

3 June 2014 | 10 pages

Brokers & Asset Managers
North America | United States

Och-Ziff Capital Management (OZM)

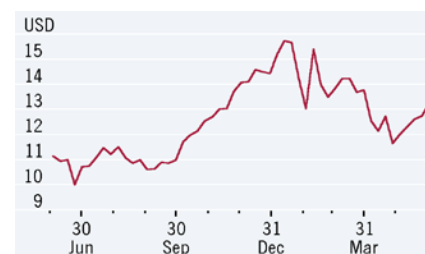
May/June AUM: Performance + Flows Should Ease Concerns

■ Estimate Change

- **Much to like** — OZM released performance / AUM metrics for May and June and we view the data favorably for three reasons. First, performance in the flagship OZ Master fund bounced back after a tough March and April. Second, implied flows appear strong and provide further evidence around flow traction. Third, we think franchise risks are diminishing with no fallout from recent media concerns.
- **OZ Master Fund rebounds** — The OZ Master Fund appreciated 1.4% in May while the Europe Master Fund depreciated 1% and the Asia Master increased 20 basis points (Figure 1). More importantly, YTD performance in the flagship fund turned positive, and the fund is now above the high water mark for the year, which is incrementally positive for performance fees.
- **Another strong flow month** — AUM increased 2.5% MTM to \$44.6B and based on monthly performance metrics, the data imply around \$600M in net inflows, or a healthy 17% annualized growth rate (Figure 2). While we don't know the composition of flows, we don't believe any CLOs were raised, suggesting flow mix is likely diversified. Equally importantly, recent news articles do not appear to be having any impact on the ability to drive new business, which we think speaks to OZM's deep relationships with LPs.
- **Edge higher 2014-16 DEPS estimates** — Raise 2014 DEPS \$0.03 to \$0.96; lift 2015-16 DEPS \$0.01 each to \$1.39 and \$1.54, respectively. Revisions primarily reflect above trend market impact.
- **Maintain Buy and \$16.50 12-month target** — The YTD pullback appears overdone, in our view, given continued momentum around flows and snapback in performance. We continue to see a favorable risk/reward and attractive upside potential and believe disclosure should help calm recent concerns built into the stock price.

Buy	1
Price (02 Jun 14)	US\$13.24
Target price	US\$16.50
Expected share price return	24.6%
Expected dividend yield	6.0%
Expected total return	30.7%
Market Cap	US\$6,554M

Price Performance
(RIC: OZM.N, BB: OZM US)



EPS	Q1	Q2	Q3	Q4	FY	FC Cons
2013A	0.29A	0.16A	0.27A	1.15A	1.87A	1.87A
2014E	0.24A	0.15E	0.17E	0.39E	0.96E	1.24E
Previous	0.24A	0.15E	0.17E	0.37E	0.93E	na
2015E	na	na	na	na	1.39E	1.73E
Previous	na	na	na	na	1.38E	na
2016E	na	na	na	na	1.54E	1.76E
Previous	na	na	na	na	1.53E	na

Source: Company Reports and dataCentral, Citi Research. 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	2012	2013	2014E	2015E	2016E
Valuation Ratios					
P/E (x)	11.2	7.1	13.8	9.5	8.6
P/BV (x)	-7.8	-16.8	-7.8	-7.8	-7.8
P/TBV (x)	-7.8	-16.8	-7.8	-7.8	-7.8
Dividend yield (%)	8.4	13.5	6.7	9.9	11.0
Per Share Data (US\$)					
EPS adjusted	1.18	1.87	0.96	1.39	1.54
Book value per share (BV)	-1.70	-0.79	-1.69	-1.69	-1.69
Tangible book value per share	-1.70	-0.79	-1.69	-1.69	-1.69
Dividend per share	1.11	1.79	0.88	1.31	1.46
Profit & Loss (US\$m)					
Net interest income	0	0	0	0	0
Fees and commissions	1,102	1,642	1,067	1,498	1,708
Non-recurring fee revenue	na	na	na	na	na
Total revenue	1,211	1,806	1,369	1,824	2,047
Total operating expenses	-1,919	-744	-713	-853	-933
Non-recurring expenses	na	na	na	na	na
FTE adjustment	na	na	na	na	na
Pre-tax preprovision profits	-708	1,062	656	971	1,114
Loan loss provision	0	0	0	0	0
Pre-tax profit	-545	1,243	865	1,174	1,326
Tax	-79	-93	-20	23	27
Extraord./Min. Int./Pref. Div.	308	-898	-682	-952	-1,076
Attributable profit	-316	252	163	245	277
Growth Rates (%)					
EPS adjusted	147.6	58.6	-48.9	44.8	11.2
Pre-tax preprovision profits	50.3	250.0	-38.3	48.0	14.7
Avg. loan growth	na	na	na	na	na
Balance Sheet (US\$m)					
Total assets	3,535	6,869	6,648	7,047	7,470
Avg interest earning assets	0	0	0	0	0
Customer loans	0	0	0	0	0
Gross NPLs	0	0	0	0	0
Liab. & shar. funds	3,535	6,869	6,648	7,047	7,470
Total customer deposits	0	0	0	0	0
Reserve for loan losses	0	0	0	0	0
Shareholders' equity	-251	-134	-293	-293	-293
Profitability/Solvency Ratios (%)					
Return on equity	43.3	44.5	24.4	40.2	44.0
Return on tangible equity	na	na	na	na	na
Net interest margin	na	na	na	na	na
Fee income / Revenues	100.0	100.0	100.0	100.0	100.0
Efficiency ratio	174.2	45.3	66.9	57.0	54.6
Net charge off ratio	na	na	na	na	na
Reserve for loan losses / NPLs	na	na	na	na	na
Loan loss provision / Loans	na	na	na	na	na
Loan to deposit ratio (LDR)	na	na	na	na	na
Tier 1 common ratio (Basel 1)	na	na	na	na	na
Tier 1 common ratio (Basel 3)	na	na	na	na	na
Tangible equity / Assets ratio	-7.1	-1.9	-4.4	-4.2	-3.9

Figure 1. Performance In The Flagship OZ Master Fund Rebounded In May...

OZ Fund Segment	May-13	Jun-13	Jul-13	Aug-13	Sep-13	Oct-13	Nov-13	Dec-13	Jan-14	Feb-14	Mar-14	Apr-14	May-14
OZ Master Fund, Ltd.	1.28%	-0.69%	1.07%	0.70%	1.91%	1.03%	1.09%	1.55%	-0.27%	2.40%	-1.99%	-1.36%	1.42%
OZ Europe Master Fund, Ltd.	1.51%	-0.01%	1.67%	-0.45%	1.53%	2.09%	1.41%	0.65%	-0.07%	1.33%	-1.21%	-1.29%	-1.02%
OZ Asia Master Fund, Ltd.	-0.93%	-0.90%	-0.51%	0.31%	1.54%	0.47%	2.04%	1.63%	-3.10%	0.52%	-4.06%	-2.67%	0.20%
Weighted-Average	1.20%	-0.65%	1.04%	0.60%	1.87%	1.08%	1.15%	1.50%	-0.40%	2.25%	-2.05%	-1.42%	1.25%
iBoxx USD Liquid High Yield Index	88.81	85.77	87.06	85.77	86.21	88.00	87.73	87.63	87.65	89.03	88.54	88.55	88.91
MTM change	-0.9%	-2.9%	2.1%	-0.9%	1.1%	2.6%	0.2%	0.5%	0.6%	2.0%	0.1%	0.5%	0.9%
MSCI World	1,062.4	1,035.1	1,083.3	1,058.8	1,096.4	1,138.9	1,161.5	1,184.5	1,145.3	1,191.4	1,190.8	1,197.1	1,220.0
MTM change	1.5%	-2.4%	4.8%	-2.0%	3.8%	4.0%	2.2%	2.1%	-3.2%	4.3%	0.2%	0.8%	2.3%
S&P 500	1,630.7	1,606.3	1,685.7	1,633.0	1,681.5	1,756.5	1,805.8	1,848.4	1,782.6	1,859.4	1,872.3	1,884.0	1,923.6
S&P 500 Index - Total Return	2.08%	-1.50%	4.95%	-3.13%	2.97%	4.46%	2.80%	2.36%	-3.56%	4.31%	0.69%	0.62%	2.10%
Relative (OZ Master vs SPX)	-0.80%	0.81%	-3.88%	3.83%	-1.06%	-3.43%	-1.71%	-0.81%	3.29%	-1.91%	-2.68%	-1.98%	-0.68%

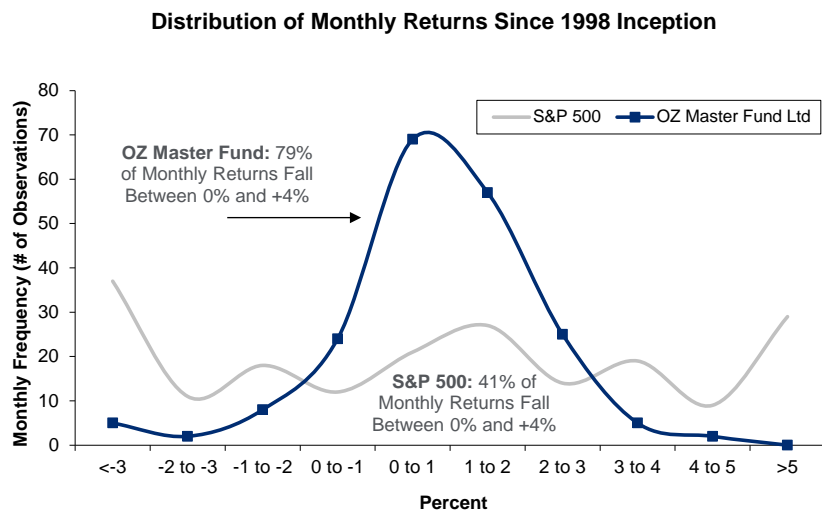
Source: Company reports, Citi Research

Figure 2. ...While Flows Continue To Appear Strong

Och-Ziff AUM	5/2 - 6/1	6/2 - 7/1	7/2 - 8/1	8/2 - 9/2	9/2 - 10/1	10/2 - 11/1	11/2 - 12/1	12/2 - 1/1	1/2 - 2/1	2/2 - 3/1	3/1 - 4/1	4/2 - 5/1	5/2 - 6/1
Beginning AUM	35.6	36.3	36.1	36.7	37.0	37.8	38.5	39.2	40.6	41.3	42.3	42.7	43.5
Market Change Estimate	0.1	0.3	0.3	0.2	0.6	0.4	0.4	0.5	-0.1	0.8	-0.7	-0.5	0.5
Monthly Flow Estimate (first of month)	0.6	-0.5	0.3	0.1	0.2	0.3	0.3	0.9	0.8	0.2	1.1	1.3	0.6
Net Change	0.7	-0.2	0.6	0.3	0.8	0.7	0.7	1.4	0.7	1.0	0.4	0.8	1.1
Ending AUM (First of Month)	36.3	36.1	36.7	37.0	37.8	38.5	39.2	40.6	41.3	42.3	42.7	43.5	44.6
Annualized Growth Rate	20.2%	-16.5%	9.9%	2.4%	6.7%	8.5%	10.4%	27.8%	23.7%	4.6%	30.8%	35.3%	17.1%
MTM % Change in AUM	2.0%	-0.6%	1.7%	0.8%	2.2%	1.9%	1.8%	3.6%	1.7%	2.4%	0.9%	1.9%	2.5%
Y/Y % Change in AUM	21.8%	23.2%	21.1%	20.1%	21.9%	21.1%	22.5%	27.3%	24.8%	22.3%	22.3%	22.2%	22.9%
Calendar month end	35.7	36.6	36.4	36.9	37.6	38.2	38.9	40.1	40.5	42.1	41.6	42.2	44.0

Source: Company reports, Citi Research

Figure 3. OZM's Historical Risk-Adjusted Returns Are Strong



The returns shown represent the composite performance of all feeder funds that comprise the OZ Master Fund since the inception of the OZ Master Fund on January 1, 1998 (collectively, the "Master Fund Composite"). The Master Fund Composite is calculated using the total return of all feeder funds net of all fees and expenses (except incentive income on unrealized gains attributable to investments that the Company, as investment manager, determines lack a readily ascertainable fair value, are illiquid or otherwise should be held until the resolution of a special event or circumstance ("Special Investments") that could reduce returns on these investments at the time of realization), and includes the reinvestment of all dividends and other income.

Source: Company reports, FactSet, Citi Research

Figure 4. OZM Summary Model

Och-Ziff Capital Management
Earnings Results and Forecasts
(\$ Millions, Except As Noted)

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KEY FORECAST VARIABLES:	1Q13	2Q13	3Q13	4Q13	1Q14	Forecast:			2013	Forecast:			% Change				
						2Q14E	3Q14E	4Q14E		2014E	2015E	2016E	2QE/1Q	2QE/2Q	14E/13	15E/14E	16E/15E
Economic Income Basis																	
Revenues																	
Management Fees	126.4	134.9	138.2	146.3	154.6	161.6	171.0	178.9	545.8	666.1	750.7	857.6	4.6	19.8	22.0	12.7	14.2
Incentive Fees	101.3	22.9	72.3	886.1	59.0	0.0	0.0	343.4	1,082.6	402.4	746.1	849.3					
Other Revenues	1.0	0.2	0.2	0.8	0.4	0.3	0.3	0.3	2.2	1.2	1.5	1.5	-43.9	12.6	-44.4	25.4	0.0
Total Revenues	228.6	158.0	210.7	1,033.2	214.0	161.9	171.2	522.6	1,630.5	1,069.7	1,498.3	1,708.4	-24.4	2.5	-34.4	40.1	14.0
Operating Expenses																	
Base Compensation	21.5	22.3	23.0	24.0	25.6	26.7	29.1	30.4	90.8	111.7	123.9	141.5	4.2	19.6	23.1	10.8	14.2
Variable Compensation	2.0	3.0	4.5	305.8	3.6	0.0	0.0	197.7	315.3	201.3	290.6	330.0					
Total Compensation & Benefits	23.5	25.3	27.5	329.8	29.2	26.7	29.1	228.1	406.1	313.1	414.4	471.5	-8.7	5.4	-22.9	32.4	13.8
Interest Expense	1.7	1.7	1.8	1.7	1.7	2.0	2.0	2.0	7.0	7.6	8.3	8.2	19.7	14.9	8.9	8.5	-1.0
General & Administrative	29.0	32.4	27.2	30.2	27.2	34.4	30.5	32.0	118.8	124.1	136.2	152.6	26.5	6.1	4.4	9.8	12.0
Total Operating Expenses	54.2	59.4	56.6	361.7	58.0	63.0	61.6	262.1	532.0	444.7	559.0	632.3	8.6	6.1	-16.4	25.7	13.1
Operating Income	174.4	98.6	154.1	671.4	156.0	98.8	109.7	260.5	1,098.5	624.9	939.4	1,076.1	-36.6	0.3	-43.1	50.3	14.6
Net loss on JVs	0.2	0.3	0.4	0.6	0.2	0.0	0.0	0.0	1.5	0.2	0.0	0.0					
others' interests	0.4	0.4	0.3	0.2	0.0	0.0	0.0	0.0	1.3	0.0	0.0	0.0					
Total Company Economic Income	174.2	98.5	154.2	671.7	156.2	98.8	109.7	260.5	1,098.7	625.2	939.4	1,076.1	-36.7	0.3	-43.1	50.3	14.6
Adjusted Income Taxes	37.3	21.0	24.0	112.8	33.0	22.2	24.7	58.6	195.1	138.6	211.4	242.1	-32.7	5.7	-29.0	52.5	14.6
Distributable Earnings	136.9	77.5	130.3	559.0	123.2	76.6	85.0	201.9	903.6	486.6	728.0	834.0	-37.8	-1.1	-46.1	49.6	14.6
Weighted-avg adjusted Class A shares	474.5	483.9	484.4	487.0	505.3	507.2	509.1	511.0	482.5	508.2	525.0	540.7	0.4	4.8	5.3	3.3	3.0
Distributable Earnings Per Sh (DEPS)	\$0.29	\$0.16	\$0.27	\$1.15	\$0.24	\$0.15	\$0.17	\$0.39	\$1.87	\$0.96	\$1.39	\$1.54	-38.0	-5.7	-48.9	44.8	11.2
Dividend Per Share	\$0.28	\$0.14	\$0.25	\$1.12	\$0.23	\$0.13	\$0.15	\$0.37	\$1.79	\$0.88	\$1.31	\$1.46	-43.0	-6.4	-50.7	48.4	11.5
Economic Income Margins:																	
Operating Income	76.3%	62.4%	73.1%	65.0%	72.9%	61.1%	64.1%	49.8%	67.4%	58.4%	62.7%	63.0%					
Distributable Earnings	59.9%	49.0%	61.8%	54.1%	57.5%	47.3%	49.6%	38.6%	55.4%	45.5%	48.6%	48.8%					
Salary & Benefits % Revenue	9.4%	14.1%	10.9%	2.3%	12.0%	16.5%	17.0%	5.8%	5.6%	10.4%	8.3%	8.3%					
Salary & Benefits % Management Fees	17.0%	16.5%	16.6%	16.4%	16.6%	16.5%	17.0%	17.0%	16.6%	16.8%	16.5%	16.5%					
Variable & Guaranteed Compensation % Reveni	0.9%	1.9%	2.1%	29.6%	1.7%	0.0%	0.0%	37.8%	19.3%	18.8%	19.4%	19.3%					
Total Compensation & Benefits To Revenues	10.3%	16.0%	13.1%	31.9%	13.6%	16.5%	17.0%	43.7%	24.9%	29.3%	27.7%	27.6%					
Non-Comp Expense to Management Fees	24.3%	25.3%	21.0%	21.8%	18.7%	22.5%	19.0%	19.0%	23.1%	19.8%	19.3%	18.8%					
Effective Tax Rate	21.4%	21.4%	15.5%	16.8%	21.2%	22.5%	22.5%	22.5%	17.8%	22.2%	22.5%	22.5%					
AUM and Net Flows:																	
AUM (\$ millions)	34,992	36,567	37,808	40,239	42,626	45,051	47,194	49,380	40,239	49,380	56,999	65,358	5.7	23.2	22.7	15.4	14.7
2-year tranche AUM	30,631	31,513	32,562	32,690	33,815	35,584	37,414	39,284	32,690	39,284	49,512	56,571					
3-year tranche AUM	1,400	1,400	1,512	3,500	3,500	3,531	3,620	3,710	3,500	3,710	0	0					
% 2-year	88%	86%	86%	81%	79%	79%	79%	80%	81%	80%	87%	87%					
% 3-year	4%	4%	4%	9%	8%	8%	8%	8%	9%	8%	0%	0%					
Net Flows (\$ millions)	1,091	895	161	957	2,210	2,150	1,250	1,250	3,104	6,860	3,800	4,000					
Annualized Organic Growth Rate	13.4%	10.2%	1.8%	10.1%	22.0%	20.2%	11.1%	10.6%	9.5%	17.0%	7.7%	7.0%					
Revenue Yield (bps)	155	154	154	152	151	150	150	150	153	150	148	147					
OZ Master Fund AUM	0	0	0	0	0	0	0	0	25,211	29,832	33,666	37,865					
Miscellaneous:																	
EBITDA	178.3	102.2	158.1	675.4	159.7	103.3	114.2	264.9	1,114.0	642.1	957.7	1,094.3	-35.3	1.1	-42.4	49.1	14.3
Free Cash Flow	136.1	76.7	128.9	557.8	121.0	76.0	84.4	201.3	899.6	482.7	725.5	831.5	-37.2	-1.0	-46.3	50.3	14.6
Free Cash Flow Per Share	\$0.29	\$0.16	\$0.27	\$1.15	\$0.24	\$0.15	\$0.17	\$0.39	\$1.86	\$0.95	\$1.38	\$1.54	-37.4	-5.5	-49.1	45.5	11.3
Return On Equity	31.3%	18.3%	29.9%	112.4%	25.1%	17.8%	19.5%	45.9%	40.8%	27.5%	39.3%	43.0%					
Book Value Per Share	\$3.49	\$3.57	\$3.64	\$4.55	\$3.38	\$3.41	\$3.44	\$3.46	\$4.59	\$3.48	\$3.53	\$3.59	0.8	-4.4	-24.1	1.3	1.6
Base DEPS	\$0.09	\$0.10	\$0.11	\$0.11	\$0.12	\$0.12	\$0.13	\$0.13	\$0.41	\$0.50	\$0.55	\$0.62					
FRE per Share	\$0.11	\$0.11	\$0.12	\$0.12	\$0.13	\$0.13	\$0.14	\$0.15	\$0.46	\$0.55	\$0.61	\$0.68					

Source: Company reports, Citi Research

Och-Ziff Capital Management

Company description

Och-Ziff Capital Management Group LLC is a global alternative asset management firm headquartered in New York City. OZM was founded by Daniel Och, together with the Ziff family in 1994 and the company has grown into one of the largest alternative firms in the world. OZM's multi-strategy approach is based on various strategies, including merger arbitrage, convertible arbitrage, equity restructuring, credit/distressed, private placements, and real estate. OZM's funds seek to deliver risk-adjusted returns throughout market cycles, with a strong emphasis on risk management. The company has approximately 130 investment professionals (including 16 partners and 39 managing directors) with offices in New York, London, Hong Kong, Bangalore, Tokyo, and Beijing.

Investment strategy

We rate shares of Och-Ziff Capital Management Buy. OZM is benefiting from a real time positive inflow inflection, and should deliver among best in class organic growth over the next several years. With 100% of AUM in alternatives, we forecast strong flow prospects as institutional demand accelerates and the search for alpha rises. Additionally, OZM is well positioned to garner market share given their impressive LT risk adjusted track record, transparent investment process, and stringent risk controls.

Valuation

We value OZM at \$16.50 using a blended methodology based on: 1) 25% sum-of-the-parts approach that combines target P/FRE, book value, and NPV of performance fees; and, 75% distributable earnings discount model (DEDM). In turn, our SOTP factors: 1) target P/E multiple of 17x to our 2015 FRE estimate; 2) adding ~\$9 for our estimated probabilistic value to OZM's potential performance fee revenue stream; and, 3) subtracting net debt. Our base-case DEDM factors a 10% cost of capital; 90% payout ratio; and specific growth assumptions.

Risks

The three central risks to our price target reflect deteriorating investment performance, slowing organic growth and major change in carried interest taxation.

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

Financial market risk — Changes in markets could impact AUM and investment advisory 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, which could result in a decline in revenue.

Redemption risk — Investors can redeem their investments with notice. A significant increase in redemption rates could have a material adverse effect on revenues, financial condition, results of operations and business prospects.

Performance fees — The lack of positive investment performance in OZM's hedge funds would limit the company to generate performance fees (incentive carry) and grow DEPS.

Appendix A-1

Analyst Certification

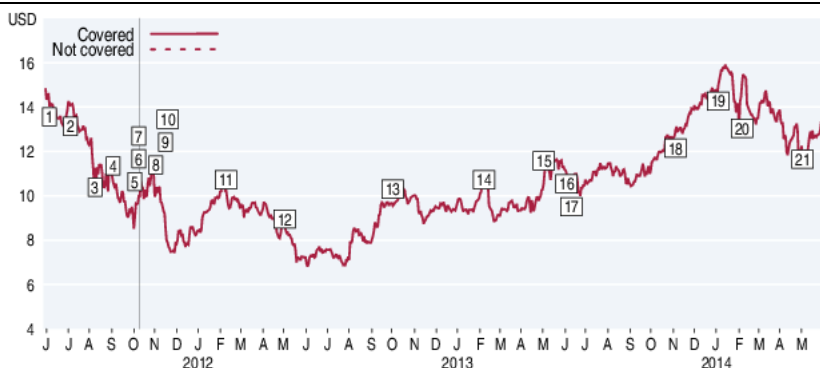
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Ratings and Target Price History Fundamental Research

Analyst: William R Katz



	Date	Rating	Target Price	Closing Price
1	6-Jun-11	1H	*20.00	14.03
2	5-Jul-11	1H	*19.00	14.08
3	9-Aug-11	1H	*16.00	11.26
4	2-Sep-11	1H	*15.50	10.63
5	4-Oct-11	1H	*14.00	9.03
6	8-Oct-11	Stock rating system changed		
7	8-Oct-11	*1	14.00	9.66

* Indicates change

	Date	Rating	Target Price	Closing Price
8	2-Nov-11	1	*13.00	10.07
9	16-Nov-11	1	*12.00	8.50
10	18-Nov-11	1	*11.00	7.91
11	9-Feb-12	1	*12.00	10.26
12	2-May-12	1	*11.50	8.72
13	2-Oct-12	1	*12.00	9.55
14	7-Feb-13	1	*11.50	10.50

	Date	Rating	Target Price	Closing Price
15	2-May-13	1	*12.00	10.54
16	4-Jun-13	1	*13.00	11.04
17	11-Jun-13	1	*14.00	10.70
18	5-Nov-13	1	*15.00	12.98
19	3-Jan-14	1	*16.00	14.96
20	6-Feb-14	1	*17.50	15.06
21	2-May-14	1	*16.50	11.86

Rating/target price changes above reflect Eastern Standard Time

Och-Ziff Capital Management (OZM)

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

Analyst: William R Katz



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Data current as of 31 Mar 2014

	12 Month Rating			Relative Rating		
	Buy	Hold	Sell	Buy	Hold	Sell
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% of companies in each rating category that are investment banking clients	55%	53%	45%	58%	53%	42%

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