



Investment Thesis

Outlook

Hold-rated Apollo is one of the leading alternative asset management firms and we view the firm as broadly well-positioned to benefit from strong secular industry trends, including rising demand for alternatives and greater concentration of fund raising toward large PEs. However, we see the units trading in a range near current levels over the next 12 months for the following reasons: 1) we see APO as more advanced in its fund realization cycle than peers, a condition likely to continue into 2014, causing distributable earnings (DE) to peak in 2013 or 2014 at the latest, 2) despite a very successful capital raise for Fund VIII at \$18bn, DE in 2015-16 is likely to remain well below 2013-14 levels as Fund VIII remains in a capital deployment mode through 2016, and distributions from other large funds will likely have waned, and 3) APO's risk profile is above average with more concentrated positions, and this could restrain APO's PE expansion in 2014 if the market becomes choppy vs. 2013. Positively, mgmt is extremely innovative and several growth initiatives may help buffer the valley in the PE cycle, the strongest being the Athene/Aviva acquisition, which will enable APO to further leverage its credit expertise & grow fee earnings. However, we don't think these efforts will fully offset the DE compression post realization cycle.

Valuation

We believe DE, from which cash distributions are paid to unit holders, is the most important earnings metric to value the Alts, rather than economic net income (ENI) that forms Consensus estimates. Our valuation is based on assigning a target PE on our 2015 estimate for distributable earnings, a year from now. With positive revaluation for the Alts, we still think APO will expand its P/E from 10.6x 2014E ENI to over 11-12x 2015E DE 12 months from now, narrowing its discount to the S&P 500 P/E from ~40% to ~30%. This drives a \$31 PT, which implies a total return of 6% over the next 12 months, inclusive of a 9.5% forecast distribution yield for 2014.

Risks

Downside risks for APO are: 1) a slowdown in US/global economy, 2) a prolonged equity market correction, 3) an inability to generate strong growth organically and/or from Aviva in 2014 that would further reduce DE in '15, 4) an inability to deploy capital in Fund VIII at a reasonable pace & 5) failure to improve P/E vs. traditional asset managers and the market broadly. Additional downside risks are: loss of key personnel, a deterioration in investment performance, unfavorable regulatory legislation, a change in tax laws creating higher taxation on carried interest and/or the partnership structure, increasing competition from traditional asset managers diversifying into alternatives, and inability to broaden the investor share base if as holding partnership units can be prohibitive for some investment funds. Upside risks are: 1) stronger investment returns than expected that drive much higher DE than forecast, and 2) much stronger organic growth at Aviva than forecast.