question is from Suneet Kamath with Citi. Please go ahead.

Suneet Kamath, Citi:
Just I guess for Marty just to walk through the outlook for 2020. It sounds like on the NIER side, results in the fourth quarter were better than what you were guiding to in 3Q and it sounds like maybe there is a change to the prepayment speeds. But then also if I recall, maybe you took up your alternative return expectations for next year versus what we were expecting for this year. So, you maintained your overall ROA guidance of the 110 to 120 basis points so I just want to see if I have those pieces right and then are there some offsets that we should be thinking about or do you think you'll be more towards the upper end of that range?

Marty Klein, Chief Financial Officer:
No, you've got those pieces right, Suneet. I think - I don't think our expense ratio, which typically drops each year, is going to really drop this year as we're making some investments to get more efficiencies over time and we're adopting these accounting things. The other thing is that I expect a slightly higher tax rate this year, I'll call it, 9% versus say 8% in the year for 2018. So, I think the combination of those things are slightly offsetting to the other kind of good guys that you mentioned.

Operator:
The next question is from Mark Hughes with SunTrust. Please go ahead.

Mark Hughes, SunTrust:
The funding agreement, it sounds like the outlook is very healthy there. Could you talk about kind of how much you've got in the near-term pipeline and kind of more broadly what is driving that?

Bill Wheeler, President:
Well, before we had this call, Belardi was bragging about what - things were looking really bright, the future was so bright, he’s going to have to wear shades. Look, it’s always hard to know how markets could turn on you later in the year, but right now, it's an attractive a market as we've had since we've gone public. Would you agree with that, Jim?

Jim Belardi, Chairman, CEO and Chief Investment Officer:
I would, Mark. I would just add, I think you should think of this funding agreement product for us in three different pieces, there is the capital markets funding agreement backed notes. We talked about, we did our first 7-year most recently, 5-year is probably our sweet spot in general, but haven't done anything in the three-year spot in a while and that's the easiest to execute and you can do it in size. But 3, 5, 7 and 10 is really the market for that. Then there is the private funding agreements issued to the Federal Home Loan Bank, which is essentially secured borrowing that comes with higher returns because the cost of funding is lower.

So, we're going to do some of that, probably more of that this quarter than we've ever done. And then there is funding agreements, not funding agreement backed notes, but funding agreements. So that's the second. The third is non-dollar currency funding agreement backed notes issued off our program that we've done none of yet, but optimistic we'll do some of that this quarter as well. So those three pieces we think we should execute on this quarter, and that leads to our optimism.

Operator:
The next question is from Ian Ryave with Bank of America. Please go ahead.

Ian Ryave, Bank of America:
My question is on the minimum guarantees for deferred annuities. So, if you look at the account value of the the accounts that are actually minimum guarantees, it's declined a bit year-over-year. I would have expected the percentage to kind of go up as you kind of take gradual rate action on the book. Just want to get some perspective on that and where you think that's trending?

Bill Wheeler, President:
Well, it's pretty stable actually, mainly because remember we're issuing new business all the time as well. And we're not at minimums there, right, we're wherever the market is at the moment. So, there is old stuff which is rolling off and a lot of that old stuff was all minimums. New stuff we're selling today, which is not. But you're right, we also are taking rate action on

the existing in-force, which is causing it to tick down. So there is really sort of three moving pieces there. And that's why it actually probably got a little better this quarter.

Operator:
The next question is from Elyse Greenspan with Wells Fargo. Please go ahead.

Elyse Greenspan, Wells Fargo:
My question is on ACRA. So, you guys got funding up there to $3.2 billion in the quarter. I'm assuming the goal is to keep raising funds there. If you can just provide an update? And my second question would be within the ROA guide you guys gave for 2020, what's the assumption that you guys have for the fees that you're going to earn on ACRA?

Bill Wheeler, President:
So, with regard to ACRA fundraising, we're at $3.2 billion, we're having, I would say, kind of closing discussions with a couple other investors so we expect that number to grow. The original goal was $4 billion. I don't know if we'll quite get to $4 billion or not before we finally stop, but it will just kind of depend.

But in our minds, we're effectively done, right and we're moving forward. We're certainly going to raise more than $3.2 billion, but will we get all the way to $4 billion, I don't know. So, that's kind of where that stands. And then with regard to fees –

Marty Klein, Chief Financial Officer:
By the way, I would just note, we've already had close to $600 million of ACRA capital - or ADIP capital, I should say, deployed into ACRA. With respect to management fees, we actually had a couple million of management fees in the fourth quarter with the closing of ACRA sale to ADIP at the beginning of the quarter. And that's roughly 15 basis points on the reserves, where the ADIP shareholders have the beneficial interest and we get about 15 basis points in that. The biggest driver of increases in that is going to be how ACRA grows and the guidance that we gave.

We didn't build in any inorganic transaction in that guidance, obviously, that's going to move around the guidance quite a lot if there was a deal, particularly a large deal. But, we do expect that PRT business that we do, a good chunk of that will - most of those deals, if not all those deals, will go into ACRA. But I don't expect the fees by the end of the year in the absence of an inorganic deal to be all that meaningful, maybe $2 million to $3 million a quarter in the absence of an inorganic transaction.

Operator:
Our final question is a follow-up from Tom Gallagher with Evercore ISI. Please go ahead.

Tom Gallagher, Evercore ISI:
Hey Jim, just a question on credit. I noticed some other companies I cover have taken energy and some retail related credit impairments in the last quarter or two and just curious what you all are seeing on the credit side, what kind of losses you've seen, I presume they haven't been large, but is there - I don't know, can you quantify both OTTIs and realized losses that you've seen and what your outlook is heading into 2020 in any areas that you're particularly focused on?

Jim Belardi, Chairman, CEO and Chief Investment Officer:
Look, we think our portfolio is in good shape. We've been, I think, pretty vocal about our efforts to upgrade, in general, the credit quality of the portfolio, buying more single As than we had in the past compared to BBBs. Within BBBs, upgrading them to the higher levels of BBBs.

Look, Marty may add something on impairments, but in general, they've been pretty consistent, low levels, even with a growing portfolio. I think in general, our view, especially in our corporate portfolio, Tom, is there's more risk to downgrade, meaning more capital required than there is to us for permanent impairments. Being in the investment-grade public corporate bond space, most of the issuers are BBB.

So to be in that space, you're going to own some BBBs, but not all BBBs are the same, obviously, and looking for companies with high capital ratios, et cetera. So, there's nothing really noteworthy to comment on as far as our expectations of losses of increasing. We don't expect that. We're continuing to be diligent on continuing to upgrade the credit quality of the portfolio.

Marty Klein, Chief Financial Officer:
It's Marty. I would just note that for the year, we had, call it, 3 basis points of impairments for the year call it in dollar terms around $38 million. Most of that is actually in energy companies, and another notable pharmaceutical one. But I think you're right, Tom. In the fourth quarter, we didn't have any energy related impairments, but we did certainly see some of that earlier in the year and that's by the biggest chunk of the 3 bps that we had for the full year.

Jim Belardi, Chairman, CEO and Chief Investment Officer:
Just further to close out the comment, within energy, 92% of our bonds in energy are NAIC 2 or higher. And we really focused on the midstream space, which we think is more insulated than others. There's been a lot of recapitalizations going on in the space, so look at it all the time, but we feel very good about our energy exposure.

Operator:
At this time, I would like to turn the conference back over to Noah Gunn for any closing comments.

Noah Gunn, Head of Investor Relations:
Thanks everyone for joining this morning. If you have any follow-up questions regarding our results or anything discussed on today's call, please reach out to myself or Sue Lee, and we look forward to speaking with you all again next quarter. Thank you.

Operator:
This does conclude today's Athene Holdings fourth quarter and full year 2019 earnings call and webcast. Please disconnect your lines at this time and have a wonderful day.