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APO - Q4 2016 Apollo Global Management LLC Earnings Call

EVENT DATE/TIME: FEBRUARY 03, 2017 / 3:00PM GMT

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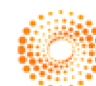

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PRESENTATION

Operator

Good morning and welcome to Apollo Global Management's 2016 fourth-quarter and full-year earnings conference call. During today's presentation, all callers will be placed in a listen-only mode, and following management's prepared remarks, the conference will be open for questions. This conference call is being recorded.

I would now like to turn the call over to Gary Stein, head of corporate communications.

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

Great. Thanks, Operator. Welcome to our fourth-quarter and full-year 2016 earnings call and thanks for joining us.

Sitting around the table with me this morning are Leon Black, Founder, Chairman, and Chief Executive Officer; Josh Harris, Co-Founder and Senior Managing Director; and Martin Kelly, our Chief Financial Officer.

As a reminder, this call may include forward-looking statements and projections, which do not guarantee future events or performance. Please refer to our most recent SEC filings for risk factors related to these statements.

We'll be discussing certain non-GAAP measures on this call, including the introduction of FRE, or fee-related earnings, which management believes are relevant to assess the financial performance of the business. These non-GAAP measures are reconciled to GAAP figures in our earnings presentation, which is available on the Apollo website.

Earlier this morning, we reported non-GAAP economic net income of $0.98 per share for the fourth quarter and $2.36 per share for the full year ended December 31, 2016. Apollo also reported distributable earnings to common and equivalent holders of $0.55 per share for the fourth quarter

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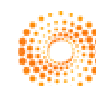

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and $1.56 for the full year. We declared a cash distribution of $0.45 per share for the fourth quarter, bringing the total for the full year to $1.42 per share.

If you have any questions about the information provided within the earnings 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.

Leon Black - *Apollo Global Management, LLC - Founder, Chairman, CEO*

Thanks, Gary, and good morning and happy new year to everyone.

When I spoke with all of you a year ago on our year-end 2015 earnings call, you may recall the world felt much different at that time compared to today. Equity markets were pulling back and credit markets were tightening, which drove a freeze in deal making for most of the market as the world anticipated a turn in the economic cycle. But signs of turmoil and forthcoming distressed investment opportunities were short-lived, and by mid-February of 2016, sentiment began to reverse course as investors regained confidence and markets charged upward through the year, along with valuations, amid historic political events around the globe.

As we reflect on the past year and look forward to the future, I'd like to walk you through some highlights of what we were able to achieve in this environment. While some years could be described as years of reaping, at Apollo 2016 was clearly a year of sowing. The funds we manage, together with co-investment partnerships, invested $16 billion in aggregate during the year, more capital in a calendar period than ever before in our history. This result may surprise you, given the prolonged high valuation environment we have been operating in over the past years.

Despite this backdrop, however, across our integrated global platform we remain committed to our value orientation and continued to embrace complexity in order to identify a variety of attractive investment opportunities at discounted valuations. We were particularly active in private equity, where the funds we managed deployed nearly $10 billion in 2016, well in excess of the $4 billion to $5 billion per year historical average, due to opportunities that arose more recently, as well as deal flow that had been in the works for the past several years.

When financing markets seized up earlier in the year, our team remained active through creative deal structuring and by leveraging Apollo's strong investor relationships. And when markets rebounded, we maintained our discipline and did not chase opportunities and we were able to identify a number of deals at attractive entry prices.

Consistent with our value orientation, the average creation multiple on investments made by Fund VIII during the year was approximately five turns, meaningfully below the industry average of some 10.5 times, so not one or two multiples slower, but actually half of what the industry average was doing. The pipeline of committed but not yet deployed capital was $2.5 billion at year-end and the team remains active on a number of fronts with plenty of new potential opportunities. Including deal activity announced since year-end, Fund VIII has committed 70% of its capital to date and we estimate the fund has approximately $3 billion remaining for investment, which dovetails nicely with the timing of the next vintage, Fund IX.

In addition, we have more than $3 billion of incremental dry powder dedicated to natural resources in ANRP(2) and we believe we are well positioned, given the investment opportunity set that continues to unfold in the energy sector.

As a leading global alternative investment manager, we have continued to solidify our position and drive our business forward through organic fundraising efforts and strategic initiatives, which accumulate permanent or long-dated capital outside of the traditional fund construct. These efforts collectively led to $35 billion of gross inflows for the year, driving us to more than $190 billion of total assets under management. $14 billion of the $35 billion in total inflows was sourced through traditional fundraising activity for mostly long-dated capital. This organic growth was driven by our teams' continued success in meeting the strong investor demand we're seeing for our differentiated investment capabilities, particularly across the credit spectrum, through raising larger successor vintage funds, bespoke managed accounts, and newer open-end products like Total Return.

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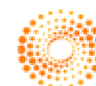

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As we look forward to 2017 and think about fundraising, the largest single driver of AUM growth will likely be our ninth flagship private equity fund, which recently kicked off an offering process. Our current expectation is for that fund to have a meaningful closing sometime in the middle of this year.

Augmenting the $14 billion of fundraising activity during the year was $18 billion of inflows related to what we broadly referred to as nontraditional asset management structures, which includes permanent capital vehicles, such as Athene and MidCap and other platforms that manage long data capital through unique structures such as AAME. We believe these initiatives are highly strategic for Apollo and can offer significant growth potential over time.

For perspective, Athene, which represents $71 billion of Apollo's AUM, was created just eight years ago. MidCap, which already has more than $7 billion of assets, became an affiliate of Apollo in 2013, and AAME was just created last year and is now advising on $14 billion of portfolio company balance-sheet assets. In aggregate, these and other nontraditional asset management structures currently represent approximately $100 billion in aggregate, or just over 50% of our total AUM, which is a significant increase from just eight years ago when these types of vehicles amounted to only $3 billion, or less than 10% of our total AUM at the time.

We believe these structures are great examples of how we can identify market opportunities and create innovative solutions to drive meaningful growth for Apollo. With respect to Athene in particular, the Company recently completed its initial public offering on the New York Stock Exchange and began trading on December 9. Everyone is very excited about the positive reception Athene has received over the past couple of months. The IPO marks another important milestone in the evolution of the Company, and as we've done from the very beginning when it was created eight years ago, we plan to continue to do our part to help drive their business forward.

While I'm proud to share these business highlights with you, it's important to acknowledge that these achievements and our path forward would not be possible without the dedicated efforts of our incredible global team. With nearly 1,000 strong and counting, we have been able to achieve remarkable feats. Since talent continues to be the lifeblood of what we do here at Apollo, we have developed a strong culture where the majority of our talent is homegrown.

That said, at times we identify talent outside the Company which we believe can have a positive impact in helping to achieve our long-term goals. A recent example of this is the addition of Gary Parr as a Senior Managing Director, who joined us just last week and will work on a variety of strategic, financial, and capital markets related matters. In addition, Gary will co-chair the Firm's management operating committee, which comprises a deep bench of our most senior leaders who work to implement and execute the Company's strategy alongside the Founders. We are very excited to have Gary join our team and believe his long career in financial services to date, sound judgment, and extensive network of relationships will be valuable to the continued growth of Apollo.

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

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

Thanks, Leon. I'd like to continue the call by providing some specific commentary around a few of our key business drivers that produced the strong fourth-quarter result and capped a year of solid performance overall.

Starting with investment performance, the funds we manage generated positive results across all of our segments for the quarter, with private equity up 5.9%, real estate up 5.3%, and credit up 2.1%. In private equity, the healthy appreciation of 6% we saw across the portfolio was driven by 4% appreciation in private portfolio company holdings and 13% appreciation in public portfolio company holdings. More specifically, Fund VIII continued to display positive momentum, appreciating by 4% in the quarter.

Energy-related private equity investments were a contributor to the quarter's strong appreciation, as evidenced by the solid performance in the stock price of EP Energy, as well as other portfolio company holdings which are private. These companies had exposure to rising oil prices.

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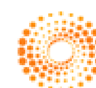

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In credit, the deposit and performance was broad based. Apollo's credit drawdown funds generated a gross return of 3.1% and our liquid performing funds delivered a gross return of 1.6% in the quarter.

As a result of strong investment performance across our platform during the quarter and over the past year, there has been significant growth in carry-generating assets. Only $27 billion, or one third, of our carry-eligible AUM was generating carry at the end of 2015. At present, the pool of carry-generating assets has more than doubled to $56 billion, representing nearly two-thirds of our total carry-eligible assets. Looking at this another way, excluding dry powder, $0.87 of every carry-eligible dollar in the ground today is generating carry.

As I mentioned last quarter, we believe this dynamic of carry-eligible assets moving into carry-generating territory and continuing to grow these assets as funds we manage build value as more capital gets invested sets the stage for the possibility of substantial realized carry income that could be distributed to investors in the future. We believe the public markets have largely ignored the embedded value of this upside potential, and for the most part it is not reflected in the current stock price of our Company.

Turning to asset growth and fundraising, as Leon mentioned, we generated nearly $35 billion of inflows across the platform during the year, including $7 billion in the fourth quarter. Our credit business generated more than $5 billion of the quarter's inflows, including a $2.6 billion first closing for our third European Principal Finance Fund, a strategy which is primarily focused on buying portfolios of assets and businesses from financial institutions in Europe. Fundraising is ongoing and, as previously mentioned, we believe this vintage will meet or exceed the size of its predecessor fund, which reached $3.4 billion in total commitments.

There were $1 billion of inflows related to Apollo Asset Management Europe, AAME, resulting from the onboarding of new assets from the balance sheet of existing portfolio companies. We raised more than $700 million across a variety of liquid performing credit strategies during the quarter, including total return, credit hedge funds, and emerging markets' debt. We also raised more than $650 million for a new strategic managed account relationship.

And finally, MidCap grew by more than $500 million during the quarter, reflecting continued origination activities for their direct lending business.

Within private equity, during the quarter we held a final close for our second natural resources fund, bringing commitments for ANRP(2) to approximately $3.5 billion, making it 2.5 times the size of our first vintage. This is an example of the multipler effect a product can have when the prior vintage performs well. In addition, we raised nearly $600 million of capital for equity co-investment partnerships to help finance the Rackspace private equity transaction.

Before I turn the call over to Martin, I'd like to highlight the strong level of fee-related earnings, or FRE, we generated in 2016. Fee-related earnings, or FRE, is a close resemblance to what we formerly referred to as management business distributable earnings. This quarter, we decided to transition our disclosures to align with the FRE metrics, which is much more commonly used by our sector. We view fee-related earnings as an important indicator of Apollo's ability to measure the more stable and predictable earnings streams of the business. The revenues we generate for FRE are primarily derived from management fees we earn from the long-lived assets we manage in our funds and in our permanent capital vehicles.

As we have noted in the past, regardless of the volatility in our realized carry income, we expect to distribute at least $1 per share per year in cash. This is supported by the stability and growth of our FRE. You can calculate from our disclosures that we generated nearly $1.30 of FRE per share in 2016 and that that was complemented by realized carry income to result in a total distribution of $1.42 per share. The distribution amount equates to a yield of approximately 7% on our share price today.

Clearly, 2016 was not a strong year of realized carry production. In fact, it represented the lowest amount of net realized carry income for a calendar year since our IPO in 2011. That said, given our growing carry receivable balance, which Martin will highlight in a moment, we believe the potential for increasing realized carry income is on the horizon as we opportunistically harvest gains that have been created in the funds that we manage.

Going forward, you can expect us to continue to be very focused on growing FRE, as well as realizing carry dollars. FRE is a metric that has grown from less than $0.50 per share in 2011 to $1.30 in 2016, which represents nearly a threefold increase over the past five years. An additional catalyst

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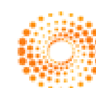

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to boost FRE is coming into view, most importantly our next flagship private equity fund that Leon highlighted. We believe FRE is an important indicator of the operational performance of the business and provides insight into our base yield earnings profile.

Now I'll turn it over to Martin for some additional comments. Martin?

Martin Kelly - *Apollo Global Management, LLC - CFO*

Thanks, Josh, and good morning again, everyone.

Turning to our results for the quarter, we generated $394 million, or $0.98 per share, of total BNI in the quarter and $947 million, or $2.36 per share, for the full year. The performance for the quarter and the year was driven by the various types of income we earn, including fee-related earnings, carried interest, and investment income.

Starting with FRE, we earned $131 million for the fourth quarter and $531 million for the full year, up significantly from 2015, primarily due to the heightened transaction fees related to the strong capital deployment trends discussed earlier. While fee-related revenue grew by 15% year over year, expenses were well managed with combined base compensation and total non-compensation expenses increasing by only 6%. Non-compensation expenses increased quarter over quarter due to the previously communicated distribution-related placement fees in the amount of $19 million, and we currently expect $7 million to $10 million more of these expenses in the first half of 2017, with more than half likely to fall in the second quarter. Excluding these placement fees, which will be fully recouped with incremental management fees over time, non-compensation expenses were roughly flat sequentially.

As we think about the outlook for FRE, we currently expect the robust capital deployment we saw in 2016 to normalize somewhat, likely offering fewer opportunities for the strong transaction fees we saw last year. However, the addition of a large flagship private equity fund would offer a sizable step function in FRE.

To put some context around it, if we were to assume the next fund is the same size and has the same terms as Fund VIII, we estimate the new fund would add approximately $0.20 to $0.25 per share of annualized FRE, before accounting for the impact of future realizations and predecessor funds.

In terms of performance fee and balance sheet related income, we earned $343 million of net carry and investment-related income during the quarter and $662 million for the full year. The results for the quarter were driven by two primary factors -- one, positive investment performance across businesses, which drove rising carry-generating AUM in all segments and produced combined carry of approximately $300 million, and two, appreciation in the value of Athene, which produced combined investment and carry income of approximately $150 million.

In private equity, carry income earned in the quarter was broad based, driven primarily by appreciation in Fund VIII and natural resources funds. In credit, carry income was also broad based, with all fund categories contributing. PE-style drawdown fund credit strategies contributed the greatest amount of carry in the quarter, with strength coming from our European Principal Finance II Fund, the Energy Opportunity Debt Fund, and the third Structured Credit Recovery Fund.

In real estate, carry income was driven by both of the US equity funds, which helped the segment post its highest quarterly economic income result to date. The most recent US fund has a 17% net IRR and is performing well to date.

Turning to Athene, the fair value increased by approximately 16% from our valuation at the end of the third quarter. The sequential increase in the valuation was driven by the pricing of its initial public offering and the upward trading activity of its stock thereafter, partially offset by a liquidity discount we applied of approximately 10%. The liquidity discount relates to the fact that there is a lockup arrangement on our shares. We expect this discount to gradually phase out by the end of 2018, concurrent with the expiration of the lockup.

The increase in the fair value of Athene during the quarter resulted in $101 million of unrealized gain within other income, as well as $48 million of net carried interest income from AAA and related accounts, driving an aggregate contribution to fourth-quarter ENI of approximately $0.37 per share.

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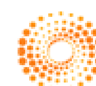

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Taking a step back and looking more holistically at our balance sheet, at year-end we had $4.31 per share of value, which is up meaningfully from just a year ago when the balance sheet value was $2.88 per share. This growth was primarily driven by the strong appreciation in the value of Athene, as well as the significant increase in the value of our net carried interest receivable, which more than doubled from $0.87 per share at the end of 2015 to $1.77 per share at the end of 2016.

With regard to our cash distribution, the $0.45 we declared today for the fourth quarter was driven by two primary factors. First, the relative cash flow stability of our fee-related earnings and the upside it can create by leveraging the Firm's integrated platform as it relates to sourcing, financing, and executing sizable transaction. And second, realized net carry driven by the crystallization of a portion of AAA carry in conjunction with the Athene IPO.

Our payout ratio for the quarter was a bit lower than recent quarters because we retained realized gains from balance-sheet investments and there was a contingent cash-based performance award related to a prior acquisition that was triggered in relation to strong carry income earned.

For the full year, our cash distribution of $1.42 per share represents a 91% payout ratio, in line with our historical average.

One last topic I'd like to touch on is taxes. You may have noticed that our DE tax rate was very low in 2016 versus prior years. Part of the reason for this relates to stock amortization deductions that ended last year. We expect that our 2017 DE tax rate will be in the high single- to low double-digit range for 2017.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Craig Siegenthaler, Credit Suisse.

Craig Siegenthaler - *Credit Suisse - Analyst*

There has been a nice improvement in carry-generating AUM over the last year. I think we know that Fund VIII was a really large contributor, but it also looks like a number of credit funds have been driving some of that growth. So, can you walk us through which credit funds have crossed into carry over the last year, and also which funds may be close to crossing the carry in the next couple quarters here, too?

Martin Kelly - *Apollo Global Management, LLC - CFO*

Sure, Craig. It's Martin. So we have -- within credit, we have about 82% of our carry funds that have money in the ground actually in carry and there's about $7 billion of assets that are not.

The uplift has been pretty broad based. There are a variety of sort of hedge fund-like funds that we have across the platform that all had a really positive year and were in carry versus a year ago. We have managed accounts that in aggregate contributed to the uplift. And then, our CLO business and drawdown funds all, for the most part, had strong performance.

So in the earnings deck, there's a page that shows depreciation needed for the assets not in carry to get into carry, and so of the $7 billion is a decent -- half of that has a decent way to go. I would expect that not to get into carry. We're focused on getting investor capital back for those funds, and the other half is sort of within shot of getting into carry.

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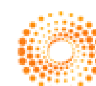

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Craig Siegenthaler - *Credit Suisse - Analyst*

Thank you, Martin. And then just a follow-up on AAMA, this kind of had a big splash in the second quarter. But I'm still wondering, when do you think that business could start generating meaningful FE AUM growth?

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

I'd say that we're -- it's now set up, it's operating. The number is actually $14 billion between Delta, Lloyd, and some of our portfolio assets.

I think that we would -- certainly we're locating capital to really buy or control -- between our private equity fund and then capital outside of our private equity fund that we would raise, we think there's a lot of opportunity to set up structures where we control or set up investor groups that control liabilities in Europe, whether they be bank liabilities, whether they be insurance liabilities, and that's a huge area, and then, obviously, we'll manage the assets at that point and our fee. So, I'd say that we expect to make progress on this in 2017. This is here and now.

Operator

Devin Ryan, JMP Securities.

Devin Ryan - *JMP Securities - Analyst*

Thanks. Good morning, guys. So Leon provided some helpful color at the end of last year just around the levels that could, I guess, potentially compel a change in the corporate structure, and so I'm sure you guys have had some more time to think about this and discuss it internally. So I'm just curious if there's anything that's changed in terms of what you're looking for out of DC around tax reform, and then if you feel any differently one way or another as you, I'm sure, are thinking about this top of mind moving forward.

Leon Black - *Apollo Global Management, LLC - Founder, Chairman, CEO*

Sure. I'm afraid that the answer is still going to have to be from 50,000 feet. We need to know a lot more as to what tax reform is going to look like coming down the pike as it relates to carried interest, as it relates to interest deductibility, as it relates to expensing capital expenses -- capital expenditures, how much are corporate and personal rates coming down. Those are kind of all the touch points that really need specificity in kind of creating the sausage here in terms of whether it makes sense to change corporate form and how so.

So the devil is going to be in the details of knowing all those things and what gets passed. But, look, it's a brave new world for all of us. I think there's a lot that could be very opportunistic and exciting and there will be some speed bumps that we'll also have to be cautious about.

Devin Ryan - *JMP Securities - Analyst*

Got it, okay. I appreciate that, and maybe just as a follow-up to some of the comments you guys were just making on credit, how should we think about the realization trajectory in that business or, I guess, cash contribution potential, just based on the types of funds that are in carry generating today? And then, obviously, you've been growing kind of the accrued carry in that part of the business as well, so trying to think about the forward trajectory of cash.

Martin Kelly - *Apollo Global Management, LLC - CFO*

Sure. So I think I'd break it into a couple of buckets. Within the carry-generating assets in credit, there is what we call liquid performing assets, including the credit hedge funds I spoke to.

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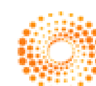

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While it's not sort of predictable, it's more stable, and so that's throwing off about $50 million of net carry a year for the last three years or so. Above that, I guess, in terms of more unpredictable of the drawdown funds, including EPS, structured credit, and the life settlements business, and like PE, it's hard to pinpoint within a time frame what the cash carry coming out of that will be. It depends on favorable asset marks realizations and meeting escrow triggers. And so, I think the only way to look at that is in the context of assets in the ground with an assumed return and carry structure and cash carry off the back of that.

Lastly, we have about $10 billion of dry powder in credit, which is largely attached to carry structures, and so with that -- with the investment, that will become both management fee income, as well as carry income, and that depends on the deployment scenario.

Devin Ryan - *JMP Securities - Analyst*

Okay. All right, thank you very much.

Operator

Mike Carrier, BofA Merrill Lynch.

Mike Carrier - *BofA Merrill Lynch - Analyst*

Thanks a lot. Maybe one just on the return outlook. I mean, I think when we look over the past two quarters, private equity has done really well. There's obviously a lot of changes going on on the policy side. I just wanted to get a sense. How have the portfolio companies been performing, and maybe more importantly, in an environment where there's a lot of change out there, how do you think -- your position? It seems like if it's pro-growth, it should be good, but obviously there's rising rates and other offsets there.

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

So first of all, the portfolio EBITDA and revenues are all up year to year, quarter to quarter. The portfolio is doing well, and obviously the portfolio -- certainly the return environment in (inaudible) at large is very, very difficult. The average multiple -- as Leon mentioned, the average multiple paid for transactions over $500 million exceeded 10 times EBITDA, and debt actually has been coming down because of regulatory pressure on the banks.

The average equity check is up and the average leverage levels are down, so we can all do the math that returns are coming down in a relatively slow growth environment. For us, obviously, it's different because we've created our portfolio at 5.5 times EBITDA, so we're in at a huge arbitrage and discount to the average player.

In terms of the environment, I would say that most of the things that are talking about policy wise are pro-growth. So lower corporate taxes, lower individual taxes, infrastructure spending, all those are pro-growth, and at the same time, obviously, I think as rates -- I think rates will go up, clearly, but when rates are going up in a pro-growth environment, as long as the Federal Reserve manages that well, that will be positive. That will be a net positive. There are two offsetting factors, clearly, but that will be a net positive.

So that's sort of the base case. The base case says we sort of go along, and if you look at all the things that are on the table, you could see growth in the US go from 2% to 3%. It's pretty significant in terms of the fiscal stimulus. So that's the positive story.

Look, there is a lot of tail risk. Certainly, we all have to watch what happens in Washington and then what happens globally in the EC and in China relative to some of the political events that are going on in the EC, Brexit, the size of the banks globally in both Europe and China, the leverage in the Chinese economy. There's a lot to really be watching for, and from our point of view as Apollo, that's an environment that we actually tend to

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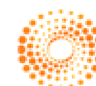

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shine in. And so, I think if the pro-growth environment works like I think, certainly we'll be sending a lot of cash your way, and if there's volatility, we'll certainly be creating more cash to send your way later as value steps back and creates opportunities for us. So that's our crystal ball.

Mike Carrier - *BofA Merrill Lynch - Analyst*

All right. That's helpful. And then, maybe just as a follow-up, when I look at the net accrued, that keeps ticking up with the performance. Martin, I know when we always think about the outlook for realizations and cash carry, it's always tough to try to predict. But I'm just trying to get a sense. When we look at the portfolio, when it was invested, maybe the seasonality of it, where the returns are, I don't know if the fund is tracking in line with historical trends, better than historical trends in terms of you typically deploy and then we see kind of the realization phase. So, any broad color there? I know it's tough to predict.

Martin Kelly - *Apollo Global Management, LLC - CFO*

So Fund VIII, which is going to be the largest driver of carry, has got gross returns in the mid to high 20s, which is wildly above any sort of return expectation that is attributed to private equity or us.

It turns out our gross returns historically are higher than that. Certainly, that was a different environment; they were in the mid to high 30s, but Fund VIII is only just over a year old, on average, but we are seeing -- again, like I said, when you buy -- when everyone else is buying at 10 and you are buying at five, there's value creation that occurs on the buy. So, certainly we are looking at -- and there are things that we're looking hard at, how we take some capital back and create some distributions. And so as Martin said, it's unpredictable, but I expect that we'll make some progress this year.

Operator

Alex Blostein, Goldman Sachs.

Alex Blostein - *Goldman Sachs - Analyst*

Morning, everybody. A question around Athene, so, A, maybe you guys can touch just on your broader thoughts on Athene's growth outlook, given the changes we've seen in the rates backdrop and obviously there's all this chatter around the DOL repeal discussion, so kind of updated thoughts on Athene growth since, I guess, the last update on the IPO. That's my first question.

Leon Black - *Apollo Global Management, LLC - Founder, Chairman, CEO*

Thanks for the question. It's tough for us to comment broadly on Athene's growth now that they are a public company. We have to be certainly cautious. They have not yet announced when they are going to report earnings, and clearly that will be a big topic of discussion on their call.

That said, clearly they are very focused on growth. It was a big part of the story of their offering. They continue to focus on a number of different levers, whether it's reinsurance flows, new product sales, and also they just did another funding agreement back note, which helps drive more assets for them. So I think there's a lot of different things happening.

Clearly, the news overnight about the DOL is interesting. I think we're all watching that carefully. It's unclear where that all lands, but that was obviously a headwind for them and for the industry, and so to the extent that either gets revised or revoked, that certainly removes a headwind. So I think there's a lot of positive things that are sort of in motion for Athene in terms of driving growth.

And then, there's always potential for strategic opportunities, given the acquisition currency they now have through their stock, as well as the capital they have on their balance sheet.

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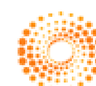

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Alex Blostein - *Goldman Sachs - Analyst*

Got you. And then my second question is kind of related to Athene as well. I guess looking at roughly $300 million of gross accrued carry in the AAA vehicle for you guys, can you just remind us again how we would think about that potentially being converted to fee over time?

Martin Kelly - *Apollo Global Management, LLC - CFO*

Sure. It's Martin. So there's lockups in place -- a series of lockups, actually. Our shares that we own direct in Athene are locked up for 24 months, and then AAA has a series of lockups that expire on three different dates and our carry attaches to those unwind dates. So there will be an unwind in 2017 and another one in 2018. So that will -- whether or not we actually take cash versus shares, we'll make a decision at the time, but that's a future choice.

Alex Blostein - *Goldman Sachs - Analyst*

Got it. But it's a 2017/2018 potential additional kind of cash carry event for you guys?

Martin Kelly - *Apollo Global Management, LLC - CFO*

One of three to come in 2017.

Leon Black - *Apollo Global Management, LLC - Founder, Chairman, CEO*

Just to reiterate, that's separate and apart from the direct ownership stake we have in Athene at Apollo. We own 15.1 million shares of Athene.

Alex Blostein - *Goldman Sachs - Analyst*

That's right. This is just the AAA vehicle. Got it. Thank you.

Operator

Bill Katz, Citigroup.

Bill Katz - *Citigroup - Analyst*

Okay. Thank you very much for taking my questions this morning. First was big picture. I joined the call a little late, so I apologize if you did cover this. I think you recently added Gary Parr to the leadership. Just given his background, sort of curious if you could comment how you are thinking about M&A at the strategic level? What properties or geographies or product sets might be of interest on sort of a go-forward basis?

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

So, obviously, we're really excited to have Gary onboard and he adds a lot of capability and deep, deep relationships across the financial world. Clearly, we are constantly looking at how to grow our platform in a way that is accretive to our value and our long-run growth and prospects, and so Gary will help with that.

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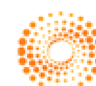

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In terms of things that we -- it's hard to talk specifically about what we're doing. Clearly, as we've said previously, we're a little small in real estate. Forget about a little small; we are too small in real estate. We'd like to get bigger. And then from a credit point of view, there are a whole bunch of different things where there are growth opportunities for us, and so those would be kind of the areas that we would be looking at.

Right now, we're kind of 75% to 80% North America and then kind of 15% to 20% Europe and only 3% rest of world. And right now, we're kind of focused in our core markets, but in that, just the value proposition, while we're global the value proposition continues to be, for at least us, better here than we're seeing in the emerging markets. But we're also going to look there, but we're kind of focused in our core geographies right now, so I hope that gives you enough. That's about as much color as I can give you.

Bill Katz - *Citigroup - Analyst*

Okay. Thank you. And then, I may have missed this, perhaps for Martin, within the -- first of all, thank you for the unit disclosures. Within that, G&A and even comp looked a little bit light, the most recent run rates. Anything unusual in there? And, again, I apologize if you already covered this in your prepared commentary.

Martin Kelly - *Apollo Global Management, LLC - CFO*

G&A, we manage carefully, so the volatile line within non-comp displacement fees, which we talk about, I would look at the current G&A number as sort of run rate levels.

Bill Katz - *Citigroup - Analyst*

Okay. Thank you very much.

Operator

Glenn Schorr, Evercore.

Glenn Schorr - *Evercore ISI - Analyst*

Hi. One quickie follow-up on the Athene side was at the time of the float, I think people in the insurance committee were -- I'm sorry, insurance community -- were having questions about the exclusivity of the relationship with you all and the fee exactly. From an Apollo analyst or investor standpoint, we think it's an awesome thing and we think you add tremendous value. From their side, they didn't know if there were any conflicts there. So, curious about on the today forward of new assets raised and as they grow their business, is it okay for us to expect the same relationship at the same levels to continue?

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

I think we, together with Athene, helped start the business back eight or nine years ago. It's been a great relationship. I think Athene has grown, I think, to levels that probably weren't expected at the time the business was created, and as we talked about just a couple minutes ago, there's a lot of growth still in front of them.

It's been a great partnership. I think us providing asset management services to them has helped them deliver really leading ROEs, and so I think as long as we continue to perform, we would expect the relationship to be very strategic and really positive for both us and Athene.

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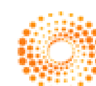

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Gary Stein - *Apollo Global Management, LLC - Head Corporate Communications*

And in terms of the community, certainly the stock itself was very well received, the offering was well oversubscribed, and the centerpiece of Athene is its relationship with Apollo, so I really wouldn't expect it to change.

Leon Black - *Apollo Global Management, LLC - Founder, Chairman, CEO*

We should add we have a long-term contract in place that comes up for renewal at the end of 2018, October of 2018, a three-year rolling contract. We did make a slight concession towards the end of last year on a certain portion of their organic assets, where we gave a fee rebate for just a small portion of their assets for the balance of 2016. So, again, being good partners, helping them have profitable growth, we will do what we need to.

Glenn Schorr - *Evercore ISI - Analyst*

Got you. Okay. I appreciate that. Also on -- just curious for any update on the retail opportunity you guys are pursuing. It looks like the subadvised fund through Waddell has been doing okay. Just curious on an update there. That would be great.

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

I'd say there's -- we continue to believe that the retail community has more demand for -- there's way more growth there, that they are underallocated relative to certainly more liquid alternatives yield. Because yield, so yield, yield, yield in terms of certainly some of our debt products, some real estate products, some real estate data, and even going into real estate core equity.

And so, we're seeing growth there in terms of what we do. We're also seeing some of the high net worth systems from the wire houses embrace some of our more -- deeper alternative products, such as our core private equity fund and ETF. Those that dig big retail demand, we're seeing growth there. And so, I just think we're going to see continued positive growth and positive momentum. It's an area where we're investing in as a Firm in terms of people.

Glenn Schorr - *Evercore ISI - Analyst*

Okay. Thank you very much.

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

And certainly the DOL thing, if it happens, would be a positive both for Athene and for that part of our business.

Operator

Ken Worthington, JPMorgan.

Ken Worthington - *JPMorgan - Analyst*

Hi, good morning. Leon highlighted energy as holding an usually good investment potential for Apollo. The theme of energy has sort of evolved over time. Three years ago, there was one theme, maybe a year ago, that the reasons to get involved in energy were different. So as we think about energy more broadly now, oil prices have kind of recovered smartly, some of the pressure has been taken off, what are the themes that you think you guys want to invest behind today as you think about the energy business for the next couple of years?

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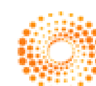

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Josh Harris - *Apollo Global Management, LLC - Co-Founder, Senior Managing Director*

So I think we have a very developed proprietary expertise in energy, and what that amounts to is teams all over North America of scientists, of land men, of engineers, petroleum experts that can look at a field of reserves and kind of figure out what it's worth and how to produce it more effectively than others.

And when you pair that with very seasoned private equity professionals and debt investors, we feel like we have a big edge in energy. It's been a really positive aspect of our franchise. If you think about what's -- and it does move around. Obviously, the opportunities change.

I think relative to the opportunities today what we're finding is the ability to buy reserves and acreage, both producing and nonproducing, in the best fields in the US, while at significant discounts to fair value as measured by acreage value or cash flow value, SEC, PV10, and we're just seeing that the problems that existed in the energy sector when oil went from $100 to $30 has put enough pressure on all the producers that people just don't have the capital to spend in even the best fields. And so, we're able to really cherry pick and end up with the absolute best real estate in North America, in the US and Canada, and control reserves that are economic at very low prices of oil and gas, well below the current curve.

And so when you can get that type of reserve, what you find is even around volatility in oil price, you have a lot of downside protection and you have real upside volatility. And so, we're creating these asymmetric risk return opportunities, particularly in private equity, which is the most active part of our energy investing business right now, where between hedging and the cost that we can bring reserves out of the ground, we're sort of really comfortable that we're going to get a positive return on under almost any energy scenario, but if the curve happens or above the curve, we get 20%, 30%, 40% returns.

And so, this is an area that right now is relatively active and interesting and that's how it's shifted today. There's also -- there's a bit of distress, but much more buying assets right now.

Ken Worthington - *JPMorgan - Analyst*

Great. Thank you for all the color there. And then, sort of a cleanup question, Fund VI and VII still well in escrow. Do you guys expect these funds to make their way back above that escrow threshold or is that just something that you guys believe is less realistic?

Martin Kelly - *Apollo Global Management, LLC - CFO*

I think in the case of VI it's unlikely we get above escrow. It's possible we get cash out, but not till the end of the Fund. The escrow ratio there is in the low 80s and there's about $160 million of cash carry that's being realized that is sort of trapped.

And so, the way the math in the formula works is it's unlikely, I think.

In the case of VII, I think it's much more likely. VII's ratio is at 103% and it didn't increase as much as you may have thought, given that we sold an asset as part of the Hostess transaction, so we sort of took some cash in. So VII is at 103%. It has $60 million of cash sitting in escrow. It needs 13% appreciation to clear its escrow, which would itself create another $100 million of carry. So that's certainly within the realm of possibility, if not likely. It needs to close the gap on the values to clear 115.

Operator

Chris Harris, Wells Fargo.

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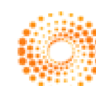

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Chris Harris - *Wells Fargo Securities, LLC - Analyst*

Thank you. Wondering if you guys could comment on how important you think tax deductibility of interest expense is to your returns and your business model in general, and I'm asking this question because there's quite a few investors that think the PE industry will be materially impacted if that gets changed. So, A, do you agree with that notion? And then, B, what's the impact on Apollo?

Leon Black - *Apollo Global Management, LLC - Founder, Chairman, CEO*

Hi, this is Leon. I would say a definite maybe, and the reason I say that, if interest rates stay relatively low, it has much less of an impact. As interest rates go up, the impact goes up.

But again, referring to my previous answer, it also is tied into what the whole picture is going to look like. Part of what Paul Ryan is talking about in his tax bill is not only interest deductibility, but also being able to expense all capital expenditures upfront, which could have a huge beneficial offset to the interest deductibility hit.

So, the answer is we don't know. Certainly on the face of it, if you are dealing in a high rate environment and that's the only thing happening to you, it would have a negative impact on private equity, whose other name is leveraged buyout. But in the context of other offsetting things and the fact that interest rates historically are relatively low, it may not have much of an impact at all.

The other thing is who knows if it happens. As we talked before, so much of this is intertwined with how much are corporate rates supposed to be going down. What happens with border taxes to make it up, the whole capital expenditure thing. Interest deductibility is a whole area that I don't think from a qualitative point of view has really been studied yet. It not only has impact on the credit markets, it has impact on the real estate sector, but basically on small businesses and new jobs' growth where an entrepreneur basically wants to take a loan out to expand a factory. That creates jobs. So, I think there's a long way before any of us are going to be able to predict the outcome here.

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

And as a business model, I think that the public markets are leveraged three times, the private markets are leveraged five times -- a little over five times. So on the margin, certainly they're a little bit more leveraged, the private markets. The private equity markets provide a lot of -- whether it be unearthing things that are too cheap in the public markets, whether it be solving management issues or helping companies grow, there are plenty of things -- there's going to be a lot for private equity to do with or without interest deductibility.

And so I think -- and I think there will be -- if either interest deductibility or a border tax or any of this other stuff happens, there will be a fair amount of dislocation industry by industry, company by company, and that will kind of create a lot of opportunity for people that are smart and nimble and opportunistic.

Leon Black - *Apollo Global Management, LLC - Founder, Chairman, CEO*

The last thing I would say is that Apollo in private equity really does have a differentiated model than our peers. We've already pointed out on this call that in a 10 multiple environment, 10 plus, that we are buying our portfolios at a 5 to 5.5.

What does that mean also as it relates to leverage? It means that we're leveraged less than our peers. If you are buying at 10 times, you're leveraging up to the cap of six times. If you are buying at five times -- or 5.5 times, it means you are on average leveraged about four times. So we are relying on less leverage in our model than most of our peers.

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

Just a quick follow-up, if I may, on this point. Is it fair to assume that the returns you guys generate in PE, the vast majority of the upside is coming from really the price you pay for companies versus your exit multiple as opposed to things having to do with deductibility of interest expense and so on?

Leon Black - *Apollo Global Management, LLC - Founder, Chairman, CEO*

I think that what we've learned in our 27 years at Apollo, almost 27, is that to be good in private equity, you have to be good at three things. One, you have to buy right. Two, you have to build value. And three, you have to sell right. All three are critically important.

I think part of our differentiated model is that we focus an awful lot on the value orientation on the buy side, so there are a lot of things that go into buying a good company. Barriers to entry, good management, growth statistics, margins, all of those are important. What we have kind of felt is that the single most important is price paid, so it's part of our focus, but it's certainly not a replacement for building value or selling right, also.

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

Just to hit your question directly, very little of our value creation comes from interest deductibility, almost -- it's negligible. So a lot of it is buying right and a bunch of it is EBITDA growth and cash flow generation. I haven't calculated the specific number, but it's not going to be a big number.

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

That's what I figured. Great. Thank you.

Operator

Brian Bedell, Deutsche Bank.

Brian Bedell - *Deutsche Bank - Analyst*

That's actually a great segue to my question. Just looking at your historical creation multiples in your prior funds, Fund V at 6.6%, Fund VI at 7.7%, Fund VII at 6.1%, and now you are at 5.5% and you are in a higher, obviously, multiple environment, so can you talk about, I guess, what's made you better at buying through these cycles? And as we think about Fund IX and you think about the opportunities in Fund IX, are you bullish on being able to mimic Fund VIII or even do better than Fund VIII on creation?

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

I'd say, look, we are just getting better at our craft. The team is getting more experience. We're adding a lot of capability to allow us to source transactions in a much more proprietary way, such as energy would be an example or financial services in Europe. So I think all of those things; I think we're just getting to be more seasoned and better at our craft.

I think also we've added a broker-dealer that allows us to go outside the traditional financing markets, so in the case of a number of transactions, the most notable one being ADT, we were able to get a deal done on a multibillion-dollar financing by placing a preferred with a nontraditional source that other people couldn't do and therefore we got a really good price on. We think we got a very good price on ADT.

And then -- so there's a whole sort of series of internal factors in terms of the development of our team. Externally, we're finding for the first time that the public markets have really -- while the public market multiple has been high, there's been a real differentiation between the haves and

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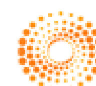

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the have-nots, and in many cases we're finding great companies at low prices. We did six public to privates in this fund and that's relative to a very small number in our history where, even though you put a premium on a company like ADT or Rackspace or Diamond Resorts or Outerwall, we found that there's misvaluation, in our opinion, in the markets.

And I think a bunch of that has to do with I think value strategies were out of favor in the marketplace. Certainly, index funds were growing. Activist investors, many times, are now lurking around and forcing undervalued companies to do something about it. The hedge funds have a lot of wind in their face, and so I think there's some external factors that are providing some opportunities hospitably in the public markets.

But those are all the reasons why I think we're doing better. I'd say in Fund IX, I think the big opportunity for us is that only 4% of Fund VIII was distressed, which is the lowest in our history, and that really had to do with, I think, the monetary environment that existed, the quantitative easing, and the liquidity that was in the markets, as well as the fact that we haven't had a recession in seven-plus years. And so when I look at Fund IX, which is going to be six years going forward, I feel like we'll have some -- in the aging credit cycle, we're going to have some distressed opportunities. Those tend to be traditionally at lower multiples. Whether we'll get below 5.5%, I think that's a tall order. I mean, 5.5% is a really good number, but we're certainly going to try.

Leon Black - *Apollo Global Management, LLC - Founder, Chairman, CEO*

Just to add to what Josh said, look, we really do have a differentiated model in PE, and the reason we are able to pay lower valuations is kind of the fact that we follow three pathways. One during recessions when -- we've had four of those since we started 26.5 years ago. We dial to our distress capabilities.

A lot of people know that that pathway is one that allows you to back into good buyouts through buying in the right part of the capital structure and delevering companies in the restructuring process, and hopefully we end up owning them. If we don't end up owning them, we make a lot of money on the debt and we recycle.

What a lot of people don't realize is that the entry level of what we've been able to do in distressed has been at about a five multiple historically. That's about one-third of our capital over history in private equity. Another one-third has been in complex deals -- carveouts, buildups, things that take a year to get done, undermanaged companies, undercapitalized divisions of companies. The average on those has been about a fixed multiple because of the complexities involved.

Finally, we do idiosyncratic buyouts where we are competitive. We do look at auctions in the nine industries that we cover really well. There, we're looking for an edge. What's an edge? ADT, the fact that we already own two security alarm companies and that we could bring $200 million of synergies to the table was an edge. Also, the fact that we had the management best in the industry that came from ADT and knew it well, and as Josh already pointed out, the ability to get things done through our capabilities in the credit markets allowed us to get it financed in a very difficult market a year ago.

So there, we're willing to pay as much as seven times. When you add all of this up, it gets us into the high fives or low sixes. It's a good model, and you asked about the progression historically. We had that model, but we made some exceptions in earlier funds. I think we stumbled when we did Realogy and we did Caesar's because we paid very high prices for those, for what we thought were good reasons. We knew the industries well. They were the best brands, but, you know, since then we've said no exceptions. You haven't seen anything like those multiples paid for anything in Fund VII, Fund VIII, nor will you in Fund IX. So the discipline is there.

So, you don't know in each vintage -- vintage seven was two-thirds distressed. As Josh pointed out, it was less than 5% in Fund VIII. So that is our differentiated model, many roads to Rome. Many of our competitors do well, but I think by paying lower prices and sticking to that we have more room for error than they do, so it's a very good model for us and has worked well for us and that's what we plan to continue with.

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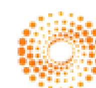

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Operator

Thank you. Ladies and gentlemen, we have reached our allotted time for questions. It's now my pleasure to hand the program over to Gary Stein for any additional or closing remarks.

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

Great. Thanks, Operator. Thanks again, everyone, for joining us today. As I mentioned earlier, if you have any follow-up questions, please feel free to give Noah Gunn or me a call.

Leon Black - *Apollo Global Management, LLC - Founder, Chairman, CEO*

Thanks.

Operator

Thank you, ladies and gentlemen. This does conclude today's conference call. You may now disconnect your line.

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