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APO - Q2 2015 Apollo Global Management LLC Earnings Call

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PRESENTATION

Operator

Good morning and welcome to Apollo Global Management's 2015 second-quarter earnings conference call.

(Operator Instructions)

This conference call is being recorded. I would now like to turn the call over to Gary Stein, Head of Corporate Communications.

Please go ahead.

Gary Stein - *Apollo Global Management LLC - Head of Corporate Communications*

Thanks, Crystal.

Welcome, everyone. Joining me today from Apollo are Leon Black, Chairman and Chief Executive Officer; Josh Harris, Co-Founder and Senior Managing Director; Jim Zelter, Global Head of Credit; and Martin Kelly, Chief Financial Officer. Leon, Martin, and I will review some prepared remarks. Then Josh and Jim will be available with us during Q&A session. I would also point out that Josh is calling in from overseas.

Turning to our results, earlier this morning we reported non-GAAP economic net income of $0.38 or share and distributable earnings to common and equivalent holders of $0.48 share for the second quarter, of which $0.42 share was declared as the cash distribution.

Before I hand the call over to Leon, I wanted to remind you that today's conference call may include forward-looking statements and projections. And we ask that you refer to our most recent SEC filings for factors that could cause actual results to differ materially from these statements and projections, as well as risk factors relating to our business. We don't undertake to update our forward-looking statements or projections unless required by law.

We'll also be discussing certain non-GAAP measures on this call, which are reconciled to GAAP figures in our second-quarter earnings presentation. This conference call is copyrighted property and may not be duplicated, reproduced, or rebroadcast without our consent. As usual, if you have questions about any information in the earnings release, presentation, or on this call, please feel free to follow up with me or Noah Gunn.

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

Leon Black - *Apollo Global Management LLC - Chairman & CEO*

Thanks, Gary.

Good morning, everyone. Amid a volatile and complex backdrop, we continued to identify opportunities for growth during the second quarter. I'd like to focus my remarks this morning around a few key drivers of our business, including the continued strength of our management business, as well as recent fundraising and deployment activity.

As you know, we have been very focused on growing the Management business contribution to the overall profitability of the Firm, particularly since it provides a steady and predictable source of cash flow. The revenues we generate in our Management Business are primarily derived from management fees we earn from long-lived assets we managed, more than $75 billion of which are in permanent capital vehicles. In addition to driving top-line growth in our Management Business, we also remain focused on margin improvement.

During the second quarter, our Management Business generated pre-tax distributable earnings of $0.27 per share, or more than $1 per share of cash on an annualized basis, which we believe represents a strong base of cash flow to our shareholders. In the context of our current share price, the $1-plus of annualized cash flow per share from our Management Business alone represents a current yield of approximately 5%. This is before any of the upside cash earnings potential from our Incentive business, where we have more than $80 billion of carry eligible assets under Management.

Turning now to Fundraising. By leveraging our integrated platform, we generated inflows of $3.2 billion during the quarter. Similar to the previous quarter, our fundraising activity came from a variety of our investment strategies and reflects the continued growth and diversification of our business. We received $1 billion from the expansion of our existing strategic investment account with the Teachers Retirement System of Texas, or TRS, bringing the total size of this account to $4 billion.

It's worth noting that this total does not include a separate credit mandate of up to $1 billion more from TRS, one-half of which is expected to close during the third quarter. We believe the highly successful partnership we've been fortunate to establish with TRS over the past few years is a powerful example of the strength of our integrated investment model and our ability to deliver value across a range of alternative investment solutions.

In addition to the incremental capital we received from TRS during the second quarter, there were a few other inflows during the quarter we'd like to highlight including: one, more than $500 million from a final closing for our new Energy Opportunity Fund, bringing the total for this fund to just over $1 billion. Secondly, nearly $300 million from a follow-on closing of our third Structured Credit Recovery Fund, bringing the current total for this fund to nearly $800 million at quarter-end. And third, over $550 million of combined new equity and leverage at MidCap, bringing MidCap's total gross assets to $3.3 billion.

In addition to these capital raises, we are also continuing to see positive net flows in some of our open-end strategies, including our credit hedge funds and total return funds. As many of you know, we're actively marketing our second natural resources fund and are approaching a first close for the fund.

Lastly on inflows, I'd like to point out that we completed the acquisition of a real estate private equity manager in Asia during the second quarter. The team that came aboard expands our integrated investment efforts throughout Asia. And this transaction added approximately $600 million to our real estate AUM.

Next I'd like to highlight the significant capital deployment activity that occurred during the quarter. Across the broad Apollo platform, the funds we manage committed or deployed nearly $3 billion, which we believe will drive future carry and realization opportunities for our investors. Despite an environment in which valuations generally remain quite high, our investment teams continue to utilize the various pathways we have created to deploy capital, defined what we believe to be attractive value-oriented investment opportunities.

In private equity, the funds we manage were particularly active during the quarter, investing or committing to invest $2.4 billion. Included in this $2.4 billion total is approximately $900 million that was invested during the quarter in transactions such as CH2M, which is a leading engineering services firm; Carige Insurance in Italy; and the funding of American Gaming Systems' acquisition of Cadillac Jack. In addition to the closed deals, there were various new investments announced by the funds we managed during the quarter, with combined total commitments of $1.8 billion.

These pending investments as of June 30, 2015, included the acquisition of the two alarm services companies, Protection 1 and ASG, to create an industry leader; secondly, the corporate carve-out of Verallia Packaging from Saint-Gobain; thirdly, the acquisition of Slovenia's second-largest bank, NKBM; and lastly, the go private transaction of specialty materials firm, OM Group.

Following the announcement of these recent investments, the committed but not yet deployed capital of the private equity funds we managed was $3.5 billion as of June 30, 2015, of which $1.6 billion was related to asset build-ups in the energy sector that is expected to be deployed over time, with the balance related to deals that have been signed but not yet closed.

As of the end of the quarter, Fund VIII is still less than two years into its six-year investment period. And the fund has invested or committed nearly one-third of its capital in a diversified portfolio of investments that we believe will generate meaningful long-term value for Fund VIII's investors.

And I would just add that we're particularly proud of the fact that we have kept to our value orientation, and that Fund VIII is approximately invested at a 6.5 multiple of EBITDA in a 10 multiple environment right now. So I think that discipline is one that we are keeping.

In Credit, the funds we manage deployed $1.4 billion across a variety of strategies, including energy lending, CLO debt and equity, and other opportunistic credit investments. And in real estate, our real estate funds and accounts deployed more than $600 million, primarily in commercial real estate and investments. Across the Apollo platform, our funds currently have nearly $30 billion of dry powder available to invest. We continue to evaluate an active pipeline of opportunities to put additional capital to work.

Before I return the call over to Martin, I'd like to say a few words around a significant milestone in our history. I am pleased to note that Apollo is now celebrating its 25th anniversary, marking 2.5 decades of incredible growth and strong investment performance, of which my partners and I are extremely proud. None of this could have been imagined 25 years ago, that we would evolve from our one-room office into one of the world's leading alternative investment managers with plenty of growth opportunities still [ahead of us] (technical difficulty).

As I think about how we oriented Apollo in these early days and look at where we are today and where we are going, I'm struck by the sentiment that the more things change, the more they stay the same. At Apollo, we have found success by staying agile amid changing markets while remaining rooted in who we are. Our investment success has always centered on four key pillars.

First, our contrarian, value-oriented approach, which we believe enables us to identify opportunities by embracing complexity. Second, our integrated model across private equity, credit, and real estate, which we believe is a true differentiator. Thirdly, our pursuit of superior investments performance, which is driven by our ability to identify the best risk/reward for our investors across investment cycles. And lastly, our deep bench of extraordinarily talented professionals, many of whom have been with us since our early days and others who have been integrated into the fabric of our culture more recently.

At Apollo, we believe our success begins and ends with our relentless drive for good investing, which means it begins and ends with our people. From leaders across our business, like Jim Zelter in Credit or Scott Kleinman in Private Equity, to our most recent hires just starting out, performance and people are inextricably linked. As we continue to grow, we will always seek out the most tenacious, smart, and creative professionals to join our team and help us push forward.

That's how we expect to continue to create and capitalize on the most attractive opportunities for our investors, fueling growth across our platform, and executing innovative strategies. When we established the Firm 25 years ago, we set out to build something that was different, something that would last and something that would outperform.

We're very proud of what we've accomplished and believe that the continuity of our strategy and the strength of our amazing team is a truly winning combination. As I look to the future, I know the best is yet to come for Apollo. And I can't wait for what our Firm accomplishes next together.

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

Martin Kelly - *Apollo Global Management LLC - CFO*

Thanks, Leon.

Good morning again, everyone.

Starting with our economic earnings for the quarter, in the Management Business we earned $92 million of economic income, which was in line with the prior quarter. While we continue to carefully manage our cost base, looking forward, we expect compensation and non-compensation expenses to rise as we continue to grow the platform.

Specifically, over the second half of the year, we expect to incur fund placement fee expenses of approximately $13 million related to various fundraising initiatives, primarily reflecting expanding distribution relationships with wealth management platforms. As Leon mentioned, we remain focused on expanding our Management Business through top-line growth and disciplined cost management, further driving our margin, which we believe is already industry-leading among our peers.

Turning to the Incentive Business, in private equity the 2.7% appreciation in the second quarter was driven by 1% appreciation in publicly traded portfolio company holdings and 4% appreciation in private portfolio company holdings. With $14 billion of unrealized value across the private equity funds we managed at the end of the second quarter, this generated total carry of $81 million during the quarter.

In Credit, the investment performance of the funds we manage was positive, up approximately 1.2% on a gross basis and 0.8% on a net basis for the quarter, excluding the non-sub advised assets of Athene. Despite the positive fund performance, carry income was on the lighter side, as one of the drawdown we managed that was earning accelerated catch-up carry reversed course and returned some of the accelerated carry that was previously accrued, as is convention.

I'd also like to note, however, that we continued to see growth in both carry-eligible and carry-generating AUM within the Credit Business during the quarter. In fact, carry-eligible AUM in Credit is higher than it's ever been, so we remain optimistic about the performance fee earnings potential in this business.

Lastly, on the Incentive Business, there was a discretionary incentive pool compensation accrual in the quarter of $20 million within realized profit-sharing expense.

Next, I'd like to provide some additional information on Athene's impact on our results this quarter. First, within Other Income in the Incentive Business, we realized a $25 million increase in the valuation of our direct ownership stake of Athene. In dollar terms, Apollo's 9.2% economic interest in Athene is valued at $471 million on our balance sheet as of June 30, 2015. Note that this amount excludes the $136 million gross carry receivable related to AAA, as of June 30, 2015, that we expect to be paid in shares of Athene at a future date.

Next, the percentage of Athene-related assets invested in Apollo managed funds was approximately 24%, or $14.4 billion, as of June 30, 2015, up from 22% as of March 31, 2015. We expect the sub-advised assets under management to continue to increase gradually over time, as long as we continue to perform well in providing asset management services to Athene and also identify opportunities to redeploy their investment portfolio.

As it relates to taxes, our ENI tax rate in the quarter of 2% was driven by a lower amount of taxable carry, as well as a tax deduction in connection with share deliveries. While subject to change based on the ultimate composition of our earnings, we currently expect our full-year 2015 ENI tax rate to be single-digit. Additionally, we expect the tax rate to normalize toward our longer-term range of 10% to 20%, previously articulated, as we enter 2016.

With regard to our cash distribution, the $0.42 that we declared today was driven by a $0.27 pre-tax contribution from our Management Business and $0.18 of net cash carry, of which $0.04 resulted from a tax-related distribution.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Luke Montgomery, Bernstein Research.

Luke Montgomery - *Bernstein Research - Analyst*

Good morning. Thanks guys. In credit, I was hoping you could just walk through the conversion of carry-eligible to carry-generating AUM. It looks like dry powder invested and invested but not earning carry AUM declined a tad. The amount of invested over 24 months is still $4.4 billion and needs about 6% appreciation, yet the carry-generating AUM increased about $2.6 billion to $23.3 billion, so perhaps you could just help me bridge the change, which is better than those indicators would have suggested?

Martin Kelly - *Apollo Global Management LLC - CFO*

Sure. You hit on a number of the points there. Within credit, the 1.2% gross return was a 2.7% gross return in the draw-down funds. And within that segment of the business, we had a number of funds that were close to carry, but not in carry last quarter, step up above the [pref]. That was really the reason for the increase. What's left, to your point, is a slightly reduced amount of AUM invested, but not in carry, but with a slightly greater gap to get to the pref.

Luke Montgomery - *Bernstein Research - Analyst*

Okay, it was the market appreciation then?

Martin Kelly - *Apollo Global Management LLC - CFO*

Yes, in opportunistic, in particular, driven by the higher-yielding assets, some of which was energy, some of which was broader base.

Luke Montgomery - *Bernstein Research - Analyst*

Okay, thanks. And then on the escrow piece from Fund VI, it always seems a little bit mysterious. You've had realizations from the fund. The remaining investments are 100% of cost versus 104% last quarter. The hurdle rate is 115%. But the balance is more or less flat at $167 million, so maybe just help me understand the puts and takes that drive that balance? There's the taxable [fan am] income that causes you to maybe distribute some of it, but what are the other inflows and outflows?

Martin Kelly - *Apollo Global Management LLC - CFO*

Sure. The escrow calculation is quite complex. The key moving parts to the calculation -- firstly, the escrow is based on what's remaining in the portfolio, so what's the value of remaining assets relative to their cost base. That ratio then is affected by a couple of different things. One is changes in value of those assets. Two is what's sold and in what sequence assets are sold, meaning higher cost base versus lower cost base, and then thirdly, any other changes to the cost base of the assets.

During the first half, we recognized an impairment on one of the assets in Fund VI. While that did not impact ENI, because we already marked it down, it did bring down the cost base of that asset and it also resulted in a diversion of cash flows from sales to the LPs. So when you stand back from it, the cash that came in from sales was diverted to LPs as a result of that impairment. The benefit of that was that it helps the escrow ratio by reducing the denominator in the ratio and it would -- all else being equal -- would result in us coming out of escrow sooner than we would otherwise.

The last point I'd make is in then that Fund VI itself lost on a mark-to-market basis during the quarter. That was mitigated by the return of capital that I just mentioned. So all of that nets off to cash is the same on a per share basis and the ratio is effectively unchanged within a couple of percentage points.

Luke Montgomery - *Bernstein Research - Analyst*

Okay. Helpful. Thank you very much.

Martin Kelly - *Apollo Global Management LLC - CFO*

Sure.

Operator

Bill Katz, Citigroup.

Bill Katz - *Citigroup - Analyst*

Okay, thanks very much. First one is actually a two-part question. I was wondering, could you lay out the timeline in terms of the elevated placement expenses for the second half of the year? And then when you step back, you been pretty active, you just linked up with Waddell (technical difficulty) you've worked with Oppenheimer. Now you have this wealth management strategy. Can you step back and tells us where you think you are strategically in terms of any real-time momentum for generating some retail flows that might boost your overall growth rate?

Martin Kelly - *Apollo Global Management LLC - CFO*

Sure, Bill I'll address the first part of the question and I'll hand it over to Gary for the second. On the placement fees, it's a couple of different funds. The most important or meaningful is our second Natural Resources Fund. Although we expect a first close of that fund during the third quarter, it's tough to predict specifically when the placement fees will be paid because they will be paid to the [wire houses] for the high net worth distribution, so it could be Q3 or Q4 or actually both.

Gary Stein - *Apollo Global Management LLC - Head of Corporate Communications*

Just on the retail component of our business, as we've said in the past, retail remains an important part of our platform and will be a growing contributor to our flows over time. Today, retail, if you include high net worth [family office] is around 15% of our AUM and we do certainly expect that to grow over time.

You mentioned, just yesterday Waddell & Reed put out a press release announcing that they had filed to launch two new mutual funds, both of which will have Apollo as a component of the funds. Specifically, it will look to replicate our total return strategy within credit, which is the more liquid end of our credit business. They hope, pending SEC approval, to launch those funds in October. We'll just have to wait on see on the timelines there.

And with respect to Oppenheimer, which we've mentioned previously, where we also have a subadvisory relationship, the shareholders of that fund did approve an allocation to Apollo and we do also expect that to begin to ramp in the fourth quarter. And then we continue to have conversations with others. We've said in the past, we do believe this subadvisory component to be very scalable and works really well in terms of marrying our less liquid solutions with the more liquid needs of daily liquidity funds. So we do expect this to grow over time.

Bill Katz - *Citigroup - Analyst*

That's follow up. And then follow-up, maybe Leon, appreciate your perspective. A couple of your peers have laid out how quickly they think they could some of their -- either their dry powder to work or more importantly some of the non-fee paying AUM yet at this point in time, so just given your thoughts about where we are in terms of market levels, how do we think about the outlook for fee-paying AUM growth, which has been pretty flat for the last several quarters?

Martin Kelly - *Apollo Global Management LLC - CFO*

Fee-paying AUM has about $10 billion of fee potential. Most of that is in credit. $7 billion of the $10 billion is in credit. Within credit, most of the draw-down funds pay fees as money is deployed versus as it's committed, so I would look at the pace of deployment in credit, which was $1.4 billion in the quarter, $2 billion on a year-to-date basis, and if you go back in time, $5 billion last year, $3 billion the year before. That's probably, if you average that, that's probably a good run rate to think about as that fee-paying AUM is put to work, realizing that not all of that is earned on deployed, some of it's earned on committed, but the majority of it is.

Bill Katz - *Citigroup - Analyst*

Okay, thank you.

Operator

Chris Harris, Wells Fargo.

Chris Harris - *Wells Fargo Securities, LLC - Analyst*

Thanks, guys. Wonder if you could provide a little bit more commentary of the real estate manager you acquired in Asia, what the plans are there, how quickly you think you can scale that and what the potential opportunities might be?

Josh Harris - *Apollo Global Management LLC - Co-Founder & Senior Managing Director*

I'll take that. We're building an opportunistic Apollo-esque business in Asia. It's hard to do that. Therefore, this business is likely to start -- and this is a great team that had a great -- was our style of investor. So by joining with us, we provide oversight and distribution to this team and it links very well with the existing private equity and credit platform that we have and it creates a special situations approach.

I would say this will be a small but growing part of our platform. If you think about Asia, today Asia is between 1% and 2% of our assets, and clearly there's a lot of upside there, but the trick is doing it in an opportunistic Apollo-esque way, and many of the investments in Asia are higher priced and the creditors' rights and legal systems in many countries are difficult. So you have to pick your spot. So we today are very focused on ramping Asia. We think Asia could grow significantly, but we're growing off a small base.

Chris Harris - *Wells Fargo Securities, LLC - Analyst*

Okay. Understood. And my one follow-up would be, as you guys continue to ramp Fund VIII, are there any restrictions to where that fund can invest, whether it's by sector or individual holdings? I'm just wondering if there's any concentration limits, particularly for that fund?

Josh Harris - *Apollo Global Management LLC - Co-Founder & Senior Managing Director*

There's no -- the limitations are very sparse but what we tend to do is apply common sense limitations. When we get to an industry -- when we get to 20%-ish to 25% of a fund, and even in a broad industry categorization, we tend to back off. Then we rarely will go above 10% of a fund in any one investment. Even 10% is a lot.

I would say that in general, the US has been 75% to 80% to 85% of everything we've done and Europe and the rest of world have been the balance. When Europe and the rest of the world are interesting, we tend to do a little more, and when Europe and the rest of the world are less interesting, we tend to do little less.

But to a large extent -- usually that fund is a primarily North American fund, but we have a global network and we're always looking. Today Europe is actually quite interesting so we might [sheet] towards the higher end of that range from an international point of view. But the constraint -- that fund is highly flexible and opportunistic, but we tend to self-constrain based on common sense.

Chris Harris - *Wells Fargo Securities, LLC - Analyst*

Thanks.

Operator

Ken Worthington, JPMorgan.

Ken Worthington - *JPMorgan - Analyst*

Hi. Good morning. A couple of things on real estate. Seeing nice AUM and fee-generating AUM growth, part of it acquisition, part of it new funds. Any reason why you wouldn't or couldn't buy in Europe the way that you just have in Asia? And on your Asian manager, what do the IRRs look like

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in its legacy funder funds? And your real estate business has been a real complement to your credit business, so can you talk about how this new manager fits in the credit area as well? Thank you.

Josh Harris - *Apollo Global Management LLC - Co-Founder & Senior Managing Director*

Lot of questions there. I would say that there's no reason why we can't buy a real estate manager in Europe. We do have through -- we have been buying a decent amount of real estate through our non-performing loan business. We have a small dedicated real estate effort in Europe, but if you think about our non-performing loan platform, the underlying collateral is greater than one-half real estate. So today that's been the right way for us, we think, to get the most value.

We also have the ability to invest out of our -- we have a global real estate business that's been focused on the US. We can also use that. So I'd say that we're always looking opportunistically at [acquisitions]. If we found the right people with the right culture and the right value orientation at the right price, we would certainly buy something in Europe. Today we are getting that exposure through the means that I chatted about. So that was question one. What was the other question?

Ken Worthington - *JPMorgan - Analyst*

The other question was just on Asia. IRRs and its legacy funder funds, and then the complement of the Asian real estate business to your credit operation, which you talked about generally, but just how does the Asia component fit in?

Josh Harris - *Apollo Global Management LLC - Co-Founder & Senior Managing Director*

The legacy IRRs -- the fellow that ran the Asian real estate business came from Warburg Pincus and his IRRs, we can't disclose, but they were quite attractive. Any time we buy a manager, certainly one big component of it will be what their historic track record has been and getting behind that. So that was a big component of our diligence.

In terms of how it complements, he tends to be very Apollo-esque, so much of what he did was very highly structured debt investing, in addition to private equity investing, similar to what we've done in the private equity funds. Therefore it fits quite nicely into our credit business, in the sense that it's similar to the way our US and our European businesses work. We used the private equity fund for control-oriented distressed and credit fits in nicely above that, in stressed and opportunistic, all the way up to performing.

So clearly this gives us a way to express a view on a company in a much broader sense. So certainly it expands the number of offices we have in Asia. It expands the team in Asia. The team is integrated very similarly to our US and European teams and therefore, when an idea comes in, we look across the capital structure up and down and so it fits quite nicely.

They have a strong presence in India, as do our credit business, as well, so there's a lot of strategic synergy to the Asian real estate business. It just gives us girth there that we didn't -- expands our team and our ability to invest. We're actually quite focused on it, in terms of it being a place where we can grow both AUM and invest our capital, which we haven't even talked about.

Ken Worthington - *JPMorgan - Analyst*

Great. Thank you very much.

Operator

Craig Siegenthaler, Credit Suisse.

Craig Siegenthaler - *Credit Suisse - Analyst*

Thanks. Good morning. On the permanent capital vehicle detail on slide 13, on a profitability basis, not AUM, how do you rank the seven permanent capital vehicles in terms of incremental future growth?

Jim Zelter - *Apollo Global Management LLC - Global Head of Credit*

This is Jim. Certainly, we have got to put Athene at the top of the list. The business that they have today, and Josh alluded to it, but not only the US, but in Europe, there is quite a bit of potential M&A out of -- opportunity with that company going forward, so certainly we think that is going to be a major driver. Following our five-year plan in December, we are still very excited about the organic and M&A opportunities around Athene.

Second to that certainly has to be MidCap. MidCap has grown. We bought it a bit ago. This quarter, or year-to-date, we've added over $500 million in assets. We are very, very excited about the success of the team to date and the opportunities they are seeing in the marketplace. With the continued deregulation and deleveraging of financial institution, the middle market lending, historically, for MidCap has been really in the healthcare industry, but we have successfully through the integrated platform brought in a variety of other financing opportunities. So our long-term goals and aspirations of MidCap are just beginning and we think that will be a big driver.

Certainly it's been alluded to in the call earlier, but real estate -- the way to plate real estate in an overvalued market or a in highly valued market is to do more debt and structured solutions. We've done that through Apollo Commercial Real Estate Finance, and certainly, we believe that, that's going to steadily grow and create a variety of opportunities for -- and that team not only supplies product for that vehicle, but also for Athene, as well, on their balance sheet.

And finally, AINV, which is the BDC, that continues in a marketplace where certainly permanent capital vehicles in the credit space are few and far between. Now saying, where the book value -- that stock is trading to book value, we still believe there's nice steady growth opportunities in that vehicle, as well.

A couple of the other ones are closed-end vehicles: the Tactical Income Fund, and Senior Floating Rate Fund. Those were created to establish a path for retail investors to be involved with us, and as Gary mentioned earlier, our dialogue on [40 ac] products with Waddell and Oppenheimer, we still feel those will be future opportunities. So really just to summarize, really we've got put Athene at the top, followed by MidCap, commercial real estate and the BDC, those of the four areas of the real drivers of continued growth.

Craig Siegenthaler - *Credit Suisse - Analyst*

Then just circling back to MidCap, which has $3.3 billion in AUM now, what -- can you remind us what the AUM growth targets are for MidCap and how we should expect that to be funded between debt and equity?

Jim Zelter - *Apollo Global Management LLC - Global Head of Credit*

We talked about it being a driver for growth in our five-year plan in December, but we did not really get into details about it. But this is a business that, compared to a variety of commercial finance companies, it has leverage facilities anywhere from 3 to 4.5 to 5 times, but certainly it has a broad base of financially facilities. But certainly, looking at the growth multiples of where it is today over an extended three-year period was certainly within our grasp and aspirations.

Craig Siegenthaler - *Credit Suisse - Analyst*

Got it. Thanks for taking my questions.

Gary Stein - *Apollo Global Management LLC - Head of Corporate Communications*

Thanks.

Operator

Devin Ryan, JMP Securities.

Devin Ryan - *JMP Securities - Analyst*

Thanks. Good morning. Maybe just starting with credit, the reversal on the catch-up carry that was highlighted, how much was that, and then also how much is left of the catch-up carry there?

Martin Kelly - *Apollo Global Management LLC - CFO*

That was in one of the European funds. We haven't disclosed the amount -- the impact on the quarter was about $0.03 a share, in terms of negative marks.

Devin Ryan - *JMP Securities - Analyst*

Got it. Okay, great. Then just following up, with respect to energy, obviously the pullback here on prices. I know that the last update you guys had said that 75% or so of your exposure was hedged over the next several years. So just curious, at what point of energy prices, commodity prices, we're going to have to revisit marks, and is that still the case, that the vast majority is hedged out for the next several years?

Josh Harris - *Apollo Global Management LLC - Co-Founder & Senior Managing Director*

I will take that. I would say that certainly we're pretty fully hedged. We're significantly hedged through 2015 and then it rolls off in 2016 and 2017. So if we see now -- so that's the answer, that certainly the companies that we own in private equity will start to be impacted. If you think about our exposure though, it is relatively small when you compare it to the capital we have let yet to invest.

The team has been very conservative about how much leverage they put on their business -- the businesses and the prices they have paid and liquidity that they have available. So I feel that -- A, the current energy cycle is going to be -- and then we also have a large amount of undeployed credit dollars work we're sitting and waiting.

So we've been quite public about the fact that we see it getting worse before it gets better. We were a little surprised at the increase in pricing. That's pulled back at this point. We thought the markets were wildly aggressive when, during the fourth quarter of last year and early this year, they -- there was a record issuance of equity and debt, to in essence band-aid many of the energy companies, and so we've sat back and waited.

And we feel like the market is coming towards this. So I do think that we have a small existing portfolio. It is in good shape. Certainly, at some, point prices need to go up, but I see much more opportunity than I see downsize for us in the energy space.

Gary Stein - *Apollo Global Management LLC - Head of Corporate Communications*

I would just add, to Josh's point, in credit we have been, with this integrated view and with Josh's view and Greg Beard's view about what was going on in the macro, we've been very, very cautious and thoughtful this year in capital that we have raised for energy opportunities. As Josh mentioned, the first quarter there was record equity and debt issuance and people thought that the need for solution-type capital across private equity and credit would be muted.

The reality is that issuance and those -- from debt and equity have severely underperformed in the last eight weeks, and certainly we believe, from the top-down macro, in addition to there will be a great deal of bank -- reserve-base lending, redetermination in the fall, this is when people talk about restrictive and regulatory environment, this is a good example where the arm of the OCC and the fed is going to be much more draconian with reserve-base lending and we feel we are in a great position to be able to deploy opportunistic capital across credit and private equity as a result of these macro and financing market conditions.

Jim Zelter - *Apollo Global Management LLC - Global Head of Credit*

Just to put some numbers around it, broadly speaking, if you look at our total AUM and back out fee and asset management, energy, broadly defined, is about 6% of our total AUM, as of quarter-end, and that's made up of about $3 billion in private equity exposure and about $3.7 billion across credit.

Devin Ryan - *JMP Securities - Analyst*

Great. Thanks for the update, guys.

Operator

Michael Carrier, Bank of America Merrill Lynch.

Mike Needham - *BofA Merrill Lynch - Analyst*

This is Mike Needham in for Mike Carrier. Just have a question on the real estate business in the quarter. Performance as pretty good in 2Q, but on an economic income basis, it's still relatively weak. Are there things there you can do to get the management business operate at a profit, be it an acquisition, finding other ways to scale that business or maybe something on the expense side?

Josh Harris - *Apollo Global Management LLC - Co-Founder & Senior Managing Director*

It's all scale. So in other words, the reality is we're investing in the business. As Leon mentioned, it's all about people, and we have a team that has critical mass, and so the assets are catching up. To a large extent, cost-cutting from here would be somewhat unproductive in the real estate business, on a large scale. We're always looking for opportunities to cut cost, but this is -- we have a good team, we have a global team, and now we need to raise assets and deploy them and that just takes time, particularly in a market that is overvalued, where you're a value-oriented investor.

Martin Kelly - *Apollo Global Management LLC - CFO*

And I'd just add, part of the uptick in expenses in the quarter was one-time costs as a result of the Asia acquisition, and then part of it is adding people, which will be part of the run rate going forward.

Mike Needham - *BofA Merrill Lynch - Analyst*

Got it. Thanks. And just one follow-up. The Athene mark-up, did that flow through the other income line, the incentive business, just wondering why that line was so strong this quarter? Thanks.

Martin Kelly - *Apollo Global Management LLC - CFO*

There's a number of items that go through that line, our GP stakes, as well. But most of -- the impact of the Athene mark-up was $25 million and that relates to our 9% economic interest in Athene.

Jim Zelter - *Apollo Global Management LLC - Global Head of Credit*

I would just add, Athene was marked up about 6% in the quarter, and if you want some additional detail on Athene, it continues to perform well. The Athene management team did a public investor call on June 23 and a replay of that is available through the AP Alternative Assets website.

Mike Needham - *BofA Merrill Lynch - Analyst*

Okay, thanks.

Operator

Michael Cyprys, Morgan Stanley.

Michael Cyprys - *Morgan Stanley - Analyst*

Good morning. Thanks for taking the question. Just back to real estate, you spoke about fundraising picking up there and the acquisition of the Asia real estate managers. Just bigger picture, could you talk to your overall strategy in real estate. You've been in the business for some time, but how are you building out that business today. What are some of the products, gaps, and geographies that you're looking to fill in? And is there any appetite for moving into [core-plus]?

Leon Black - *Apollo Global Management LLC - Chairman & CEO*

I would say all of the above. If you look at Apollo today, our AUM in real estate is something in the $10 billion range. If you add all the different parts, it might even be a little higher, in the $14 billion to $16 billion range. Our view, as we said last December, is we would like -- we're not projecting, but our aspiration, to double that.

Some of that's going to be organic and some of it's going to -- in terms of new product development, like what we're doing in Asia, but we are also aggressively looking to strategic add-ons, and there is really a matter of finding the right people, the right chemistry, fitting into our Apollo-esque of valuing the world. But it's an area that we would like to be a bigger piece of Apollo, but it has to make sense from a valuation and a people point-of-view.

Michael Cyprys - *Morgan Stanley - Analyst*

And any additional color you could share, in terms of products or geographies, where you're thinking about team then and potential acquisitions there?

THOMSON REUTERS

Jim Zelter - *Apollo Global Management LLC - Global Head of Credit*

Certainly, as Josh said, we do a lot more in Europe than people would look at, because our NPL business really capitalizes on that. And if you said to us right now, where's your favorite place to invest around the globe in real estate, it's key gateway cities in the US, key gateway cities in Asia, and then throughout the continent in Europe. And that's what we are doing.

As Leon said, certainly, [four] or something, it's a little bit later for us to add, but we're adding a whole host of -- we'd like to add more debt capability, more origination capability, and more opportunistic capability. But you need to have a market cycle have a little bit of choppiness and volatility, and we're six, seven years up into an upswing in that marketplace. So being patient right now, the opportunity in Asia came around. We looked at a lot of teams. That one was -- it developed in time and we're going to be patient on the other areas as well.

Michael Cyprys - *Morgan Stanley - Analyst*

Great. Thank you.

Operator

Brennan Hawken, UBS.

Brennan Hawken - *UBS - Analyst*

Good morning. We've seen a withdrawal of some sovereign wealth fund money among traditional asset managers, and obviously different liquidity profile there, but given the decline in oil, have you noticed any change in allocations, appetites, or behaviors from your sovereign wealth fund clients?

Leon Black - *Apollo Global Management LLC - Chairman & CEO*

The answer emphatically is no. In fact, our dialogues have expanded. It's a little bit the way of fundraising in general. It's a bifurcated world of haves and have-nots, and fortunately with our performance, we've been in the position of haves and that includes our relationships with sovereign funds.

Brennan Hawken - *UBS - Analyst*

Terrific. And on the levered finance funding markets, given the regulatory pressure there, are you seeing any change? Are you seeing a shadow banking system stepping in to any material degree and how do you think that this could impact deal velocity from here?

Jim Zelter - *Apollo Global Management LLC - Global Head of Credit*

What we have found in our recent acquisitions in private equity, we have not had any challenges of accessing in the market. We've really gone out to make sure that investors know what our strategy has been, what our returns have been, and we've been very positively and nicely surprised by the breadth of investors who want to spent the time to get to know us because they know that we will be a large issuer going forward.

Certainly there are some opportunities. Could we see the traditional banking financial providers be augmented by some alternative providers in our capital structures of private equity? Certainly do and not surprised by it. On the other side of the coin, our activities, whether it's in MidCap, our activities in our loan business, in a lot of our opportunistic business, we continue to benefit from that.

I do think the headlines are correct, that the leveraged lending guidelines are being followed in stricter manner by a variety of banks today and that is impacting some loan origination. Loan origination is down year-over-year about 25%. But that's not held us back from achieving our goals in CLO formation, in structured credit formation.

So as Leon said about the fundraising of the sovereigns, we're in the haves versus the have-nots, so we've been able to be able to navigate that and we have been the positive beneficiary. I see that continuing. I don't see a massive widening of new issue yields because of some players withdrawing, but I see a pretty firm market for companies that can have access.

Brennan Hawken - *UBS - Analyst*

Okay. Thanks for the color.

Operator

Chris Kotowski, Oppenheimer.

Chris Kotowski - *Oppenheimer & Company - Analyst*

This is a question for Jim Zelter. Recognizing that you invest in a lot of non-traded illiquid credit, if you look at the portion of the iceberg that is liquid and traded, it just seems like you can't get an uptick in the past year, that we've -- whether you look at the high yield indexes or leveraged credit indices, they're all down steadily in the past year.

The BDC sector, including Apollo, they all trade like we're on the brink of a recession. My question is what is the market trying to tell us? And other than energy, do you see any stress on the borrowers that would imply deteriorating credit quality in terms of coverage ratios or things like that?

Jim Zelter - *Apollo Global Management LLC - Global Head of Credit*

There was a bunch of questions there, but let's go through them one at a time. You are correct. If you look at year-to-date loan and high yield returns, loan funds are up 2% or 3%, high yields, breakeven to 1%. And the performing, our loan funds and our CLOs have done very, very well. So that part of the market.

The market you identified is whether it's the BDCs or high yield funds, there's a great deal of concern about energy exposure. There's a great deal of concern about liquidity of the underlying assets. And what you're really highlighting is the indexes are still in the black year-to-date nominally, but if you look at the amount of credit dispersion, energy, metals and mining, some of the consumer retail, there has been a lot of pain and performance out there along with names like Puerto Rico, which we're not involved in, and some of the liquidation trades, whether it was WaMu or Nortel.

So there has been a lot of pain in the stressed and distressed area of credit. Luckily, we don't have -- most of our capital is really in the performing side or in the deep distressed side. But in your BDC question, it really is more of a question of people's perception of their ability to raise equity or inability to raise equity right now because they're trading at a discount. It's really -- while it's a nice business for us, and it's a $3 billion, $3.5 billion, the other parts of our credit business are much larger, and have been a beneficiary of positive performance.

So from our perspective, whether it's what's going on in China, energy, the commodity concern of imploding commodities across the spectrum, this redetermination of energy, we think that there is going to be good opportunities for us over the next six to 12 months in terms of deploying some of our dry powder. But you are right, the indexes and headlines don't reflect the dispersion that's going on in the underlying markets.

Chris Kotowski - *Oppenheimer & Company - Analyst*

Okay. All right. Thank you.

Operator

Patrick Davitt, Autonomous.

Patrick Davitt - *Autonomous Research LLP - Analyst*

Hi, good morning. On the Athene mark, is there any group of comps we could track in those or is it really just best to pay attention to what they are reporting to the public, like you pointed to that June call, in terms of trying to track when those big marks are going to come through?

Martin Kelly - *Apollo Global Management LLC - CFO*

We value Athene -- when we raised the financing a year or so ago, we marked at the then offering price. Since then, we apply the a valuation model which is called embedded value. It is basically a DCF model of the in force business. That's affected by changes in rates, so the back-up in rates this quarter increased the value, given that it's a structurally short company, and new origination of apology policies.

We expect to move to a multiples approach once we have a current and reliable book value. And so as Athene continues working through their catch-up phase and restating their earnings, we will, likely in the next couple of quarters, get to a point where we move to a multiples approach.

Patrick Davitt - *Autonomous Research LLP - Analyst*

Okay. Great.

Jim Zelter - *Apollo Global Management LLC - Global Head of Credit*

Just wanted to clarify that with respect to Athene, they obviously -- they had restated their Q1 2014 financials. On the June 23 call, they released their Q2 and Q3 financial statements for 2014 and they should be caught up with 2014 financials by September and fully caught up by year-end.

Patrick Davitt - *Autonomous Research LLP - Analyst*

Great. And finally, could you give an update of the distribution quarter-to-date. There's a big [Hostess] recap coming through?

Martin Kelly - *Apollo Global Management LLC - CFO*

The distribution is of announced but closed transactions is $0.10 and that is related to Hostess.

Patrick Davitt - *Autonomous Research LLP - Analyst*

Okay. Great. Thank you.

Operator

Robert Lee, KBW.

Robert Lee - *Keefe, Bruyette & Woods, Inc. - Analyst*

Thanks, and I appreciate all the patience with all of the questions today. First question is, we'll do the modeling question, but I'm on page 10 of the deck. If I look at the taxes payables that drive the E, it is down $40 million year-over-year. So curious what's driving that and how -- should we assume that over the second half of the year that, that's going to bounce back towards historical norms or is this -- is there something going on here that's going to leave it below historic trends?

Martin Kelly - *Apollo Global Management LLC - CFO*

Rob, I would look at the ENI effective tax rate in the [DNI] effective tax rate. I'd say a couple of things. One is, if you compare us now this year with where we were last year, the tax rate is benefiting from two things. One is we had the CNS fee from Athene last year, which was taxable non-cash income and taxed at a high marginal rate. And since that ended last year, that has benefited the tax rate.

And we're also benefiting from, in this year, a number of stock delivery deductions. That would relate to stock that was issued back at the roll-up and it's only just being delivered now. So there's no impact of that on our share count. It's in the [fully] diluted share count, but we're getting the tax benefit for it now.

And then we're also benefiting in the tax rate from a low taxable carry period of time, so mix of taxable income to non-taxable is important to the rate. So I would say, for the balance of the year, as I said in my remarks, think single-digit, although that's subject to taxable carry. Longer-term, as we get into next year, the ENI tax rate would be in the teens, so think 10% to 20% range. The cash tax rate on a fully diluted basis will lag a bit behind that on the assumption that realizations lag behind value creation.

Robert Lee - *Keefe, Bruyette & Woods, Inc. - Analyst*

Okay. Great. And maybe a follow-up. This goes back to middle market lending and MidCap and AINV. I'm just curious -- both MidCap and AINV do middle-market leading to different permanent capital vehicles. Understanding one's a BDC, has a -- can't raise capital right, has a limit on leverage. MidCap Financial is a C-Corp, can put more leverage on it.

But in terms of at least deal sourcing or origination, are they really doing the same thing or how are their business different? And you guys have been pretty creative over the years. Is there a way of actually combining those platforms to build scale even faster and maybe grow the middle market lending business faster?

Jim Zelter - *Apollo Global Management LLC - Global Head of Credit*

Let me answer the two questions. While they are both origination enterprises, they really service a different set of clients and a different product set. MidCap really is a senior secured lender. Typically they're lending whether it's an ABL or revolver or term loan, at leverage points of 3 to 4.5 times and for that they get LIBOR [450] to [550], [600].

As you're correct, that entity then can have some financing such that you get return on equity with that type of loan with 3 to 4 turns of leverage in the low to mid-teens. That is a business that MidCap is pursuing, so a variety there -- they're servicing middle-market sponsors and other corporations, really as a senior secured lender.

The BDCs for the most part, not only Apollo but all of our peers, we -- because of the leverage limitations of 1 times and you never really want to operate at 1 times, you typically operate between 0.5 and 0.7, making that LIBOR plus [450] to [500] loan, you are not able to lever that enough to actually have the return requirements. So you are much more of an enterprise or a -- while you want to be a senior lender, you're lending more as an enterprise risk than really a cash flow senior secured lender.

So it is two different markets. We work very well together. We source together. We hand transactions back and forth. So it's a very, very -- it's an integrated approach with our coverage model. And certainly, we think of ourselves as creative and that there's a time in the future where either the leveraged lending changes in terms of what a BDC can do, that may give us more opportunity to us, but right now we look at the businesses that they pursue, while integrated yet distinct and unique to each other.

Robert Lee - *Keefe, Bruyette & Woods, Inc. - Analyst*

Thanks. That's helpful. If I could squeeze in one more quick question on Athene. Delta Lloyd, if I remember correctly, that was expected to close later, at a few billion of assets. Is that still the case?

Gary Stein - *Apollo Global Management LLC - Head of Corporate Communications*

Yes, Delta Lloyd, it is $6 billion of assets and on target to close during the fourth quarter. And as we said, really Athene looks at Delta Lloyd as potentially a platform within the German market. And looks to that potentially as a vehicle to consolidate the German market just as they've done in the US over the past five years.

Robert Lee - *Keefe, Bruyette & Woods, Inc. - Analyst*

Great. That was it. Thanks for taking my questions.

Operator

Thank you. That concludes the Q&A portion of today's call. I will now return the floor to Gary Stein for any additional or closing remarks.

Gary Stein - *Apollo Global Management LLC - Head of Corporate Communications*

Thanks, operator. Thanks everyone for joining us this morning for the call. As we said, if you have any follow-up questions, please feel free to circle back to Noah Gunn or myself.

Operator

Thank you for participating in the Apollo Global Management's 2015 second-quarter earnings conference call. You may now disconnect.
