

# A P O L L O

*Strictly Confidential*

## Intercompany Loan

A Discussion Document  
September 10<sup>th</sup>, 2014

## Key Considerations

The proposal is to interpose an **intercompany note between AGM and APO Corp**, which would be effected by way of a dividend. The intercompany note should result in **future ongoing interest deductions** which should in turn reduce AGM's ETR and cash taxes, which should in turn increase DNI and increase the trading price of AGM's Class A Shares.

### Key Considerations

#### *Legal, tax or reputational issues*

- Conflicts and disclosure
- Compliance with tax covenants
- Compliance with credit facilities
- Commentary on Asset Manager peers
- Tax risk to AGM

#### Sizing and Pricing of the Note

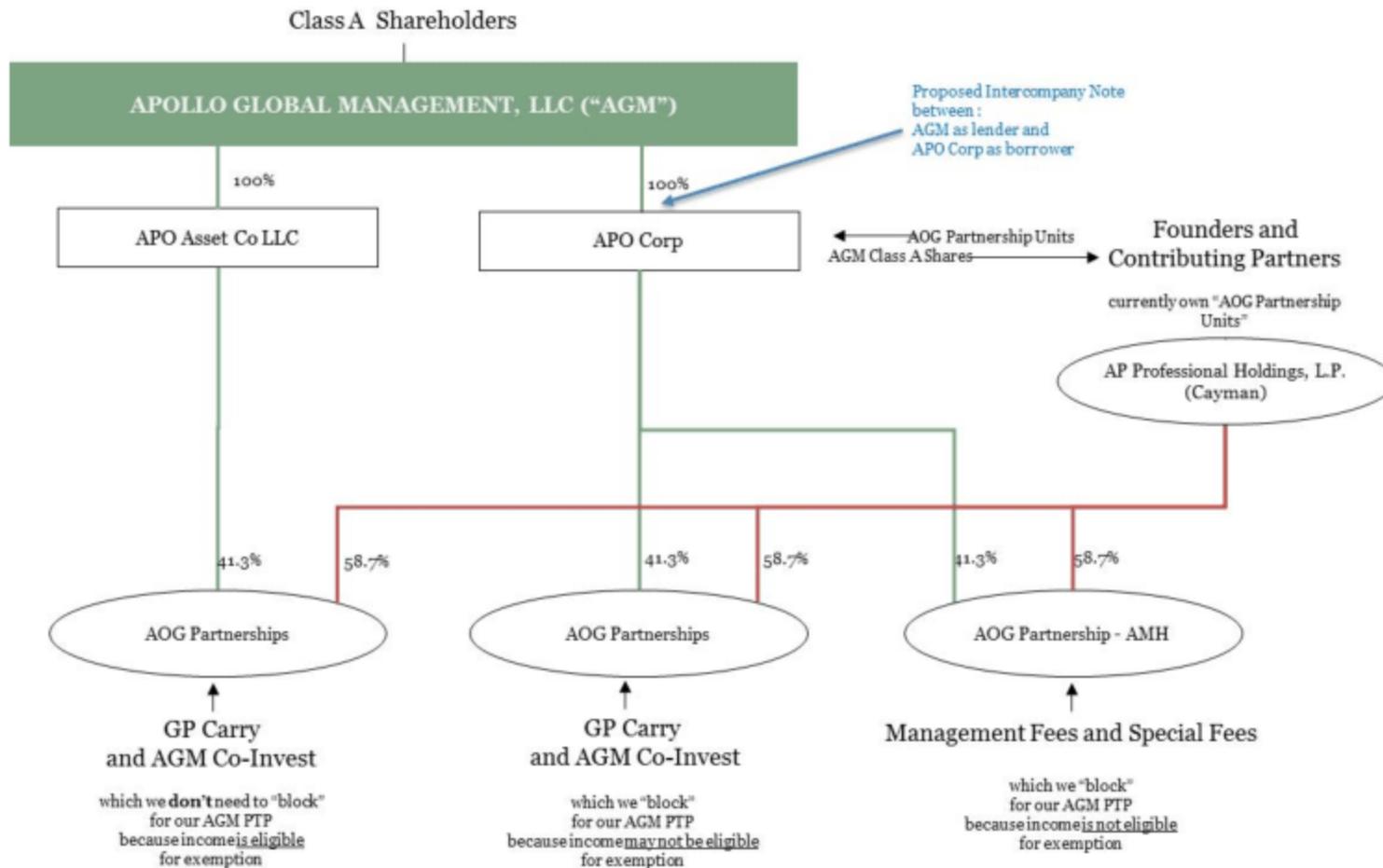
- Note must be respected as debt for tax purposes
- Note must contain arm's length terms and reflect market pricing
- Consistency with AGM's dividend policy
- Size must be limited to ensure deductibility
- Impact on projections including an analysis of whether a valuation allowance is required on the DTA

#### Tax Implications

- For US Shareholders of AGM (tax rate differential between interest income and qualified dividends)
- For Non-US Shareholders of AGM (increase in withholding for ADIA)

# General Background and Discussion Points

The proposal is to interpose an intercompany note between AGM and APO Corp, which would be effected by way of a dividend. The intercompany note should result in future ongoing interest deductions which should in turn reduce AGM's ETR and cash taxes, which should in turn increase DNI and increase the trading price of AGM's Class A Shares.



## Economic Impact – Cash Taxes

We are proposing to issue a \$950M note @ 6.74% coupon. The following tables shows the estimated impact on cash taxes:

Cash Tax Projection					
	FY'14 Budget	FY '15 Plan	FY '16 Plan	FY '17 Plan	FY '18 Plan
<i>(\$ in millions)</i>					
Pre-Tax DNI	1,232	892	1,236	1,130	1,552
<b>Total Taxable Income</b>	<b>555</b>	<b>507</b>	<b>680</b>	<b>853</b>	<b>1,039</b>
<b>Cash Taxes @ Marginal Tax Rate</b>	<b>36.4%</b>	<b>35.9%</b>	<b>35.0%</b>	<b>37.2%</b>	<b>37.3%</b>
Corporate Taxes	42	28	54	79	107
TRA Payment	37	39	40	42	44
Pretax Payment to Founders	115	102	142	183	229
Statutory Taxes	12	8	14	17	18
<b>Total Cash Taxes</b>	<b>206</b>	<b>176</b>	<b>249</b>	<b>320</b>	<b>398</b>
<b>Effect of Incremental \$64 million of Interest Expense to APO Corp</b>	<b>(19)</b>	<b>(64)</b>	<b>(64)</b>	<b>(64)</b>	<b>(64)</b>
Pre-Tax DNI <sup>1</sup>	1,232	892	1,236	1,130	1,552
Corporate Taxes <sup>2</sup>	35	5	28	53	81
TRA Payment <sup>3</sup>	37	39	40	42	44
Pretax Payment to Founders <sup>4</sup>	104	67	103	144	189
Statutory Taxes <sup>5</sup>	12	8	14	17	18
<b>Total Cash Taxes</b>	<b>189</b>	<b>119</b>	<b>185</b>	<b>255</b>	<b>333</b>
Reduction in Cash Taxes (After-Tax DNI View)	18	57	65	65	65
Increase in DNI Payments to Founders	11	34	39	39	39
Increase in DNI Payments to Common Unit Holders	7	23	26	26	26
<b>Net increase (decrease) in cash</b>	<b>(0)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>

<sup>1</sup>Pre-Tax DNI would remain unchanged, however after-tax DNI would increase by the amount of the tax-benefit (which would increase DNI distributable to common shareholders by the same tax benefit)

<sup>2</sup>Over 5 year period corporate taxes are reduced by \$107M (36% avg. marginal rate on \$275M of new interest expense)

<sup>3</sup>TRA Payments are unchanged in total over the five year period but are deferred to later years due to the decrease in taxable income in initial years

<sup>4</sup>Total cash distributions to Founders remains the same (equivalent to the Founder's share of pre-tax DNI). The reduction in corporate taxes and TRA payments increases the amount of the regular dividend payment to the Founders and decreases the pre-tax payment (gross-up) by an equivalent amount.

<sup>5</sup>Statutory taxes are unchanged as interest expense is at the APO Corp level

The note was sized at \$950M as Apollo should keep its debt-to-equity ratio under 1.5 to 1 as calculated under §163(j). Staying within these bounds allows AGM to benefit from a “safe harbor” from rules that could disallow deductions for interest expense

Corp Note Calculation	
Note	950,000,000
Interest Rate	6.74%
Interest Expense	64,030,000
Months	12
Interest Expense Per Month	5,335,833
<b>Sept 15th Issue Date</b>	
Months	3.5
<b>2014 Interest Expense</b>	<b>18,675,417</b>

Pretax Payment to Founders Rec			
	Without Note	With Note	Difference
Tax Payments	79	72	7
Per Share	0.51	0.46	0
Founder Share	225.0	225.0	-
Pretax Payment	114.74	104.17	11

## Economic Impact – ENI Tax Provision

The following table shows the estimated impact on AGM's Tax Provision:

ENI Tax Projection					
	FY'14 Budget	FY'15 Plan	FY'16 Plan	FY'17 Plan	FY'18 Plan
<i>(\$ in millions)</i>					
Total ENI	1,107	1,223	1,574	1,779	1,666
Incentive Co. - Pass thru ENI	266	471	565	625	493
<b>Tax Base</b>					
Management Company Pre-Tax ENI	552	426	545	635	675
Management Company Tax Adjustments	(243)	(272)	(128)	(53)	(35)
Incentive Company Taxed ENI	310	327	464	519	498
<i>Incentive Company Private Equity Taxed ENI</i>	79	99	119	132	88
<i>Incentive Company Credit/Real Estate Taxed ENI</i>	142	140	182	241	287
<i>Incentive Company Taxable Balance Sheet</i>	53	87	163	146	123
<b>Total Tax Base</b>	<b>619</b>	<b>481</b>	<b>881</b>	<b>1,101</b>	<b>1,138</b>
<b>ENI Tax Provision</b>					
ENI Corporate Tax Provision	222	178	333	419	444
Tax True Up <i>(Due to Changes in State Tax Rates)</i>	3	-	-	-	-
Statutory Taxes	11	10	10	10	10
<b>Total ENI Provision</b>	<b>236</b>	<b>189</b>	<b>343</b>	<b>429</b>	<b>454</b>
<i>ENI Effective Tax Rate</i>	21.3%	15.4%	21.8%	24.1%	27.3%
<b>GAAP Provision</b>	<b>98</b>	<b>80</b>	<b>140</b>	<b>174</b>	<b>183</b>
<sup>1</sup> Effect of Incremental \$56 Million of Interest Expense	(19)	(64)	(64)	(64)	(64)
<b>Total Tax Effect @ 40.35% Marginal Rate</b>	<b>(7)</b>	<b>(26)</b>	<b>(26)</b>	<b>(26)</b>	<b>(26)</b>
<b>ENI Tax Provision</b>	<b>229</b>	<b>164</b>	<b>318</b>	<b>404</b>	<b>429</b>
	20.7%	13.4%	20.2%	22.7%	25.8%
<b>GAAP Provision</b>	<b>91</b>	<b>55</b>	<b>115</b>	<b>149</b>	<b>158</b>

<sup>1</sup> Interest expense is at the APO Corp level. As such, the tax benefit for GAAP and ENI Provisions are the same.

<sup>2</sup> Assumes \$950M note at 6.74% coupon. Assumes only 3.5 months of interest expense for 2014.

## Appendix – Pricing and Support

The credit rating, size and interest rate on the corporate note were determined based on comparison to existing Apollo debt and industry benchmarks.

### Intercompany Loan

The starting point for the credit rating was the ten year bonds we recently issued in May 2014 @ 4% with an A- rating, but given the following factors we concluded that a **BB is appropriate** for the intercompany loan:

1. The 4% Bonds issuance is guaranteed by the APH and AMH entities and the APO borrowings from related parties is not guaranteed.
2. In bankruptcy proceedings third party debt is (and in fact many other payments to third parties are also) senior to related party debt. Thus, related party debt is structurally subordinate to debt like that in the 144A issue.
3. The APO loan includes a PIK provision and prepayment rights without penalty.

### *Characteristics of the Intercompany Loan*

<i>Rating:</i>	<i>BB</i>
<i>Maturity:</i>	<i>10 years</i>
<i>Amount:</i>	<i>\$500m - \$1,000m</i>
<i>Int. Rate:</i>	<i>5.22% - 7.07%</i>
<i>Convertibility:</i>	<i>None</i>

## Appendix – Pricing and Support ( )

Given the above features, we ran a screening of all recently issued comparable fixed income securities. We ran two analyses, each based on a different set of comparable securities:

1. a broader Finance industry including diversified firms and banks
2. a set focused on the Capital Market sector including asset management firms

Both analyses arrived at similar ranges with Median Interest Rates of **6.13%** and **5.93%**, respectively.

### Transfer Pricing Study – Interest Rate Analysis

We engaged Deloitte to assist with a Transfer Pricing Study to help determine the optimal characteristics of the potential intercompany financing. Based on their finding, a similar 10 yr loan would require a rate between **5.22%** and **7.07%**, with a median of **6.21%**.

Notes	Min	Low Q-tile	Median	Up Q-tile	Max
10-Year Note	5.22%	5.57%	6.21%	6.74%	7.07%
8-Year Note	5.00%	5.34%	5.97%	6.52%	6.83%
5-Year Note	4.20%	4.53%	5.15%	5.72%	6.02%
3-Year Note	3.18%	3.47%	4.06%	4.70%	4.93%