

# Letter to Shareholders

## Overview

Results during the quarter were excellent. FFO from most operations were strong, and we generated a number of gains on asset sales. Operational performance gave rise to a significant increase in unrealized performance income and strong overall net income.

Our cash levels, core liquidity and dry powder are at their highest levels across our franchise, ever. Some of this is because our business is larger, but it is also because we are continuing to harvest cash from investments while investing at a conservative pace.

The remainder of 2018 looks strong. We have a lot still to do in order to ensure a successful year, but we are off to a good start.

## Global Investing

The impact of politics on business seems to be on every investor's mind today. This is always the case to a certain extent, but Brexit, U.S. trade tariffs, NAFTA, China, Iran, Syria and others that are in daily social media and news headlines seem to be making investors even more preoccupied.

With respect to our operations, we are not macro investors, but micro investors. Of course, broad economic trends affect all of our businesses but what is more important to our long-term success is our ability to find great businesses in good countries that will stand the test of time, irrespective of short-term politics. While in the long term, negative political situations could impact our businesses, in the short to medium term, politics for the most part do not materially impact our business plans. In fact, the short-term noise frequently provides opportunities to acquire assets at reduced valuations (or to sell them for premium returns).

With respect to entering new countries, it takes a great deal of effort to establish our operations. We therefore try to choose countries wisely, stay forever, and grow incrementally in order to prevent mistakes early on.

There are three important factors we always consider when entering a country. These include its size, a culture of respect for capital (also sometimes referred to as a rule of law, but it's more than that), and the ability to operate with the high global ethical standards we adhere to everywhere we do business.

With respect to size, some countries are excellent places to invest but the size of their economy may not give rise to a large enough investment opportunity. It takes a lot of effort to understand the tax, regulatory and business customs in a country, so we need our major investment areas to have the potential to be meaningful to our overall business in the longer term. We also hope that over time, each of our businesses will benefit from the overall operation established in any one country.

If a country is large enough, we next consider how it has historically treated foreign capital. It is relatively straightforward to recognize the pattern, over time, of behavior regarding foreign capital. In countries that do not have a culture of respecting capital, when times get tough, foreign investors' capital often is encroached upon in some way. Often people look to the "rule of law" to assess this risk, but our view is that, while rule of law is clearly important, more is needed. Some investors have made mistakes when a country appears to have rule of law but does not have respect for private capital. This can be fatal. In other cases, countries that do not appear to have a

separate judiciary from government do respect capital. The circumstances can also differ if you own a particularly strategic resource. These nuances are very important to consider.

Once a country meets these first two tests, we then consider whether we are confident we can operate there with the high ethical and moral standards we operate with globally, or not. Our commitment to these high standards has proven to be a competitive advantage when dealing with global companies, so we are extremely careful not to make any mistakes that could disrupt this. While our experience has shown that we can achieve this in many countries, there are others where it is not possible.

Having a global franchise provides us with an enormous competitive advantage. It offers us both diversification and the ability to find value in markets that few others operate in. This is important, as different regions go through different economic cycles at different times. Our global franchise allows us to scale up our investing activities in markets when things are tougher and returns therefore should be better. Conversely, it allows us to harvest capital in markets that are more fully priced. In all of this, the critical point is that we are able to turn ideas into actionable opportunities.

Ensuring that we adhere to the above principles gives us a common basis to measure our successes and our mistakes. Over time, this continuously makes us better and gives us a definable competitive advantage.

## **Transelec**

This quarter we sold an investment in a Chilean company called Transelec that we acquired in 2006. The story is instructive of how we operate our overall business.

In 2006, we acquired the entire backbone infrastructure electrical transmission system that transmits virtually all the electricity in Chile. This system is approximately 10,000 kilometers, spans the entire country and will never be replicated. At the time, we did not have a flagship infrastructure fund so we funded the investment by investing just under 30% of the equity ourselves, and partnering with three institutional partners for the balance.

Chile at the time was emerging as a strong country with improved rule of law and respect for capital. Having built mining projects there in the past, we were better informed than most other global investors. Given we were early – and in hindsight, right – we invested with a significant margin of safety and the return for the risk we took over the 11 years was exceptional.

To acquire the investment, we invested \$2.7 billion for 100% of the entity that owned the system. We financed the purchase with \$600 million of acquisition debt and inherited \$800 million of existing debt. As a result, our total equity investment was \$1.3 billion of which we retained a 28% investment (~US\$400 million), the balance with institutional clients.

Over the years, we re-invested capital in the business to expand and grow the system, and the cash flows grew as the tariff escalated at a 10% real return. During the 11 years of ownership, after reinvesting into the system for growth, we distributed over \$1 billion of cash dividends to both our partners and Brookfield.

Recently, given the attractiveness of this asset, we decided we could redeploy the capital invested into higher earning investments elsewhere. Transelec is still a great investment, but the asset is at a point where most of the hard work has been done and the upside secured, with the country doing extremely well. As a result, we decided to sell our investment and redeploy the capital into opportunities that will now better benefit from our operating expertise.

After discussion with our partners, we decided to sell our interest only. The end result was that we found a strategic buyer who recently paid \$1.3 billion for our 28% interest in the equity of the company. This was a \$7 billion value on a total enterprise value basis compared to the \$2.7 billion at acquisition.

We generated total proceeds of \$1.6 billion of cash on our equity from this investment. This was four times our initial equity investment, resulting in a compound 16% internal rate of return. We are very pleased with this outcome, and are equally excited about the potential to put this capital to work in new opportunities where our operating expertise and investment capabilities can generate similar premium returns.

This also illustrates our strategy of rotating capital. Our goal is to make investments and use our operating expertise to increase cash flows and de-risk the business; the outcome is an investment that has a lower risk profile and warrants a lower future return. At that point, we sometimes monetize the investment.

We believe that we have left the buyer and our institutional partners with a very successful company that will continue to compound attractive returns for many decades to come. All told, a very good investment.

## GGP

Late last year, we made a proposal to acquire the balance of GGP that we do not already own from the other shareholders. In March, after extensive negotiations with the independent directors of GGP and their advisors, we reached agreement on a revised transaction and the independent directors of GGP have recommended to shareholders that they approve it.

Our formal offer to shareholders will be mailed later this quarter and we expect to be able to close the transaction in the third quarter. Our offer is approximately 61% in cash and 39% in units of Brookfield Property Partners (BPY) or shares of a newly created Brookfield Property REIT. This REIT will be economically equivalent to an investment in BPY but qualify as a U.S. REIT security. Total consideration for the equity of the non-Brookfield owned shares is \$15 billion.

To complete the transaction, we have raised \$9.25 billion of cash by agreeing to sell \$4 billion of interests in retail centers to institutional partners, and borrowed approximately \$6 billion. We expect to sell a further \$2 to \$3 billion of retail center interests shortly following closing, and refinance other assets permanently to repay the full \$6 billion. Nonetheless, the bridge debt we arranged has an average five-year term so we have plenty of time to complete the sales and permanent refinancings.

Given the size of the transaction, we are also issuing BPY units to complete the transaction. We are always reluctant to issue units when they trade at a discount to NAV, but in this case, we are issuing them on an “apples for apples” basis and are hopeful that shareholders of GGP recognize that they are receiving equal or possibly greater NAV back in the form of the BPY units, when they are choosing to take the equity component.

From a BPY and BAM perspective, the transaction is accretive to FFO. More importantly the transaction will provide BPY with access to all of the assets of GGP (as opposed to owning a 34% stock-holding interest). This means that the full global franchise of BPY and BAM will be fully available to re-work the high-quality real estate that GGP owns in what is a rapidly evolving/changing retail real estate environment.

## Performance in the Quarter

Our asset management activities continue to expand at a rapid pace, resulting in very substantial and growing free cash flow to BAM, and total assets under management exceeding \$280 billion.

AS AT AND FOR THE TWELVE MONTHS  
ENDED MARCH 31 (MILLIONS)

|                                           | 2014       | 2015       | 2016       | 2017       | 2018       | CAGR |
|-------------------------------------------|------------|------------|------------|------------|------------|------|
| Total assets under management             | \$ 190,172 | \$ 207,132 | \$ 239,766 | \$ 245,205 | \$ 282,731 | 10%  |
| Fee bearing capital                       | 80,899     | 90,632     | 99,223     | 113,114    | 126,965    | 12%  |
| Annual run rate of fees plus target carry | 1,044      | 1,264      | 1,568      | 2,058      | 2,465      | 24%  |
| Fee related earnings (last twelve months) | 324        | 404        | 569        | 691        | 1,076      | 35%  |

Fee related earnings surpassed \$1 billion for the last twelve month period, an increase of 56% over the prior last twelve months, and fee bearing capital reached \$127 billion at quarter end. This growth in capital includes new private fund fee bearing capital from the first close of our latest real estate opportunity fund, and we added \$4 billion of fee bearing capital in our public securities business with the acquisition of a focused infrastructure manager. This business added retail distribution capabilities, and an experienced investment team. Performance fees were \$143 million in the quarter, or \$285 million in the last twelve month period.

We were active with fundraising and continue to see expanding investor appetite for our funds. In addition to our flagship products, we continue to add income alternatives for clients. This includes core and credit products.

During the quarter, we raised additional capital for our core real estate open-end fund, our real estate mezzanine lending open-end fund, and our infrastructure credit fund. We also launched fundraising for two additional perpetual fund products; a core infrastructure fund and an Australian core real estate fund. In our flagship funds, we continue to invest and have \$22 billion of uncalled third-party fund commitments available to deploy, positioning us well to respond to opportunities.

Over the last couple of quarters, we have included Economic Net Income, or ENI, as a key performance measure in our asset management segment. This measure is the sum of fee related earnings and unrealized carried interest generated in a given period. While we use FFO as our primary measure of performance, we believe that ENI is a useful measure for investors to assess the total value created within our funds in a period and the potential for future growth in FFO as previously generated carry is realized and recorded as FFO. Furthermore, ENI is a widely used measure in the alternative asset management industry, and we believe it provides investors a meaningful data point to benchmark our performance against our peers.

Both FFO and ENI include fee related earnings, but FFO includes only *realized* carried interest, whereas ENI also includes *unrealized* carried interest. As a reminder, we only recognize carry in our financial statements once we have sufficient assurance that it is no longer subject to future investment performance. This is different than most alternative asset managers. Unrealized carried interest represents the amount of carried interest generated based on investment performance to date, and can be used to track progress toward future carried interest realizations in FFO. Changes in unrealized carried interest provides investors with an indication as to how we are tracking towards the eventual realizations, which typically occur in the final years of our funds.

ENI in our asset management business increased to \$2.1 billion in the last twelve month period, more than double the prior year's tally of \$1.0 billion. This is in part because we are still in the early stages of our carried interest potential of our larger funds. Our realized carried interest to date is from older fund vintages, which are smaller in size. As we raise more capital, our carry eligible capital base is increasing. We almost doubled carry eligible capital from \$25 billion in 2015 to \$40 billion in 2016, and these funds are only now beginning to generate carried interest that will be captured in our ENI. We currently have an accumulated unrealized carried interest balance over \$2 billion, which should be realized in FFO over the next few years as the corresponding funds meet their performance hurdles and assets are monetized into cash.

## Closing

We remain committed to being a leading, world-class alternative asset manager, and investing capital for you and our investment partners in high-quality assets that earn a solid cash returns on equity, while emphasizing downside protection for the capital employed.

The primary objective of the company continues to be generating increased cash flows on a per share basis and as a result, higher intrinsic value per share over the longer term.

Please do not hesitate to contact any of us should you have suggestions, questions, comments, or ideas you wish to share with us.

Sincerely,



J. Bruce Flatt  
Chief Executive Officer

May 10, 2018

## CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS AND INFORMATION

*This letter to shareholders contains “forward-looking information” within the meaning of Canadian provincial securities laws and “forward-looking statements” within the meaning of Section 27A of the U.S. Securities Act of 1933, as amended, Section 21E of the U.S. Securities Exchange Act of 1934, as amended, “safe harbor” provisions of the United States Private Securities Litigation Reform Act of 1995 and in any applicable Canadian securities regulations. Forward-looking statements include statements that are predictive in nature, depend upon or refer to future events or conditions, include statements regarding the operations, business, financial condition, expected financial results, performance, prospects, opportunities, priorities, targets, goals, ongoing objectives, strategies and outlook of Brookfield Asset Management Inc. and its subsidiaries, as well as the outlook for North American and international economies for the current fiscal year and subsequent periods, and include words such as “expects,” “anticipates,” “plans,” “believes,” “estimates,” “seeks,” “intends,” “targets,” “projects,” “forecasts” or negative versions thereof and other similar expressions, or future or conditional verbs such as “may,” “will,” “should,” “would” and “could.”*

*Although we believe that our anticipated future results, performance or achievements expressed or implied by the forward-looking statements and information are based upon reasonable assumptions and expectations, the reader should not place undue reliance on forward-looking statements and information because they involve known and unknown risks, uncertainties and other factors, many of which are beyond our control, which may cause the actual results, performance or achievements of Brookfield Asset Management to differ materially from anticipated future results, performance or achievement expressed or implied by such forward-looking statements and information.*

*Factors that could cause actual results to differ materially from those contemplated or implied by forward-looking statements include, but are not limited to: the impact or unanticipated impact of general economic, political and market factors in the countries in which we do business; the behavior of financial markets, including fluctuations in interest and foreign exchange rates; global equity and capital markets and the availability of equity and debt financing and refinancing within these markets; strategic actions including dispositions; the ability to complete and effectively integrate acquisitions into existing operations and the ability to attain expected benefits; changes in accounting policies and methods used to report financial condition (including uncertainties associated with critical accounting assumptions and estimates); the ability to appropriately manage human capital; the effect of applying future accounting changes; business competition; operational and reputational risks; technological change; changes in government regulation and legislation within the countries in which we operate; governmental investigations; litigation; changes in tax laws; ability to collect amounts owed; catastrophic events, such as earthquakes and hurricanes; the possible impact of international conflicts and other developments including terrorist acts and cyber terrorism; and other risks and factors detailed from time to time in our documents filed with the securities regulators in Canada and the United States.*

*We caution that the foregoing list of important factors that may affect future results is not exhaustive. When relying on our forward-looking statements, investors and others should carefully consider the foregoing factors and other uncertainties and potential events. Except as required by law, Brookfield Asset Management undertakes no obligation to publicly update or revise any forward-looking statements or information, whether written or oral, that may be as a result of new information, future events or otherwise.*