

## Equities

14 February 2012 | 14 pages

# Affiliated Managers Group (AMG)

## Reaching A Higher Sustainable Plane — Management Meeting Takeaways

### ■ Company Update

<b>Buy</b>	<b>1</b>
Price (13 Feb 12)	US\$106.38
Target price	US\$120.00
Expected share price return	12.8%
Expected dividend yield	0.0%
<b>Expected total return</b>	<b>12.8%</b>
Market Cap	US\$5,475M

### Price Performance (RIC: AMG.N, BB: AMG US)



- **Maintain Buy; \$120 standalone 12-month price target; remains on TPL!** – following CIRA-sponsored investor meetings on 2/13 in NY with senior management. Sessions bullish around: 1) structural positioning; 2) flow outlook; 3) deal outlook/capacity; and, 4) performance fee leverage. We believe AMG's model is increasingly differentiated versus peers/industry, which should allow for a higher sustainable multiple.
- **Favorable flow outlook** – Mgmt noted that the pipeline remains strong into 1Q, and such visibility now seems to extend into 2012 more fully – impressively: a) generated positive flow in nearly 2/3 of 350 products in 2011; and, b) flows and performance continue into highest margin businesses among largest affiliates where AMG has among the greatest ownership. AMG is benefiting from: 1) generally strong performance; 2) improving distribution leverage; and, 3) more structural shift into global equities, EM and alternatives, with the bulk of growth coming from non-US investors.
- **Deals now seem only a matter of time** – Mgmt reiterated buyback remains on hold and a strong deal pipeline across each phase of the negotiations, with pipeline akin to late 2008 levels that drove \$1.5B in deal flow into 2009-10. We see similar potential at present; \$1.4B deal capacity, with deals still pricing at lower end of 8x-10x range, or ~\$1.00 accretion at midpoint. Favorably, mgmt targets a “cleaner” B/S which should lead to a higher sustainable multiple. Deals still driving upper teens return on capital.
- **No change to EPS outlook, but visibility climbing** – We affirm our 2012-14 ENI estimates of \$7.14/\$8.01/\$8.97. Should AMG measurably put money to work in next few months, we could see \$10.00 of earnings power come into focus into 2014.
- **Potentially stronger stock performance** – Lower quality A/Ms rallied strongly YTD but we see reversal as underlying flow dynamics inure toward AMG while US retail flow recovery likely remains elusive. Management commentary around institutional re-risking bullish for APO, BX and KKR and mixed for AB, LM and most generic retail managers, we believe. Indeed, management seeing allocations into GE, EM and alts and away from traditional US equities. They are not seeing material improvement in US institutional pipeline, but expect such traction to shift away from generic L/C mandates should risk appetite recover. At 14x 2012E EBITDA, some investors bristle at valuation but we see AMG growing into the valuation given superior & more historically consistent flow dynamics + pro forma EPS power for market action + step function potential for deals, the latter driving favorable daisy chain around FCF and flows.

EPS	Q1	Q2	Q3	Q4	FY	FC Cons
<b>2011A</b>	1.60A	1.71A	1.55A	1.76A	6.62A	6.62A
<b>2012E</b>	<b>1.52E</b>	<b>1.66E</b>	<b>1.74E</b>	<b>2.22E</b>	<b>7.14E</b>	<b>7.16E</b>
Previous	1.52E	1.66E	1.74E	2.22E	7.14E	na
<b>2013E</b>	<b>na</b>	<b>na</b>	<b>na</b>	<b>na</b>	<b>8.01E</b>	<b>8.15E</b>
Previous	na	na	na	na	8.01E	na
<b>2014E</b>	<b>na</b>	<b>na</b>	<b>na</b>	<b>na</b>	<b>8.97E</b>	<b>8.97E</b>
Previous	na	na	na	na	8.97E	na

Source: Company Reports and dataCentral, CIR. FC Cons: First Call Consensus.

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Fiscal year end 31-Dec	2010	2011	2012E	2013E	2014E
<b>Valuation Ratios</b>					
P/E adjusted (x)	17.5	16.1	14.9	13.3	11.9
P/E reported (x)	37.7	34.2	29.5	23.8	19.6
P/BV (x)	3.2	3.0	2.5	2.0	1.7
P/Adjusted BV diluted (x)	na	na	na	na	na
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
<b>Per Share Data (US\$)</b>					
EPS adjusted	6.09	6.62	7.14	8.01	8.97
EPS reported	2.82	3.11	3.61	4.48	5.44
BVPS	33.37	35.21	43.35	52.61	63.35
Tangible BVPS	-32.54	-29.67	-21.34	-11.90	-0.97
Adjusted BVPS diluted	na	na	na	na	na
DPS	0.00	0.00	0.00	0.00	0.00
<b>Profit &amp; Loss (US\$m)</b>					
Net interest income	0	0	0	0	0
Fees and commissions	1,358	1,705	1,962	2,111	2,342
Other operating Income	0	0	0	0	0
<b>Total operating income</b>	<b>1,358</b>	<b>1,705</b>	<b>1,962</b>	<b>2,111</b>	<b>2,342</b>
Total operating expenses	-910	-1,106	-1,240	-1,309	-1,438
<b>Oper. profit bef. provisions</b>	<b>448</b>	<b>599</b>	<b>722</b>	<b>801</b>	<b>904</b>
Bad debt provisions	0	0	0	0	0
Non-operating/exceptionals	-69	-146	-172	-166	-160
<b>Pre-tax profit</b>	<b>379</b>	<b>453</b>	<b>550</b>	<b>635</b>	<b>744</b>
Tax	-91	-93	-118	-145	-175
Extraord./Min. Int./Pref. Div.	-149	-195	-240	-253	-281
<b>Attributable profit</b>	<b>139</b>	<b>165</b>	<b>191</b>	<b>237</b>	<b>288</b>
Adjusted earnings	299	351	378	424	475
<b>Growth Rates (%)</b>					
EPS adjusted	39.5	8.7	7.8	12.2	12.0
Oper. profit bef. prov.	59.6	33.6	20.6	11.0	12.9
<b>Balance Sheet (US\$m)</b>					
<b>Total assets</b>	<b>5,291</b>	<b>5,291</b>	<b>5,506</b>	<b>5,726</b>	<b>5,955</b>
Avg interest earning assets	na	na	na	na	na
Customer loans	na	na	na	na	na
Gross NPLs	na	na	na	na	na
<b>Liab. &amp; shar. funds</b>	<b>5,291</b>	<b>5,291</b>	<b>5,506</b>	<b>5,726</b>	<b>5,955</b>
Total customer deposits	na	na	na	na	na
Reserve for loan losses	na	na	na	na	na
Shareholders' equity	1,800	1,866	2,298	2,788	3,357
<b>Profitability/Solvency Ratios (%)</b>					
ROE adjusted	20.6	19.4	18.4	16.7	15.5
Net interest margin	na	na	na	na	na
Cost/income ratio	67.0	64.9	63.2	62.0	61.4
Cash cost/average assets	20.1	21.1	23.0	23.3	24.6
NPLs/customer loans	na	na	na	na	na
Reserve for loan losses/NPLs	na	na	na	na	na
Bad debt prov./avg. cust. loans	na	na	na	na	na
Loans/deposit ratio	na	na	na	na	na
Tier 1 capital ratio	na	na	na	na	na
Total capital ratio	na	na	na	na	na

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# Reaching A Higher Sustainable Plane

## Investment Summary

We affirm our Buy rating and 12-month standalone \$120 price target following CIRA-sponsored investor meetings with Mr. Jay Horgen, CFO, and Ms. Alexandria Lynn, Investor Relations in NY on 2/13. Coming on the heels of recent 4Q earnings update on 1/31, there was little groundbreaking news. That said, the broad takeaway, in our view, reflects step function in the efficacy of the business that should lead to a higher sustainable multiple relative to both history and peers, the latter facing more mixed lead indicators, in our view.

While off to a solid start YTD, the stock has lagged higher beta peers. However, given underlying flow dynamics, we believe AMG should be able to resume leadership – absent 5%/month market gains akin to the last couple of months. Indeed, discussion around flow dynamics would suggest: 1) broad-based re-risking across distribution channels is not unfolding; and, 2) to the extent re-risking picks up, such volumes continue to migrate away from traditional L/C growth/value mandates and into global equity, emerging markets and alternatives, where the number of viable players demonstrating strong LT track records is far more limited versus more commoditized L/C US centric mandates, we believe. Such dynamics broadly benefit APO, BX and KKR while have less potency for much of the traditional managers, in our coverage universe.

Key takeaways: 1) flow story remains robust – 2012 now looks like yet another robust year, and momentum could accelerate to the extent institutional mandate activity broadly recovers, with several powerful secular drivers setting the stage for a boom of organic growth over the next several years; 2) deal backdrop remains quite favorable, driving significant potential EPS accretion – management noted pricing remains advantageous and pipeline strong to further improving; 3) constructive discussion around performance fee leverage; and, 4) likely around EPS prospects. Encouragingly, flows remain strong across most of the key affiliates and broad-based – with over 200 products generating positive flows in 2011, or nearly 2/3 of entire footprint and likely more diversified than investors fully appreciate.

## Seeking Higher P/E Equilibrium

In addition to another surprisingly pleasant winter day in NY, we note the following key takeaways from our meetings:

1. **Powerful secular flow story unfolding at time of uneven growth for much of the industry** – Beyond the favorable flow dynamics for niche player WETF into ETFs – see also our 2/12 notes, [Solid Weekly Flows \(W/E 2/10\)](#) and [Flowing Like A River In An Otherwise Dry Seabed—Resuming Coverage With A Buy](#) –and possibly nascent flow inflection at IVZ, we are hard pressed to find a more vibrant flow story among our coverage universe within “traditionals”. Encouragingly, many of these drivers are only in the “early to middle innings” to mix our metaphors, setting the stage for: a) continued strong flow generation; and, b) solid organic growth dynamics versus key peers (Figures 1-2).

**In brief, such drivers include:**

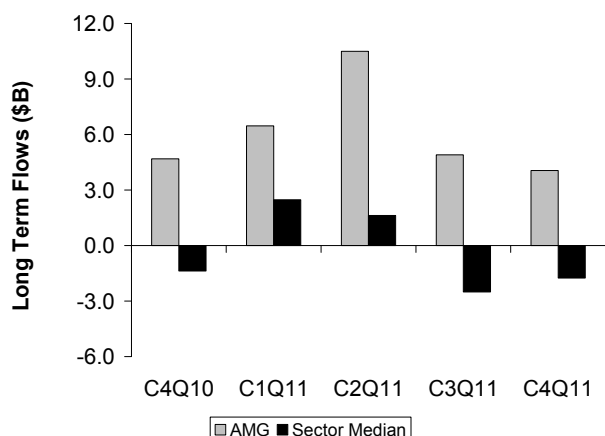
- **In the right products at the right time** – Over the past several years, management has repositioned AMG into faster growth segments, including GE, EM and alternatives overlaid by increasingly global footprint. In turn, allocations continue to rise into each of these three sectors, many of which

we believe offer super cyclical growth potential. Indeed, over 100% of flows came from non-US investors in 4Q and over 50% over the past 7-8 quarters. Such themes seemingly align strongly with shifting industry dynamics in light of market volatility, low interest rates and broadly under-funded pension plans globally – see also our 10/18 report, [Turning The Business Upside Down - Takeaways From CIRA-Sponsored Institutional Consultant Call](#);

- **Developing a more potent global distribution footprint** – Here, AMG is benefiting from both stronger acumen of its footprint, greater usage of affiliates through the distribution platform and seasoning of global platform. We expect management to further invest into the platform – including possible expansion into ME, for instance – adding further volume momentum without necessarily compromising margins. Per management, the number of affiliates working through AMG's centralized institutional distribution effort globally is up dramatically, rising from essentially zero just a few years ago. We look for stepped up leverage over the next 1-3 years as: 1) allocations continue to migrate into non-US, low volatility/low correlation, and income oriented products; b) recent investment spending begins to pay off; along with, c) further expansion of the footprint;
- **Taking market share** – Management pointed toward share gains versus traditional managers in both institutional and retail segments. In the institutional channel, mandates are migrating away from L/C growth and value products into either passive (where AMG does not compete) and superior alpha generators, particularly among mid-sized/boutique platforms. Management noted that L/C mandates remain under the deepest structural pressure in the US, and face highest pricing pressure among mandates generally.

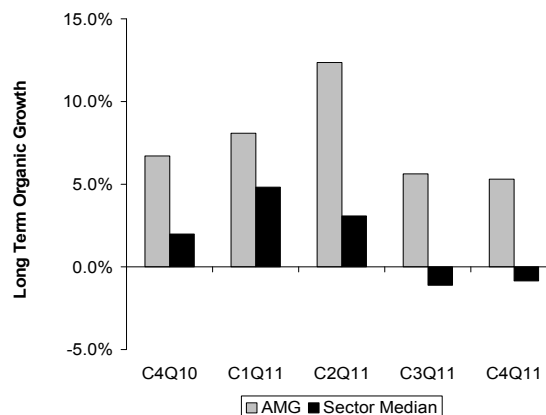
Within retail, mgmt continues to see migration away from generic mutual funds into alternative products, including absolute return, risk management and other income-generating mandates.

Figure 1. AMG Has Among Best-In-Class Flows...



Source: Company Reports and Citi Investment Research and Analysis

Figure 2. ...And Organic Growth Versus Peers



Source: Company Reports and Citi Investment Research and Analysis

2. **2012-2014 setting up for strong real time flows as well** – While management did not provide explicit update around the flow pipeline, they did reiterate: a) 1Q outlook remains robust; and, b) such visibility seems strong into 2Q/2H12 as well. And, should markets continue to move higher and institutional activity levels normalize, such unit growth could potentially step function a bit higher. Unlike a number of players where unit growth is coming from either one specific fund or style, AMG is meeting with broad-based flow success. At the affiliate level, mandates are strong broadly among the larger products and the larger affiliates, in which AMG owns a greater percentage of the economics. In turn, management also noted that the firm generated net growth in 65% of its 350 products in 2011. Performance metrics generally remain strong, and coupled with stronger distribution that is employing more affiliates globally, we believe the stage is set for favorable flow dynamics on both an absolute and relative basis.
3. **Deal pipeline seems ready to yield investments** – On one hand, we sensed frustration by management that a deal has yet to come to fruition. On the other hand, management did not back away from strong descriptors around the state of the pipeline, suggesting deal visibility is not far off and setting the stage for a “step function” in EPS power. In turn, we note:
  - **Management remains on the sidelines around buyback;**
  - **Management affirmed that activity levels across all three broad facets of the pipeline remain strong, including introductory, contract discussion and final due diligence;**
  - **Deal pricing remains favorable – with recent interest by larger firms such as JPM and GS likely to keep pricing down.** To be sure, management affirmed pricing remains in the 8x to 10x run rate of EBITDA range;
  - **Pipeline has replenished nicely since 2Q/3Q decline as markets have normalized** – here, divestiture activity is picking up, including both auction and self sourced transactions while wealth succession deals are also more visible;
  - **Deal accretion still likely to range between \$0.10 to \$0.20 per share per \$100M employed;**
  - **Management continues to see \$1.4B in deal capacity, aided by ~\$400M annual FCF.**
4. **Performance fee discussion favorable** – Management affirmed broad guidance for performance fees to account for 5% to 10% of EPS, though admitted upside could be material should upward trending markets persist. Encouragingly, based on both growth in AUM and strong performance, management feels strongly that there is high probability that 5% to 10% should be rather persistent level of contribution. There are no major high water mark issues across affiliates, with 12 generating performance fees in 2011, most notably AQR, Blue Mountain and Value Act.
5. **2011 guidance feels conservative on two fronts** – 1) Low end; and, 2) absolute range, in our view. While management did not alter its view of \$6.70 to \$7.40, we do believe the low end remains conservative and should markets continue to move higher, the upper range may also prove too pessimistic. Indeed, with nearly 70% of EBITDA from a combined GE, EM and alternatives,

the rally in these segments YTD bodes well for earnings leverage into the year, with performance fees becoming a greater oscillator to the upside, we believe.

## Why We See Higher Sustainable Multiple

Several aspects lead us to believe AMG warrants a higher multiple:

- We see AMG generating more persistent flow story driven by diverse mandates;
- We see further leverage to developing global distribution story;
- We see management migrating toward simplified balance sheet;
- We see less annual dispersion around performance fees as the franchise continues to diversify;
- We see less organic growth for many key peers.

## Isn't It All Baked In Already?

At 14x 2012E EBITDA, AMG trades at a moderate sector premium. However, with markets up nicely into 2012, we believe the pro forma multiple has narrowed. And, we believe AMG is that much closer to a deal or set of deals that not only set the stage for solid EPS growth in 2012 but also provide further valuation support into 2013.

Indeed, higher beta stocks have outperformed AMG YTD yet we believe flow traction may prove more elusive than commonly perceived for many key players. Should the anticipated migration back toward retail/institutional active equities mandates not play out – which seems to be the case for 2012 – we believe AMG will assume performance leadership. We believe another quarter of superior flow metrics in 1Q12 will be a catalyst.

## Laterals

Management noted: 1) institutional mandates in the US remain choppy and they are not yet seeing stepped up activity levels; and, 2) when volumes improve, they expect to see further migration away from US equities mandates, instead further shifting into global equities and EM – where allocations remain low versus underlying global market cap – and alternatives, the latter to drive lower volatility + income generation. As noted above, management also sees greater commoditization of L/C mandates – a building theme, we believe.

In turn, the discussion reinforces our constructive stance on alternative managers, a group we broadly see taking further market share, while affirms our more selective stance among traditionals – absent above trending markets. Drilling into specific names, the discussion is mixed to negative for AB, ART, EV, JNS, and FII followed more distantly by LM, TROW and WDR, we believe. No question, all asset managers are solidly leveraged to the inexorable rise in equities markets underway, yet we believe more idiosyncratic flow dynamics could temper multiple expansion, at some point.

Companies Mentioned: (AB.N; US\$14.08; 2); (APO.N; US\$14.40; 1); (ART.N; US\$4.51; 3H); (BEN.N; US\$117.16; 2); (BLK.N; US\$192.45; 2); (BX.N; US\$16.10; 1); (EV.N; US\$27.96; 3); (FII.N; US\$17.88; 3); (IVZ.N; US\$24.36; 1); (JNS.N; US\$8.53; 3); (KKR.N; US\$15.01; 1); (LM.N; US\$27.56; 2); (OZM.N; US\$9.60; 1); (TROW.O; US\$60.10; 3); (WDR.N; US\$31.33; 3); (WETF.O; US\$6.55; 1)

## Affiliated Managers Group

### Company description

Affiliated Managers Group, Inc. (NYSE: AMG) is an asset management company that makes equity investments in a group of boutique investment management firms. AMG has investments in a broad range of investment styles and distribution channels. Under AMG's structure, the entrepreneurial orientation of the firms can be maintained while holding company provides benefits in terms of scale with distribution, operations, and technology.

### Investment strategy

We rate the shares of Affiliated Managers Group Buy. Our positive stance reflects our view that: 1) the company is well positioned for further flow upturn, which will be aided by recent deals, and 2) AMG's model efficacy is strong and rising. Additionally, we believe the firm's manager of manager model collars downside market & EPS risk reflecting robust revenue, income and equity sharing arrangements across high performing – and increasingly global footprint.

### Valuation

We value the shares of AMG at \$120 using the target P/E method. We apply a ~16.5x target P/E against our 2012 economic EPS estimate. AMG has historically traded at 14x and 15x FTM economic (cash) P/E.

### Risks

AMG's manager of managers model collars downside market and EPS risk reflecting revenue, income, and equity sharing arrangements across an increasingly global footprint. The two central risks to our price target reflect a delay in the closing of deals and sustained below trend capital markets which might reduce our EPS expectations and temper P/E multiple expansion.

If the impact from any of the following factors proves to be greater than we expect, the stock may have difficulty reaching our target price. If market conditions improve faster than anticipated, the stock may outperform our target.

Financial market risk — Changes in markets have a direct impact on AUM and investment advisory and services fees.

Performance risk — An inability to meet relevant investment benchmarks could result in clients withdrawing assets and in prospective clients choosing to invest with competitors. This could also result in lower investment management fees, including minimal or no performance-based fees, which could result in a decline in revenue.

Redemption risk — Investors can redeem their investments without notice. A significant increase in redemption rates could have a material adverse effect on revenues, financial condition, results of operations and business prospects.



## Appendix A-1

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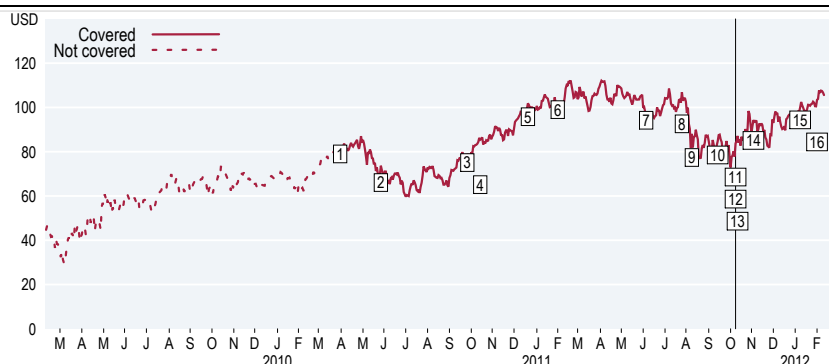
### IMPORTANT DISCLOSURES

#### Affiliated Managers Group (AMG)

##### Ratings and Target Price History Fundamental Research

Analyst: William R Katz

Covered since March 31 2010



Date	Rating	Target Price	Closing Price
1 31-Mar-10	*1M	*105.00	79.00
2 27-May-10	1M	*100.00	73.68
3 27-Sep-10	1M	*104.00	77.71
4 14-Oct-10	1M	*106.00	85.42
5 21-Dec-10	1M	*123.00	101.86
6 1-Feb-11	1M	*128.00	100.01

\* Indicates change

Date	Rating	Target Price	Closing Price
7 6-Jun-11	1M	*122.00	94.22
8 26-Jul-11	1M	*125.00	106.92
9 9-Aug-11	1M	*110.00	88.07
10 14-Sep-11	1M	*107.00	84.71
11 8-Oct-11	Stock rating system changed		
12 8-Oct-11	*1	107.00	77.85

Date	Rating	Target Price	Closing Price
13 12-Oct-11	1	*105.00	87.15
14 3-Nov-11	1	*110.00	94.30
15 9-Jan-12	1	*115.00	99.99
16 1-Feb-12	1	*120.00	103.41

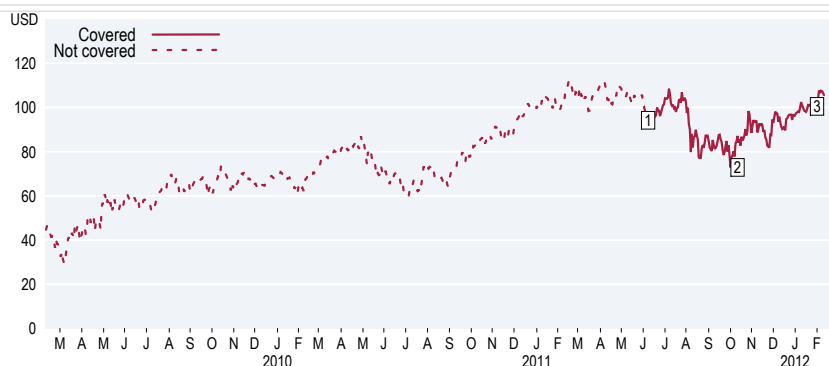
Rating/target price changes above reflect Eastern Standard Time

#### Affiliated Managers Group (AMG)

##### Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: William R Katz

Covered since March 31 2010



Date	Rating	Target Price	Closing Price
1 8-Jun-11	*ADD MP	-	94.59

\* Indicates change

Date	Rating	Target Price	Closing Price
2 12-Oct-11	*REM MP	-	87.15

Date	Rating	Target Price	Closing Price
3 1-Feb-12	*ADD MP	-	103.41

Rating/target price changes above reflect Eastern Standard Time

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#### Citi Investment Research & Analysis Ratings Distribution

<i>Data current as of 31 Dec 2011</i>	<b>12 Month Rating</b>			<b>Relative Rating</b>		
	<b>Buy</b>	<b>Hold</b>	<b>Sell</b>	<b>Buy</b>	<b>Hold</b>	<b>Sell</b>
Citi Investment Research & Analysis Global Fundamental Coverage	57%	34%	9%	10%	79%	10%
<i>% of companies in each rating category that are investment banking clients</i>	45%	41%	40%	49%	43%	41%

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CIRA's stock recommendations include an investment rating and an optional risk rating to highlight high risk stocks.

**Risk rating** takes into account both price volatility and fundamental criteria. Stocks will either have no risk rating or a High risk rating assigned.

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