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CORPORATE PARTICIPANTS

David M. Lesser *AllianceBernstein Holding L.P. - Corporate Secretary*

James Andrew Gingrich *AllianceBernstein Holding L.P. - COO of AllianceBernstein Corporation*

John Charles Weisenseel *AllianceBernstein Holding L.P. - CFO & Senior VP of AllianceBernstein Corporation*

Seth Perry Bernstein *AllianceBernstein Holding L.P. - President, CEO & Director of AllianceBernstein Corporation*

CONFERENCE CALL PARTICIPANTS

James John Robert Steele *Jefferies LLC, Research Division - Equity Associate*

Michael Roger Carrier *BofA Merrill Lynch, Research Division - Director*

William R. Katz *Citigroup Inc, Research Division - MD*

PRESENTATION

Operator

Thank you for standing by, and welcome to the AllianceBernstein third quarter 2019 earnings review.

(Operator Instructions) As a reminder, this conference is being recorded and will be available for replay for 1 week.

I would now like to turn the conference over to your host for this call, Corporate Secretary for AB, Mr. David Lesser. Please go ahead, sir.

David M. Lesser - *AllianceBernstein Holding L.P. - Corporate Secretary*

Thank you, Jessa. Good morning, everyone, and welcome to our third quarter 2019 earnings review.

This conference call is being webcast and accompanied by a slide presentation that's posted in the Investor Relations section of our website, www.alliancebernstein.com.

Seth Bernstein, our President and CEO; John Weisenseel, our CFO; and Jim Gingrich, our COO, will present our results and take questions after our prepared remarks.

Some of the information we will present today is forward looking and subject to certain SEC rules and regulations regarding disclosure. So I'd like to point out the safe harbor language on Slide 1 of our presentation. You can also find our safe harbor language in the MD&A of our third quarter 2019 10-Q, which we filed earlier this morning. Under Regulation FD, management may only address questions of a material nature from the investment community in a public forum. So please ask all such questions during this call.

Now I'll turn it over to Seth.

Seth Perry Bernstein - *AllianceBernstein Holding L.P. - President, CEO & Director of AllianceBernstein Corporation*

Thank you. Good morning, and thank you for joining us today. Our third quarter results reflect momentum in several key areas of our business. Firm-wide active flows were positive $9.3 billion in the third quarter, bringing year-to-date active net inflows to $21.6 billion, which translates to a 6.3% active annualized organic growth rate, continuing our best year-to-date in more than a decade. Flows were driven by a continued rebound in fixed income and ongoing success with retail active equities. And in an environment of declining fee rates, AB's overall portfolio fee rate continues to be stable.

Now let's get into the specifics, starting with a firm-wide overview on Slide 4. Third quarter gross sales of $26.3 billion increased 36% year-on-year and were down slightly sequentially. Total firm-wide net flows were positive $8.1 billion versus $1.3 billion in the prior year period and net inflows of $9.5 billion in the second quarter. Total assets under management of $592.4 billion at quarter end increased 8% year-on-year and 2% sequentially, making our highest AUM since the financial crisis. And average AUM was up 7% versus the prior year period and 4% sequentially.

Slide 5 shows our quarterly flow trend by channel. Firm-wide net inflows were driven by Retail and Institutional, while Private Wealth flows remained negative for the quarter. In Retail, gross sales reached a record $21.1 billion, the highest in our Retail history, and increased versus both prior periods. And net inflows of $7.4 billion compared to modest inflows in the year ago period and were higher sequentially. In the bottom left chart, you can see Institutional gross sales of $2.9 billion, while redemptions were flat. This resulted in Institutional net inflows of $1.5 billion.

In Private Wealth, gross sales of $2.3 billion were down versus the prior year period and from this year's second quarter due to softening sales trends caused by clients' cautious market sentiment, leading to net outflows of $800 million. Our annualized outflow rate remains below the 20-year average despite volatile markets.

Now let's turn to investment performance, beginning on Slide 6. In fixed income, our percentage of outperforming assets for the 1-year period remained flat sequentially but has improved relative to recent results. And our percentage of assets outperforming for the 3-year period increased to 82% from 63% last quarter. With a rebound in the percentage of assets outperforming, we continue to have high conviction that our global, diversified approach will produce the best risk-adjusted returns over time, which you can see in our 5-year track record with 90% of assets outperforming. In equities, our investment performance was noteworthy, with 63% of assets outperforming for the 1 year, 79% for the 3 year and 84% for the 5 year.

Slides 7 and 8 provide more insight on retail fixed income and equity investment performance. The fixed income table on Slide 7 reflects that our long-term track records remain compelling. Performance in our income portfolios has been particularly strong. American income is top decile for the 1-year period and top quartile for the 3- and 5-year periods. European income is top decile for both the 1- and 5-year periods and top quartile for the 3-year period. Mortgage income beat its benchmark by 200 to 300 basis points for the 1-, 3- and 5-year periods, and AB income remains top decile for the 3- and 5-year periods and top quartile for the 1-year period.

Moving on to equities on Slide 8. Our concentrated global, global low vol, global core and large-cap growth strategies are significant outperformers. In fact, concentrated global, global low vol and global core are each top decile across all time periods. Concentrated U.S. growth is top decile for the 1 year and top quartile for the 3 year, and large-cap growth is top quartile for the 1- and 3-year and top decile for the 5 year. These are impressive rankings even as we continue to see underperformance in our values emerging market strategies.

Let's move on to our client channels, beginning with Retail on Slide 9. We're seeing remarkable results from the years we spent investing in our Retail platform. Our overall sales of $21.1 billion were up 67% year-over-year and surpasses last quarter as the highest sales quarter in Retail history by 12%. We also saw sales strengthen across regions during the quarter, including sequential increases across all regions except EMEA; and year-on-year sales growth in Asia ex Japan, U.S. Retail, EMEA and Latin America. The top left chart shows the pickup in Asia ex Japan industry-wide retail bond fund sales for the 12 months period. Our third quarter sales of $11.3 billion in the region were the highest in history. What's more, the average fee rate on our gross sales in the quarter is 22% higher than our overall channel average.

Net inflows of $7.4 billion were the highest in 19 years, positive for a fifth straight quarter and represent our third consecutive quarter exceeding $5 billion. And our sources of flows are diverse. 14 funds attracted net flows of $100 million or more in the quarter, with 7 of them fixed income, 6 equity and 1 multi-asset, and we hit a number of milestones during the quarter as well. AB Retail assets under management of $223 billion at quarter end is again at an all-time high. 50 retail offerings had more than $1 billion in assets under management at quarter end, and AB ranked 6th out of 458 asset managers in U.S. retail active equity net inflows for the quarter and 7th year-to-date.

Now I'll discuss Institutional on Slide 10. We saw substantial pipeline growth and net inflows turned positive for the year at $1 billion, with gross sales reaching $2.9 billion and limited client outflows. Our Institutional pipeline grew from $7.1 billion at the end of the second quarter to $11.6 billion. That's up 63% sequentially and 47% year-on-year. Our pipeline's annualized fee base also reached a new high of more than $40 million, with strong equity and alternative divisions. And it's our eighth straight quarter in which we exceeded $30 million, as illustrated in the top left chart.

New additions in the third quarter of $6.4 billion, including more than $3 billion in active equities, are the highest in 2 years at the average fee of more than twice the channel average. This is notable considering the industry-wide fee rate contraction. The consultant support is also contributing to the success we're having. New ratings reported in the second quarter have resulted in 3 third quarter pipeline adds, and we continue to see a steady stream of RFP activity. And beyond equities, it's important to note that we're seeing success in other areas, including multi-asset and alternatives, lifetime income strategies, custom alternative solutions, middle-market direct lending. This bodes well for our future revenues.

Moving to Private Wealth Management on Slide 11. Client engagement remains high in the face of softening sales trends. Third quarter gross sales of $2.3 billion are down 23% sequentially and year-on-year, and the flows were negative with outflows of $800 million. But despite volatile markets, our annualized outflow rate remains below the 20-year average. We're seeing client engagement as they maintain their long-term strategic allocations due to advice that includes volatility tools and alternative strategies. Our advice model and investment platform continue to resonate with a broader and more affluent and high-complexity client base. We've added more than $1.6 billion in net inflows to our suite of alternative and focused equity services year-to-date, bringing total deployed and committed assets to $10.8 billion at quarter end. That's the bottom left chart. We closed our first Opportunity Zone transaction, $50 million in commitments, with an additional offering planned for the fourth quarter. Growing our adviser base remains a top priority for us as well. We've reached our year-end targeted adviser head count, up 5% year-to-date.

I'll finish our business overview with the sell side on Slide 12.

Bernstein Research continues to feel the effects of a difficult environment as customer activity remain depressed in most geographies. Revenues of $102 million were near flat year-on-year and down 4% sequentially. However, excluding our April 1 acquisition of Autonomous Research, revenues declined 10% year-on-year. While disappointing, we continue to believe that differentiated offering will ultimately drive client activity. The integration of Autonomous is going well, and our cross-selling efforts are ramping up with more than 100 potential new clients. We had another strong showing in the Institutional Investor AART survey with 18 top-ranked sectors compared to 17 last year. Bernstein Research ranked #1 for best European dark pool liquidity algos in the annual Greenwich Associates survey. And we're finalist in all 5 electronic trading categories in another respected survey.

We continue to globalize our research and trading capabilities. A new global emerging markets financial research product was launched and a research shed and sales operation was built out this past July in India. While year-to-date trends continue to be below our expectations, we're thoughtfully managing our operations in navigating through a tough environment.

I'll close by highlighting some of our third quarter accomplishments on Slide 13. We continued delivering differentiated returns for clients with our diverse products. And we further scaled and commercialized our offerings with continued success of our Retail active equity franchise and a pickup in fixed income. We recently established a loan and CLO management business which will leverage the resources and infrastructure of our existing high-yield credit business and our middle-market direct lending platform. And we remained focused on expense management in executing our relocation to Nashville, which is on plan to achieve our annual -- ongoing annual expense savings target once the transition is completed in 2024.

I'll also add that we made great strides with our responsible investing platform and our broader corporate responsibility efforts. In this past quarter, we announced a collaboration with Columbia University's Earth Institute, home to the Lamont-Doherty Earth Observatory, to create a first-of-its-kind intensive curriculum focused on climate risk and investment performance. I'm very proud of what we've achieved during the quarter despite the presence of some challenges.

Now I'll turn it over to John to review our financials.

John Charles Weisenseel - *AllianceBernstein Holding L.P. - CFO & Senior VP of AllianceBernstein Corporation*

Thank you, Seth. Let's start with the GAAP income statement on Slide 15. Third quarter GAAP net revenues of $878 million increased 3% from the prior year period. Operating income of $203 million increased -- decreased 5%. And the 22.6% operating margin decreased by 250 basis points. GAAP EPU of $0.62 compared to $0.68 in the third quarter of 2018.

As always, I'll focus our remarks from here on our adjusted results, which remove the effect of certain items that are not considered part of our core operating business. We base our distribution to unitholders upon our adjusted results, which we provide in addition to and not as substitute for our GAAP results. Our standard GAAP reporting and a reconciliation of GAAP to adjusted results are in our presentation's appendix, press release and 10-Q.

Our adjusted financial highlights are included on Slide 16. Third quarter revenues of $727 million were flat to the prior year, while operating income of $200 million and our margin of 27.5% all decreased year-on-year. We earned and will distribute to our unitholders $0.63 per year -- per unit compared to $0.69 for last year's third quarter. Lower performance fees combined with higher compensation and G&A expenses primarily drove the weaker results. Revenues, operating income and margin all increased from the second quarter primarily due to higher base investment fees; and lower promotion, servicing and G&A expenses. We delve into these items in more detail on our adjusted income statement on Slide 17.

Beginning with revenues. Third quarter net revenues of $727 million were flat year-on-year. Third quarter base fees increased 6% from the same prior period due to higher average AUM across all 3 distribution channels. Compared to the third quarter of 2018, total average AUM increased 7.2%. The portfolio fee rate of 41 basis points has been relatively stable both year-on-year and sequentially. Third quarter performance fees of $8 million compared to $41 million in the same prior year period. As discussed on our previous earnings call, last year's third quarter performance fees included $35 million related to 2 funds, Financial Services Opportunity Fund I and Real Estate Equity Fund I, which have either been liquidated or mostly liquidated. As expected, these 2 funds did not generate any performance fees in the current year's third quarter and are the drivers to the decline versus the prior year period.

Third quarter Bernstein Research Services revenues of $102 million were relatively flat year-on-year and include revenues from the Autonomous acquisition, which closed on April 1. Excluding Autonomous, Bernstein Research Services revenues decreased 10% year-on-year and 4% sequentially from this year's second quarter primarily due to lower global client activity and trading commissions.

Third quarter net distribution expenses increased $7 million year-on-year as a result of higher Asia retail fund sales and AUM. Investment gains of $4 million increased by $2 million versus the same prior period due to higher seed investment gains. Other revenues increased $2 million compared to the same prior period because of higher dividends and interest earned on our broker-dealer and seed investments.

Moving to adjusted expenses. All in, our total third quarter operating expenses of $527 million increased 3% year-on-year. For the third quarter, transition costs related to our Nashville corporate headquarters relocation totaled $8 million compared to estimated expense savings of $4 million, resulting in a net $4 million reduction in operating income at about a net $0.01 reduction in EPU. Of the net $4 million, approximately $2 million is compensation related, with substantially all included in the comp ratio calculation, and the remaining $2 million representing increased occupancy costs. For the 2019 9 months year-to-date period, transition costs totaled $25 million compared to estimated expense savings of $12 million, resulting in a net $13 million reduction in operating income. Of the net $13 million, approximately $8 million is compensation related, with substantially all included in the comp ratio calculation, and the remaining $5 million representing increased occupancy costs.

Total compensation and benefits expense increased 2% year-on-year on higher base salaries and fringe benefits, which were partially offset by lower incentive compensation. We accrued compensation at a 48.5% of adjusted net revenues for the third quarter this year compared to 49.5% for the first half of this year and 47.5% for the third quarter of 2018. We plan to revisit our comp ratio and adjust accordingly as we gain further clarity as to the full year's revenue, compensation requirements for our business and the transition costs relating to our corporate headquarters relocation. Given current market conditions, we do not expect the fourth quarter comp ratio to exceed 48.5%.

Third quarter promotion and servicing increased 7% versus the same prior year period due to higher T&E and marketing expenses resulting from the timing of our client meetings and digital marketing initiatives, and the 8% sequential decrease came from lower expected seasonal T&E and marketing spend. Third quarter G&A increased 6% year-on-year due to higher occupancy relating primarily to our Nashville relocation and higher technology expenses relating to our business initiatives. Excluding the increase in occupancy, G&A would have increased 3% year-on-year.

Our 9-month year-to-date combined promotion, servicing and G&A expenses of $471 million increased less than 4% versus the prior year. Excluding the occupancy portion of the Nashville relocation expenses, the increase was less than 3%, reflecting our continued focus on expense management.

Third quarter operating income of $200 million decreased 7% from the prior year on flat revenues, while expenses increased modestly. The 11% sequential increase is due primarily to higher base fees and a moderate decline in expenses. Third quarter operating margin of 27.5% decreased 220 basis points year-on-year and increased 240 basis points sequentially. Of the 220 basis point year-on-year decline, 100 basis points is attributed to the higher comp ratio.

You may have noticed that our third quarter adjusted EPU was $0.01 higher than our GAAP EPU, while adjusted operating income was $3 million lower than our GAAP operating income. This is due primarily to the exclusion of the following 2 items from our adjusted results, which are not part of our core business operations. First, we excluded approximately $500,000 of acquisition expenses relating to Autonomous Research. Second, we deconsolidated certain seed investments in our adjusted results that we consolidated for GAAP reporting. Consolidating these investments increased operating income by $4 million but did not affect net income or EPU.

The third quarter effective tax rate for AllianceBernstein L.P. was 5.3%, about as expected.

Finally, the range of cost savings to be realized over the transition period of 2018 to 2024 for our corporate headquarters location is now expected to range from $180 million to $190 million compared to our previously forecasted range of $190 million to $200 million due to the delay in the relocation of certain roles to Nashville and the related compensation savings. All other components of our guidance remain unchanged, including the largest EPU impact of an estimated $0.08 reduction for 2019; breakeven or possibly a slight increase in EPU by 2021; and ongoing annual expense savings of $70 million to $75 million, beginning in 2025.

And with that, Seth, Jim and I are pleased to answer your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Mike Carrier from Bank of America Merrill Lynch.

Michael Roger Carrier - *BofA Merrill Lynch, Research Division - Director*

Maybe first, just retail sales and net flows were impressive just given the environment, yet the Private Wealth was muted. It seems maybe a little bit odd, obviously, like the client base is different, but still it's still unlike the Retail category. So maybe if you can provide some color around maybe the mix and drivers for that difference. And then what do you think could turn those net flows around on the Private Wealth side?

James Andrew Gingrich - *AllianceBernstein Holding L.P. - COO of AllianceBernstein Corporation*

Mike, that's a good observation. The -- because you're correct that if you look at our U.S. Retail business was actually quite strong. And as you point out, the big issue with flows in our wealth management business this quarter was our overall production levels. I -- all I can say is that in our wealth management business we continue to be thrilled with the level of engagement that we're having with the types of clients that we want to have conversations with. The -- we are seeing exactly what we said, which is some delays in transactions and other liquidity events given some of the turbulence in the market; and also, I think, some caution on the part of our clients that's leaving some of their money in cash. But our overall momentum and excitement in that business remains robust, and we continue to do the right things to move the business in the right direction, so we're feeling good about how that business is trending.

Michael Roger Carrier - *BofA Merrill Lynch, Research Division - Director*

Okay. That's helpful. And then given the announcement on the syndicated loan and the CLO strategy. I guess, on one hand, it makes some sense just given the demand that we're seeing in that area and then maybe like fixed income strength, but it also seems like fairly competitive and maybe later cycle. So just, look, why now? And how do you think AB will try to differentiate from a lot of the players out there?

Seth Perry Bernstein - *AllianceBernstein Holding L.P. - President, CEO & Director of AllianceBernstein Corporation*

I think that -- Mike, it's Seth. With this, it's been a long credit cycle. I do think that we have very strong credit skills embedded in both our high-yield business and our middle-market lending business. We've been looking for the right group, looking for the right talent, and we have found some really good people who we have confidence in. We're going to take our time to develop it because we recognize where we are in this cycle, but it fits -- it fills a gap for us in the asset class. It's a direct extension of our own capabilities. And I think we feel that we are experienced enough in managing CLOs in our own portfolios and other securitized assets that we can manage well through what could be more volatile market conditions for spread product. So I think it's a timing issue, but ultimately, we're doing this with a very long perspective in terms of the growth of this business and its place in our lineup. And it was really about finding the right talent.

Operator

Your next question comes from the line of Dan Fannon from Jefferies.

James John Robert Steele - *Jefferies LLC, Research Division - Equity Associate*

This is actually James Steele filling in for Dan. So my question is just on the fee rate. Obviously, you mentioned kind of a declining fee environment that continue to see the Institutional business come in at higher fees, which is kind of very different from what we're seeing elsewhere in the industry and kind of different to what your existing book of business seems to be doing. So just curious as to what might be driving that kind of disconnect.

John Charles Weisenseel - *AllianceBernstein Holding L.P. - CFO & Senior VP of AllianceBernstein Corporation*

Sure. James, it's John. As we talked about, that the pipeline is a great example of this. So over $6 billion added to the pipeline this quarter, to the Institutional pipeline, and roughly half of that was equities, which were obviously higher fee rate than in the past when maybe we had a lot of fixed income in the pipeline. And when we look at the composition of the pipeline right now, it's very well diversified between equities and alternatives and multi-asset and fixed income. In fact, equities and alternatives for the entire $11.6 billion pipeline are the highest-weighted strategies. And that will bode well into the future for the fee rate, as we talked about, with that pipeline having the highest annual fee base associated with it that we've ever had, which is over $40 million.

Seth Perry Bernstein - *AllianceBernstein Holding L.P. - President, CEO & Director of AllianceBernstein Corporation*

But I think it -- just to add. I think it really speaks to where we came from relative to others. We had a much more fixed income-heavy Institutional book of business relative to our peers, and that's just a reflection. We're seeing the same effects as the rest of the industry.

John Charles Weisenseel - *AllianceBernstein Holding L.P. - CFO & Senior VP of AllianceBernstein Corporation*

Absolutely in terms of definitely we're seeing pressure on Institutional on the fixed income mandates. Without a doubt, that's there, and we expect that to continue to be. But the other factor also impacting the overall fee rate on the entire portfolio and keeping it stable to slightly higher, the 41 basis points, is also the strength in our Retail business, particularly in the Asia retail products, which carry high fee rates.

James John Robert Steele - *Jefferies LLC, Research Division - Equity Associate*

Got it. And then secondly, just on American income, I know that that's been a huge driver of inflows for you guys year-to-date. Knowing that, that has sort of been a cyclical product in terms of asset gathering, just if there's a way for us to think about where we are in the cycle.

Seth Perry Bernstein - *AllianceBernstein Holding L.P. - President, CEO & Director of AllianceBernstein Corporation*

Yes. Look, I think Asian investors, which is where we sell the predominant amount of that service, have just a very strong demand for yield. They just are an income-oriented market set for us, but it's a very volatile part of the world. And we've seen it. We've seen it in our flows. We saw it last year, where it was negative. And so it's hard for us to forecast where those flows are going to go, but it's clear that the appetite for fixed income flows globally, demand, has been much stronger as policymakers have been cutting rates. But I mean, frankly, populations which are focused more on retirement, income is the product that they really want. They want security around that. So we're very positive about our income suite globally. And the performance of that income suite, it's not just American income, I think, has warranted the interest it's received.

Operator

(Operator Instructions) Your next question comes from the line of Bill Katz from Citi.

William R. Katz - *Citigroup Inc, Research Division - MD*

Okay. So call it big picture questions, I guess. The first one is a 2-parter, so bear with me. So there's been a fair amount of what I would call commoditization or democratization of the retail system over the last few weeks or so. So sort of the question is you've seen the migration of free trading from some of the online brokers. And then secondly, one of your peers in sort of U.S. wealth management has sort of shifted their strategy around that proprietary SMA platform and then using third-party SMAs. Can you talk a little bit about how either of these might impact the business just from an earnings perspective tactically? But then the broader picture is how you're thinking about your captive strategy in the private client business. And is there any risk to that as a result of these changes?

James Andrew Gingrich - *AllianceBernstein Holding L.P. - COO of AllianceBernstein Corporation*

Bill, I think, if I look at our wealth management strategy, as we've indicated, we are focusing on higher-wealth, higher-complexity clients, which we're some of the -- anticipating some of the trends that you just called out. And if you look at, for example, some of the attach rates on alternatives with those clients, it just speaks to the types of differentiated return sources that we're seeking to provide that set of clients, in addition to all the other things that those clients need in terms of generational wealth planning and tax issues and the like. So we feel good about where we're going because we think that, that serves a distinct need in the client -- in the marketplace that helps insulate us against some of the commoditization issues that I think you're speaking to.

William R. Katz - *Citigroup Inc, Research Division - MD*

Okay. And a follow-up. I'm just curious on your thinking. I know you've had some changes here and there around the MLP structure in terms of not looking at C corp, looking [at there being a fair amount] in -- of arbitrage between earnings dilution and the multiple, but given the fact that the bulk of the alternative managers have now converted to C corp and arguably have enjoyed some very strong multiple expansion, can you give us your updated thoughts on the pros and cons of staying as MLP versus converting to C corp?

John Charles Weisenseel - *AllianceBernstein Holding L.P. - CFO & Senior VP of AllianceBernstein Corporation*

Yes. Bill, it's John. Again, I think it's the story is still the same for us. And I think maybe what differentiates us against some of the other folks who have converted is that we still have the large ownership of AXA, over 65% of the firm. And so I think, some of the other folks who have converted, their play is to get included in an index and hope that, that will help drive increased trading and multiple expansion in their stock. And with us, I don't see us being able to get included in an index with that large ownership of AXA. So that and for the reason that our effective tax rate is so low compared to the others, there's so much tax leakage that, if we did convert and, again, would require a multiple expansion of well over 12% just to keep folks whole, we currently pay out, we have a payout ratio that's over 100%. We're paying out all of our earnings. We're buying back the equity that we issue for stock-based comp, so I really don't see the benefit to our unitholder if you look at it to them on an after-tax basis through the conversion. So we're still -- we'll still monitor it. We'll still continue to look at it. But right now, we're staying in MLP.

Seth Perry Bernstein - *AllianceBernstein Holding L.P. - President, CEO & Director of AllianceBernstein Corporation*

And Bill, it's Seth. Just to clarify, AXA is AXA Equitable.

Operator

There are no further questions at this time. Mr. Lesser, I turn the call back over to you.

David M. Lesser - *AllianceBernstein Holding L.P. - Corporate Secretary*

Thank you, everyone, for participating in our call today. Feel free to contact investor relations with any further questions. Have a great day.

Operator

Thank you. Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.
