GCM Grosvenor 2024 First Quarter Results
May 7, 2024

GCM Grosvenor Speakers:

- Stacie Selinger, GCM Grosvenor, Head of Investor Relations
- Michael Sacks, GCM Grosvenor, Chairman and Chief Executive Officer
- Jon Levin, GCM Grosvenor, President
- Pam Bentley, GCM Grosvenor, Chief Financial Officer

PRESENTATION

Stacie Selinger: Thank you. Good morning and welcome to GCM Grosvenor's First Quarter 2024 Earnings call. Today I am joined by GCM Grosvenor's Chairman and Chief Executive Officer Michael Sacks; President Jon Levin; and Chief Financial Officer Pam Bentley.

Before we discuss this quarter's results, a reminder that all statements made on this call that do not relate to matters of historical fact should be considered forward-looking statements. This includes statements regarding our current expectations for the business, our financial performance, and projections.

These statements are neither promises nor guarantees. They involve known and unknown risks, uncertainties, and other important factors that may cause our actual results to differ materially from those indicated by the forward-looking statements on this call. Please refer to the factors in the Risk Factors section of our 10-K, our other filings with the Securities and Exchange Commission and our earnings release, all of which are available on the Public Shareholders Section of our website.

We'll also refer to non-GAAP measures which we view as important in assessing the performance of our business. A reconciliation of non-GAAP metrics to the nearest GAAP metric can be found in our earnings presentation and earnings supplement, both of which are available on our website.

Our goal is to continually improve how we communicate with and engage with our shareholders and in that spirit, we look forward to your feedback.

Thank you again for joining us, and with that, I'll turn the call over to Michael.

Michael Sacks: Thanks, Stacie.

The first quarter of 2024 was strong from the perspective of both our investment performance for clients and our business performance. Our funds performed well on an absolute basis and relative to peers. With regard to business performance, the first quarter of 2024 was one of the strongest we have reported with regard to year-over-year increases in fundraising, adjusted net income and fee related earnings growth, as well as FRE margin. Year-over-year, Q1 fundraising was up 74%, Adjusted Net Income grew 39% and Fee-Related Earnings grew 26%. Our first-quarter Fee-Related Earnings margin surpassed 40% for the second consecutive quarter.

The quarter was a pleasant change from the first quarters of the last four years, which were marked by Covid, Russia's invasion of Ukraine, the meme stock debacle and, just a year ago, bank failures. While we are always conscious and prepared for the type of volatility and disruption we have seen recently, and we are focused on the possibility of continued global geopolitical volatility, particularly in an election year in the US. It feels great to have gotten off to a good start this year.

We are broadly above high water in Absolute Return Strategies and therefore enjoy increased performance fee prospects. However, the first quarter remained depressed in terms of carry revenue. Announced private transaction volume is up and we look forward to an increase in closed transactions and attendant carry distributions in the future. Generally, our prospects are good and we continue to believe in our ability to double 2023 fee related earnings by the end of 2028. We look forward to moving toward that goal throughout the year.

The $1.6 billion of capital raised in the quarter was the largest quarter of fundraising in the last 6, and the second highest first quarter total since we started reporting earnings during the quarter. Absolute Return Strategies was the highest contributor to fundraising at nearly $500 million, resulting in modestly positive net ARS flows. Recent performance has been solid in Absolute Return Strategies, with the GCM Grosvenor multi-strategy composite achieving gross performance of 4.8% in Q1 and 12.3% over the last 12 months. Despite the good news, we are not changing our general expectation of flat net flows over time, with growth primarily from compounding in the ARS vertical. Consequently, we do expect we will have some negative outflow periods this year while we enjoy revenue growth from performance.

In addition to Absolute Return Strategies, Private Equity and Credit were the other significant contributors to first quarter fundraising. In the case of Private Equity, where we raised almost $500 million, re-ups were a key driver. We've spoken in the past about our high re-up rates and page 10 of our earnings presentation, which Jon will cover, makes it clear that this is a powerful feature of our business that will continue to aid growth going forward.

On last quarter's call, we discussed the general market momentum around private credit and our solution for clients in that vertical. We raised nearly $400 million in credit this quarter across customized separate accounts and specialized funds, including an additional $128 million of commitments to SCF II, our credit co-investment fund. During the first quarter, we hired two additional team members to bolster our direct credit investment capabilities. We believe our value as a solutions provider and our unique origination position enable us to grow private credit meaningfully from these levels.

We are always looking for both investment opportunities to help us deliver performance and the opportunity to grow our relationships with existing investors while adding new investors. The breadth of our platform is proving to be a real asset in the pursuit of those goals. We have and will continue to identify and pursue growth in adjacent investment strategies, such as our Elevate and Impact strategies, and in broader distribution channels, including individual investor channels. Looking across the platform, I'm excited for the numerous ways we have to add value to clients, win and grow the business for shareholders.

Thanks for joining us today. And with that, I'll turn the call over to Jon.

Jon Levin: Thank you. Michael.

Each quarter we drill down on a particular area of our business in my section of the prepared remarks. Today, we're going to cover our customized separate account capabilities in a bit more detail. Our market leading, customized delivery model has been a cornerstone of our historical success, provides stability and predictability to our financial results, as well as significant opportunities for growth. Customized separate accounts represent 73% of our AUM as of Q1, and a similar amount of our fundraising in any given quarter.

We intentionally focused on building the separate account capabilities at our firm almost 30 years ago, long before it was a normal market practice, because we believe that offering a flexible solution was in the best interest of investors. Frankly, we probably didn't realize back then the extent to which offering that solution was also a great foundation for the firm from a business perspective. The initial client acquisition is usually the result of a fairly long, intense, and often competitive process. But the reward in victory are relationships that are often perpetual-like in their long-term nature. We do not take this privilege for granted. We work hard each and every day to collaborate with our partners to drive value in these relationships. We have been rewarded with long standing and growing partnerships, as evidenced by relationships that are almost 30 years long and a 15-year average relationship length of our largest customized clients.

To put some financial metrics around this topic, I point you to page 10 in our earnings presentation. This page depicts an illustrative program that starts out with a $100 million commitment, with a three-year investment period. Our experience is that at the end of the three-year investment period, 90% of clients will re-up their program at a nearly 30% larger size than the original commitment. That new program is layered onto the first-generation program, and that layering continues on a 3-year cycle. Hence, what was initially a $100 million commitment easily becomes $500 million of fee-paying AUM in a dozen years, creating this built in growth dynamic that we've discussed frequently with our shareholders. We have dozens of these programs across our business and different strategies and sizes, representing $58 billion of capital.

Each relationship that underlies a separate account also embeds attractive growth opportunities. Over the last 2 years, 25% of our capital raised has been from existing clients, but into new incremental programs. Such relationship extensions are a natural feature of the customized separate account business and the nature of those relationships. More than 50% of our top clients work with us in more than one strategy.

Our customized separate accounts have also been a driving factor in our meaningful shift towards direct-oriented investment strategies over recent years. The majority of our clients have made a meaningful shift towards including co-investments, secondaries and direct investments into their programs.

We need to earn every re-up and every new client win by delivering strong investment performance and exceptional client service. But assuming we continue to deliver, our customized separate accounts will provide both stability and a meaningful tailwind to our growth. Looking forward to the remainder of 2024, we have more than $4 billion of separate account re-ups in our pipeline, providing key support for what we expect will be a stronger fundraising outcome in 2024 as compared to 2023.

We're truly proud of the culture and platform built over many years that enables us to offer these highly value-added specific solutions to our clients.

With that, I'll turn the call over to Pam.

Pam Bentley: Thanks, Jon.

Our results for the quarter were consistent with our expectations and reflect a strong start to the year.

Assets under management were $79 billion as of quarter-end, a 5% increase from a year ago, and Fee-Paying AUM increased 6% year over year. Private markets continues to be a key growth driver, with private markets Fee-Paying AUM growing 7% year-over-year. As of quarter end our private markets business represents 70% of total AUM and 65% of our Fee-Paying AUM.

Private markets management fees, excluding catch up fees in the quarter, grew 7% year over year, in line with our guidance of mid to high single digit growth. We expect a similar year over year growth rate in private markets management fees, excluding catch up fees in the second quarter. For the full year 2024, we reaffirm our expectation of double-digit private markets management fee growth, excluding catch up fees.

Absolute Return Strategies management fees were stable in Q1 as compared to last quarter, and we expect second quarter ARS management fees to rise slightly on a sequential basis. Most importantly, we are pleased with our ARS investment performance for the quarter, which builds on our strong performance last year.

Administration fees and other operating income was $2.9 million in the quarter. The increase from the prior quarter was due to a $1.8 million contractual fee, related to an end of a particular client program. We expect administration and other operating income in the second quarter to return to 2023 quarterly levels.

We realized $10 million of incentive fees in the quarter, including $6 million of ARS performance fees, the majority of which are from programs that crystallize fees annually on March 31st. We believe our incentive fees provide significant embedded earnings potential, which we look forward to being unlocked as the capital markets and M&A environment improves. While it's difficult to predict the timing of carry realizations, the high diversification of our carry makes it especially valuable given its limited single asset exposure. As of quarter end, we have $779 million in gross unrealized carried interest, diversified across 140 programs. On top of that, our run rate annual performance fees, which are tied to ARS investment returns and typically crystallize in the fourth quarter each year are $29 million assuming ‘normalized’ annual returns of 8% for multi-strategy and 10% for opportunistic investments.

Turning to our expenses, our compensation strategy is rooted in fostering alignment between our employees, clients, and shareholders. As expected, Q1 FRE compensation of $37 million was consistent with our 2023 quarterly average. We do expect a modest uptick in FRE compensation expense in the second quarter. In Q1, we had a 40% margin on the firm's share of incentive fees, and we expect that to increase over time as our total incentive fee revenue and the firm's share of that revenue increases. Separately, our stock-based compensation was higher in the first quarter, consistent with the same period of last year. We expect stock compensation expense to decrease significantly in the second quarter to levels just above Q2 of last year.

We remain disciplined in managing expenses, and non-GAAP General and Administrative and other expenses were $19.7 million in the quarter. We expect similar levels next quarter, with the potential for a slight uptick from increased travel.

Pulling together these factors, on a year-over-year basis, Fee-Related Earnings grew a healthy 26% in the quarter and Adjusted Net Income grew 39% in the quarter. Our Fee-Related Earnings margin grew from 34% in the first quarter of 2023 to 40% in the first quarter of 2024. We expect our Q2 FRE margin level to be closer to that of the full year of 2023. That said, we enjoy significant operating leverage, and our overall FRE margin trajectory for the full year is expected to move upward despite any quarterly fluctuations.

Our balance sheet is strong, and we are very comfortable with our capital structure. We launched a transaction this morning to extend the tenor of our term loan two years from 2028 to 2030. For almost 20 years, we have run our business with a modest amount of leverage to enjoy the attractive cost of capital, and we have always been vigilant about managing duration. The current market provides an attractive maturity extension opportunity. If completed, subject to market conditions, the transaction will result in a modest $50 million upside to our term loan. The incremental cash will be used for general corporate purposes, continued investments in the business, and opportunistic stock repurchases.

We are maintaining a healthy quarterly dividend of 11 cents per share, or an annual yield of 4.6% as of last Friday. There is room for future dividend growth as we enjoy positive momentum in our Fee-Related earnings. We also continue to repurchase shares under our repurchase authorization plan. Year-to-date through April, we have repurchased $28 million of stock through cash settlement of stock-based compensation issued to employees, leaving $37 million in our share repurchase program as of the end of April.

We continue to have confidence in our 2024 financial objectives, including double-digit growth in private markets management fees, excluding catch up fees, stabilization of ARS management fees, expanded FRE margin and significant growth potential in our incentive fee revenues. Looking further into the future, we are focused on doubling our Fee-Related earnings in the next five years, with further Fee-Related earnings margin expansion. We look forward to the opportunities ahead to deliver value to our clients and shareholders.

Thank you again for joining us. And we're now happy to take your questions.

Operator: Thank you. If you would like to ask a question at this time, please press star one on your telephone keypad. If you are using a speakerphone, please ensure your mute function is turned off. Again, that function is star one. Our first question comes from Bill Katz with TD Cowen.

Bill Katz: Okay, thank you very much, and good morning, everybody. Maybe two questions. First one, Michael, for you, you've mentioned that your origination capabilities continue to expand. I'm just sort of wondering if you could maybe click into that a little bit and talk about some of the areas of expansion and opportunity from here?

Michael Sacks: Sure. Thanks for the question. If you think about our business and you think about all of the relationships we have from our primary fund investment activities, and you look at our co-investment activity in infrastructure and in private equity as two examples. I think the same holds in the real estate space. We're sort of proven that we have great origination capability and great flow with regard to equity co-investment.
We think we have that same capability but probably kind of multiples of volume with regard to debt origination in the infrastructure space, in the private equity space, and in the real estate space. We're using some of our origination capability now for our credit funds now. I think the origination capability that we have outstrips the capital that we have at this time in credit. So,

our view is we are long origination, and we have lots of ability to be a very valuable partner to investors providing unique credit investment opportunities on a co-investment basis either in commingled fund or in separately managed account. I think there's a lot of origination upside there that we can provide to investors.

Bill Katz: Okay, thank you. And Jon maybe one for you. You sort of highlighted the opportunity here in terms of re-ups and encumbered opportunity set. The $4 billion you said in terms of the pipeline - can you provide some perspective on that? How big was that maybe a quarter or a year ago? And then how quickly do such sort of pipelines tend to fund through AUM and or fee-paying AUM? Thank you.

Jon Levin: Sure. Well, look, I think Bill if you think about it, which is implied in the numbers, we raised $1.6 billion of capital in the first quarter. And we're saying we have $4 billion of re-up pipeline that we feel good about for the balance of this year. The combination of those two numbers alone would take us north of total fundraising for last year.
And so just to perspective, on the environment relative to last year it's clearly a more productive environment for capital formation. I don't think we're back at kind of 2021 levels. But in terms of the ability to have constructive conversations with investors there's a lot more activity right now than you would've seen kind of a year. And you see that across all the metrics of the business whether that's RFPs we're filling out or marketing books we're preparing, or frankly even travel and things of that nature. And so, I think that's definitely indicative of the environment.
When you look into that $4 billion of pipeline, you're going to see all the different verticals represented. And you're going to obviously see all the different activities represented too in terms of fund investing, co-investing, secondary investing, direct investing, et cetera. So hopefully that answers your question. If there's anything else you want to drill down in there, fire away again.

Bill Katz: That's good for now. Thank you very much.

Operator: We'll now take our next question from Ken Worthington with JP Morgan.

Ken Worthington: Good morning and thanks for taking the questions. When we look at fundraising in private markets and contributions to fee-paying AUM, less of the quarterly flows today are being generated by current fundraising and more is coming from CNYFPAUM. Can you talk about how fundraising is evolving here and changes to preferences in terms of fund structure that you're seeing from your investors in private markets?

Michael Sacks: Sure. It's Michael. Ken, thanks. So, I think that what you're highlighting is really more of a function of what happened last quarter as opposed to a trend or anything. Jon just talked about $4 billion of re-ups we think gets done by the end of the year and obviously that doesn't include any of the specialized fund fundraising, and that doesn't include any new client activity or new programs for existing clients. So, generally robust environment there.

We've said before on these calls that there has been a shift in the industry. I think we talked about this early, like literally, as we were coming to market back in 2020 and it's why we published and continue to publish CNYFAUM because in the separate account space for some co-mingled funds in the industry, certain strategies, capital comes in on either a fee on timed ramp-in basis or a fee on an as invested basis as opposed to a fee on committed capital basis. And we have accounts, we have commingled funds that have both.

When we price our funds, we're always looking at effective fee and, I think Jon once talked about this on a quarterly call, we're trying to price to neutrality on effective fee because the way

these structures work are different. But I don't think there's any change that has occurred. Frankly, I think by the time we were coming public in 2020, we were talking about CNYFAUM as part of our initial offering. There had been a significant change in the industry and certainly nothing reversing that trend over the last four years. Effective fee rates on fee-paying AUM have stayed stable.

And obviously, the individual investor market offers opportunity for improved fee to some extent. And so, I think the effective fee rates are good but the structure changed a while ago and that's continuing. But it is nothing short-term. It's something that is part of the industry today. It's something we've talked about literally years ago and I think we may have dug into it a little bit deeply on one of the calls.

Ken Worthington: Okay, great. Thank you. And then can you just give us an update on your insurance build-out? You sort of announced a program. How is that progressing and how is it building?

Michael Sacks: It is progressing well it and we have continued some fundraising there. We have continued to have strong pipeline there and we continue to try to tailor our investment manufacturing capability to make the most sense for that market and really unlock that market. And so, we believe that was a very good investment for us. We're seeing others target the space and we believe that channel has a lot of promise for us over the next five years as we seek to double our FRE.

Ken Worthington: Okay, great. Thank you.

Operator: Again, if you have a question, please press star and then one on your telephone keypad. We'll now take a question from Adam Beatty with UBS.

Adam Beatty: Thank you and good morning. Just wanted to touch on the outlook for ARS. Obviously, a bit of a milestone here with net flows turning positive. And it still seems you're guiding sort of stable fees a little bit cautious, which is fair given 1Q was still down from prior periods. But want to get a sense of the level of interest, the level of dialogue with clients, and how you're seeing flows possibly improving either this year or over the long term in ARS? Thanks very much.

Michael Sacks: Yeah. Thank you, Adam. You heard us in our prepared remarks and you're correct with regard to what you heard. But it's just like our realistic view. So, we are not changing our budgeting convention. If you then extrapolate that based on what happened the first quarter you'd expect some outflows between now and the end of the year. We did say that, not only fee rates are stable, but we think revenues are stable and we think revenues are going to grow going forward through compounding. And that is sort of how we've budgeted for the rest of the year.

And your question on pipeline is a good one. The pipeline is up, the pipeline in ARS is definitely up, the interest level is up. It is not really a surprise in light of the very good recent performance. But believe me when we see a real change we'll call it, we're not afraid to say we see it we think it's a little early and so we're maintaining our convention. But the pipeline's up and we're certainly going to try to win every single piece of business that is in that pipeline.

Adam Beatty: Appreciate it. Thanks, Michael. And then maybe for Jon on the pipeline, definitely got our attention with the $4 billion figure out there. Just wanted more qualitatively to drill into kind of how you go about thinking about that? Are the re-up rates and the increased

contribution rates similar to historical averages? Maybe a bit less right now given the environment or what have you? And how much of that is based on sort of specific, pre-commitments or other dialogue with certain clients? Thank you.

Jon Levin: Yeah, so just to be clear on the $4 billion and Michael clarified this but I think it's an important point. The $4 billion of re-up pipeline we mentioned the prepared remarks is just about our separate account re-ups. So, it doesn't include fundraising activity for ARS. It doesn't include fundraising activity for new client acquisition. It doesn't pick up our specialized funds. And so that's important to understand in terms of how we think about the balance of the year from a fundraising perspective.

But it's also important to understand because it ties in pretty directly to the comments that I was drilling down my section which was the nature of these separate account relationships. And the nature of them is these are predominantly institutional investors that we are talking to every day, every week, every month. And that means you're talking to them about how much dry powder is remaining in the program.

That means you're talking to them about their own calendar in terms of when they are scheduled to go through various processes on their end internally. Whether those be investment committees or legal document review whatever it is. And you actually are working as partners to look at what date or weeks within what period of time you're trying to sign the re-up. So, you have very good visibility into that and that's the nature of those collaborative close relationships that you understand when those re-ups are happening. So, it's kind of just a calendar and it's a calendar that you have exceptional transparency into.

Our re-up rates remain very strong at 90%+ and the fact that oftentimes the re-up are occurring at a higher level than the previous program - we talked about the average of being close to 30% on that front. And so, it's a part of your pipeline that you feel highly confident in.

Now do you have times sometimes where you thought something might happen on one day, but it happens a couple weeks later? Sure. But you feel very confident that that re-up calendar is going to occur and that's one of the reasons, obviously beyond delivering the strong value proposition to clients, that we love that business because of the predictability and the stability and the transparency and the opportunities for growth that it offers.

Adam Beatty: Super. Thanks again for the extra detail on the slide. Appreciate it.

Operator: We'll now take our next question from Tyler Mulier with William Blair.

Tyler Mulier: Hi, good morning. It's Tyler on for Adam and Jeff. And we just covered the net flow outlook pretty well but it was a particularly strong quarter for ARS in terms of performance. Could you provide some key color with some of the key drivers there? Thank you.

Michael Sacks: Yeah, I think that in general the environment over the last six quarters or five quarters has been a better environment for absolute return strategies. There has been ample volatility, there's been more dispersion than we've seen in the past, higher rates are constructive. So all of those macro factors are constructive for ARS returns. In particular, dispersion among equity returns and the ability to have a better return set from credit investments, better yield on short credit rebate, things like that. So, it's just been a good environment for a hedged approach and for ARS strategies.

Tyler Mulier: Congrats to the team. Thank you.

Operator: We'll now take a follow-up from Bill Katz with TD Cowen.

Bill Katz: All right, excellent. Thank you. Just a couple clean up ones. In terms of the buyback how much that actually reduces the actual share count versus maybe offsetting stock issuance given the Q1 elevated stock base comp?

Michael Sacks: Most of the buyback, substantially, if not all that was managing the dilution from stock-based comp which as you know, is a goal of ours.

Bill Katz: Okay. And then just another one on comp. So if I did my math right the cash comp component of variable incentive on your share of the incentive fees, I think that ratio this quarter was 60% which is up I think quarter on quarter, year on year pretty substantially. And I think you talked about this a little bit last quarter, I want to get your updated thoughts. To the extent that the incentive pool rises and you start to monetize more of the incentive revenues and your share of that goes up, is there an opportunity to continue to lift that ratio? And by doing so does that give you a little more control over the FRE comp underneath that? Thank you.

Michael Sacks: Yeah, so that's actually a great question and very glad that you asked that. As you know we believe that we have a lot of earnings power in that line. I think I said in my comments the only thing that wasn't like a bright spot in the first quarter was we didn't see the carry revenue grow. Good that we've got announced transactions up, but we need to see them close. And we need to see distributions and we know that it will come, we are waiting for it.

As the carry revenue grows and as our percentage of the gross carry revenue grows because the firm's ownership percentage of carry 2014 forward is much higher than it was prior to 2014. And you can see that in the presentation. As that grows, we do think we have real margin opportunity in that line.

Obviously, when we have very low levels of revenue we will have a lower margin there. And as we get to more normal levels of revenue and we get some of the growth that we believe is a question of when not if, we would hope to have higher margin there in the future and have the ability to be smart about that. So, I appreciate the question and I think your suspicions in effect are correct. And hope that answer was clear.

Bill Katz: Thanks for taking the extra questions, and very helpful. Thank you.

Operator: And it appears there are no further questions at this time. I'd like to turn the conference back to our presenters for any additional or closing comments.

Stacie Selinger: Thank you for joining us today. We appreciate the interest and we look forward to speaking with you next quarter if not beforehand. Have a great day.

Operator: Ladies and gentlemen, thank you for your participating in today's conference. This concludes today's program. We hope everyone has a great day. You may all disconnect.