



Theme I

How should the alternative asset managers be valued?

A key part of our investment thesis centers on at least modest P/E multiple expansion for the alternative asset managers relative to the traditional asset managers over the next 12 months. We think this will be driven by both cyclical and secular factors. As outlined within the report, the key positive cyclical factor is the current realization cycle, which we think is in about midstream and should continue to grow into 2015 before beginning to wane thereafter. This of course depends on market conditions, which began to improve more meaningfully in 2012 and have been especially favorable in 2013. However, barring a prolonged market downturn, and provided equity markets are not extremely volatile and have a positive direction, conditions for portfolio position exits via IPOs, secondary offerings, and M&A, for example, should remain relatively favorable.

This situation is likely to drive considerable improvement in distributable earnings (DE) growth, which is the closest measure to cash flow as it pertains to distributions being paid in cash to unit holders. Hence, we think the market will increasingly focus on this metric, at the expense of the more mark-to-market-driven (and GAAP-like) economic net income (ENI), which forms Consensus and can also form valuations. Thus, the crux of our argument is that the earnings metric to value the Alts should transition to DE, which should be a favorable dynamic for the Alts at this part of the cycle, a condition likely lasting through 2014 and 2015.

Figures 15-17 show our earnings forecasts for two different metrics (ENI and DE) for the Alts through 2016, with Figure 15 showing the ratio of DE to ENI. We regard this ratio as somewhat of an earnings quality measure, with a higher ratio of DE to ENI implying a larger proportion of ENI is distributable in cash to unit holders (with typical payout ratios on DE ranging from ~75-95%).

Figure 15: DB Forecasted Ratio of Annual DE as a % of ENI for the Alts

Alts	DB Estimated Ratio of DE to ENI				
	2012	2013E	2014E	2015E	2016E
APO	48%	84%	129%	116%	94%
BX	53%	55%	75%	90%	107%
CG	98%	74%	105%	117%	131%
KKR	71%	70%	85%	89%	95%
OAK	94%	96%	118%	116%	115%
Median	71%	74%	105%	116%	107%

Source: Company reports and Deutsche Bank

The steadily improving ratio at BX and CG (to the extent our forecasts are correct) is a key pillar of our Buy theses for these stocks. OAK also has a relatively good ratio on an absolute level and trend. We also expect KKR's ratio to improve over time, though it will likely be much more volatile than we are forecasting given volatility in market returns forming ENI. In contrast, we expect APO's ratio to peak in 2014 given our expectation for realizations to begin slowing down in 2014 and through our forecast horizon.