GCM Grosvenor Fourth Quarter 2021 Results
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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 fourth quarter and full year 2021 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. These 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 or performance to be materially different from our expectations of future results. Please refer to the factors discussed in the risk factor section of our 10-KA for the fiscal year ended December 31, 2020, our other filings with the Securities and Exchange Commission and our earnings released available on the public shareholders section of our website. These factors could cause actual results to differ materially from those indicated by the forward-looking statements on this call.

We'll also refer to non-GAAP measures that 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 the public shareholder section of our website. Our goal is to continually improve how we communicate with and engage with our shareholders 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: Thank you Stacie. Our business performed really well in the fourth quarter and for the full year of 2021. As you can see on slide three, we met or exceeded consensus and our own guidance for fundraising revenue growth and profitability. Importantly, we added value to client portfolios, enjoying good investment results across our various verticals. For the fourth quarter and full year of 2021 as compared to the fourth quarter and full year of 2020, we grew fee related revenue by 17% and 12%, fee related earnings by 37% and 27%, adjusted EBITDA by 19% and 22%, and adjusted net income by 23% and 31%. Based on the strength of these results, our board has increased our stock and warrant buyback program by an additional $20 million.

The strength of 2021 has set us up well for 2022 and we reiterate our 2022 guidance for fee related revenue growth of 12% to 15% and fee related earnings growth of 20% to 25%. Last year's success was led by $9.4 billion of fundraising across the firm. Our fundraising was highly diversified across vertical, geography, client channel and account structure, as you can see on slides four and five. On slide five, we provided more information on specialized fundraising that we hope you find helpful. In 2021, we raised $1.5 billion for diverse managers. That total was comprised of $1 billion for our private equity vertical and $500 million for our real estate vertical. The $1 billion of diverse manager capital raised for our private equity vertical includes a successful first fundraise of $770 million for our Advance fund. We look forward to delivering good results for Advance fund investors, bringing successor advanced funds to market, and growing that fund series over time.

Infrastructure captured the largest share of our overall fundraising at $3.5 billion last year. Both our non-institutional or retail fundraising and our ESG and impact fundraising were important contributors. We believe both of these areas provide opportunity for significant growth going forward. Absolute return strategies had net flows in 2021 that were flat, and that was and remains our base case assumption.

While 2021’s strong fundraising and fee-paying AUM growth provides strong momentum for 2022, it's also important to look at the growth in our incentive opportunity that occurred last year. On slide 10, you can see that our run rate annual performance fees increased by 15% this past year, while the firm’s share of carry at net asset value grew by $34 million or 11% in the fourth quarter and $198 million or 149% for the full year. The firm's investments also grew increasing by $25 million or 22% in the fourth quarter and $58 million or 72% for the year.

Importantly in the fourth quarter and for the year, the firm captured a higher share of the increase in carry at net asset value, which should continue over time as our larger ownership of later carry vintages comes through.

Looking at 2022, we like what we see. Our fundraising pipeline is larger than the one we enjoyed a year ago. We start the year with more business development resources than we have ever had before. And we have four specialized funds with solid track records in market, none of which are first time funds. The key drivers of our 2022 FRR growth are pretty straightforward. Our 12% to 15% guidance means that we need $42 - $52 million of FRR. We enter the year with approximately $17 million to $20 million of that growth pretty secure as it relates to the full year impact of our 2021 fundraising and the normal operation of our CNYFPAUM less distributions.

That leaves us with $25 million to $32 million of FRR growth to achieve and we get that from $3.5 billion to $4.5 billion funds raised into FPAUM. Our plan has us raising those funds roughly equally between specialized funds and custom separate accounts. Just as 2021's success set us up well for 2022, repeating that success in 2022 will set us up well for 2023. Looking at slide 11, you can see the various opportunities that we think have legs and give us confidence with regard to the future. Consequently, we believe our FRR can continue to grow in 2023 and beyond, as it did in 2021 and as we have guided to for 2022.

In closing, I want to say that I think our stock affords good value at these levels. As of Friday's close, we were trading at 15.6x trailing FRE and 14.4x trailing adjusted net income. We had a 4.4% dividend yield, we have solid growth prospects, and we've been around a while.

Someone once said to me that when looking at P/E ratios, it's management's job to drive the E and the P will sort itself out. We continue to see a lot of opportunity for Grosvenor, and we're focused on driving the E. And with that, I'll turn it over to Jon.

Jon Levin: Thank you, Michael. As Michael said in his remarks, it was a strong year for the firm in which we successfully drove returns for clients and harness the platform's flexibility to deliver solutions to clients across the full spectrum of alternatives. Our first job is to deliver strong risk adjusted returns for our clients on an absolute and relative basis. We were pleased to deliver on that front in what was admittedly a positive environment for risk assets. Gross performance for absolute return strategies was 7.2% for the year and 9.3% annualized over last three years. Which means we exceeded client objectives and also generated sign significant alpha. We think the environment of heightened volatility and increasing interest rates sets us up well for absolute return strategies generally. Even though January was negative for performance, it was in line with our expectations, given a broader market sell off.

Moving to our Strategic Investments Group, put simply, it's just a really exciting story. We have a unique origination engine, and we are leveraging it well to deliver for our clients. As a reminder, the SIG group pursues opportunistic direct and co-investments sourced in some way, shape or from the full breadth of the firm's open architecture, multi-alternatives platform. We primarily run three strategies out of this group. A more liquid strategy we call the Special Opportunities Fund a longer duration private equity-like strategy, which we refer to as the MAC franchise, and a credit only capability, which we call Strategic Credit. Returns across each strategy last year and since inception are fantastic.

More broadly across private markets, we saw strong performance in every strategy, which in addition to delivering value to our clients caused total unrealized carry to double during the year. Private equity had exceptional returns last year, returning more than 30%. This includes our most recent vintages for our secondaries and co-investment funds setting those funds up well for strong overall performance. Our Real Estate vertical typically pursues value-add or opportunistic type investments through partnerships with smaller fund managers or operating partners. And after a period of modest impact from the pandemic, we have seen a strong returns recovery and are quite excited about the forecasted returns for our clients in those strategies. In Infrastructure, we generally target longer data time horizons and lower return targets than in PE and Real Estate, and we are pleased that even through the pandemic, we have continued to deliver on our goals, generating low single digit cash yields and low double digit net returns for clients.

Michael spoke about 2022, and I want to dive a bit deeper on two areas that were significant drivers of our growth last year. First, Infrastructure was the largest contributor to our fundraising with $3.5 billion of capital raised. Infrastructure assets under management increased 34% in 2021 to $9.1 billion, the highest AUM increase in any strategy. The combination of cash yield generation, long dated capital appreciation, inflation protection, and a generally growing market opportunity has led to significant growth in infrastructure appetite globally. Layered on top of that generally constructive backdrop is the natural opportunity to drive ESG and impact initiatives through infrastructure capital deployment. So, we think this is only the beginning of this market's evolution.

Our Infrastructure platform is ideally positioned to benefit from these dynamics. In an asset class with a longer time horizon, having a long-standing track record is paramount and we've been investing for two decades and have a cycle tested track record. We have experience, scale and deep relationships and multiple ways to implement our investment ideas, investing through the full range of primaries, secondaries, co-investments and directs. In an increasingly in-demand strategy, our platform-based approach provides the comprehensive solution to investors seeking diversified global exposure to infrastructure.

The second driver, which we see accelerating in importance, is investors' focus on co-investment, secondaries, and direct investments. Our platform for these complimentary strategies benefits from our scale and relationships. The intelligence and insight into thousands of fund managers we actively track and invest with are critical to this effort. Further, successfully executing transactions requires experienced and deep teams that can move efficiently to complete transactions. The market increasingly recognizes the strength of this value proposition, which has resulted in significantly higher flows into these areas. Last year, for example, 70% of our flows into private equity were into these transaction oriented investments. We see this dynamic persisting, which has the opportunity to impact not only our flows, but also our revenues. The economics to us for co-investing, secondary and direct investing are accretive to our business, while importantly, still representing a compelling economic value for opposition to investors. And of course, we can only win when our clients win.

Each quarter, we will attempt to address a couple of the key themes driving the business, and there are many exciting stories to tell. Now I'll turn the call over to Pam to address our financial performance.

Pam Bentley: Thank you, Jon. We are very pleased with our results for the fourth quarter and full year and enter 2022 in a position of strength with highly attractive tailwinds. Fee related revenue grew 17% for the quarter compared to the fourth quarter of 2020 and 12% year over year, both in line with or ahead of our guidance and indicative of the continued momentum in capital formation and investment performance.

As Michael mentioned, the growth in fee paying AUM combined with our anticipated activation of contracted not yet fee paying AUM, yields approximately 6% of fee related revenue growth in 2022, nearly half of what we have guided before any incremental fundraising. And as Jon noted, we continue to see a very strong market for capital formation across the full breadth of the platform. A primary driver of this dynamic is our private market specialized fundraising, which we foresee being a meaningful contributor to revenue next year.

Catch up management fees associated with these funds compound over time, so typically are higher in the back half of the year. To that point, catch up fees in the fourth quarter of 2021 were $4.3 million, the highest of any quarter during the year. In the first quarter of 2022, we do not anticipate any significant specialized fund closings. So therefore, there will be limited to no catchup fees in Q1 and we expect first quarter fee related revenue to be almost $3 million lower than the fourth quarter. As was the case in 2021, we expect our 12% to 15% revenue growth to be nonlinear and weighted heavily toward the back half of 2022.

Our fee rates continue to be very stable across the business, a sign of our value proposition resonating in the market. We also continue to experience a mix shift towards higher fee activities, such as co-investments, direct investments, and secondaries.

Mid last year we noted that we expected our administration fees would level off at less than $1 million per quarter and we expect that to occur starting in the first quarter of 2022. As a reminder, we provide administrative services primarily to private markets clients for over a quarter trillion dollars in assets. This is an ancillary service we offer to many of our clients, which has significant benefits in the form of client retention and data.

Our fee related earnings compensation of $39.1 million was relatively flat in the fourth quarter compared to the third quarter of 2021, and less than 2% higher than the fourth quarter of 2020. As we discussed last quarter, we have aligned a greater portion of our compensation with achievement of investment performance and resulting incentive fees, given the growing incentive fee earnings power that Michael mentioned.

With the broader environment, we expect fee related earnings compensation to increase by 6% to 8% in 2022, which is already incorporated into our fee related earnings guidance and anticipated margin expansion. Non-GAAP general and administrative and other expenses were $17.3 million in the quarter in with the third quarter levels. And again, lower than normalized levels due to COVID's impact on travel and office related expenses. As activity in that regard has already begun to return, we expect increases in general administrative expenses in the first quarter that will continue to modestly increase through the rest of the year. Importantly, this trend is already factored into our fee related earnings growth guidance of 20 to 25% and the implied margin expansion that goes along with that. Our fee related earnings margin was 35% in 2021, up from 31% a year ago, and given significant operating leverage in our platform, we foresee continued margin expansion in 2022 and beyond.

Turning to incentive fees, I won't repeat Michael's comments other than to emphasize the broader trend that the growth in our incentive fee earnings power is accelerating. As a reminder, realized carried interest is difficult to predict, and historically has been most significant in the back half of each year. Similarly, the majority of annual performance fees crystallize in the fourth quarter of each year based on annual investment performance.

Consequently, and as I mentioned earlier, we had an opportunity to better align our cash incentive fee compensation framework last quarter, which created more stability in our fee related earnings compensation, while further aligning our team with the interest of our clients and shareholders. Importantly, the right way to look at our cash incentive fee compensation is relative to our firm share of incentive fees, which are net of contractual obligations. This is most clearly shown on slide 10. As we've noted in the past, we expect to retain 50% to 60% of the firm's share of incentive fees in 2022.

Turning to stock compensation, the vast majority of this continues to relate to awards made in conjunction with our transaction to go public. The second third of those awards vest in March of 2022, and the last third vest in March of 2023. Outside of that original transaction grant, we expect 2022 dilution to total shares outstanding from normal course restricted stock awards to be minimal, around two tenths of a percent.

The business continues to generate strong cash flow. And as you'll see on slide 12, our cash balance at quarter end with $96 million. As Michael noted, we have increased our stock repurchase plan to $45 million, of which we have spent more than $9 million in 2021. We continue to view the repurchase of shares and warrants as an attractive use of cash in creating shareholder value, so anticipate a continuation of our repurchase activities.

Finally, we have often cited strong free cash flow generation, and the ability to return capital to shareholders as attractive features of our business. Last quarter, we increased our dividend to 10 cents per share. And this quarter we are maintaining that dividend, which will be payable on March 15 to shareholders of record on March 1. We continue to be excited by the positive trend of the business and the significant earnings power we are creating.

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

Operator: Thank you. [Q&A instructions]. And our first question will come from Ken Worthington with JP Morgan.

Ken Worthington: Hi, good morning. First, I'd love to get an update on the insurance side of the business. If I recall correctly, you closed I think $500 million in insurance solutions in 3Q and sort of the inaugural close. And if I'm backing into numbers correctly, it looks like there may be some additional in 4Q. So, can you talk about any milestones reached during the fourth quarter, and how we should think about the pipeline for that business going forward?

Michael Sacks: Sure. Thanks, Ken. We have, as you know, high hopes for that insurance channel. We've made a couple of additional hires there since our first hire and since launching that. And I think that the third quarter success that you mentioned in a way was early and larger than anybody should have been expecting. We did have some modest success in the fourth quarter, but nothing that I would signal or say as a milestone or of the magnitude of the success that you reference.

Our pipeline there is full. Our activity set there is significant and robust, and we are enjoying there the type of interaction exchange and opportunity that we thought we saw when we made the commitment to the space. So, I would expect for that to grow. It's one of the things that we think will help us make our 2022 numbers. It's one of the reasons we're confident putting out some thoughts on 2023 and I'd expect it to continue to grow pretty consistently throughout 2022 and 2023 and beyond.

Ken Worthington: Okay. Great. Thank you. And I forgot to thank you when I started for the additional disclosure. Amazing, super helpful. So, thank you there. Just for sort of a follow-up question on the absolute return business. I guess maybe my opinion was the hedge fund industry had kind of a mediocre year in 2021 and it looks to me like Grosvenor performed pretty much in line with that. You did nail your projections on the business, all different parts of your projection. But given the backdrop for market conditions, I guess maybe today and the hedge fund environment, what are you doing to make Grosvenor better than breakeven for sales for 2022 and beyond?

I heard your guidance for breakeven, but I assume you're kind of working behind the scenes to hopefully do better than that. So, what are you doing, and what are sort of the opportunities there? And with the equity market and interest rate environment where they are to begin 2022, do those help, or do those hurt the outlook for net sales and interest in absolute return as we sort of move through the year?

Michael Sacks: Great, so thanks. I want to just want to start with, as Jon mentioned in his comments for the one in three-year periods, and frankly, even if you go look at a five-year period, our results are in line with or exceed client expectations. So, it's always important to remember what the investors are looking for when they make commitments, what that risk-reward profile is, and then how are we doing relative to that risk-reward profile? And we're doing well in that regard. So, while those returns may look a bit lackluster compared to the tremendous returns we've seen from the equity markets, they are meeting, actually exceeding the objectives of the client base, which is obviously incredibly important. And I want to make sure to point that out.

Generally, as we've said before, market conditions where there's a lot of volatility, where the markets aren't one way, where there's more uncertainty, those tend to be better environments for alternative strategies, better environments for hedge portfolios. We tend to have less volatility in our returns than traditional portfolios do. And so, I think that that's a decent backdrop for us and for the strategy set.

The last thing I just want to remind everybody of is that within absolute return, we have different strategies. We have different offerings and some of our offerings, in particular, our Strategic Investments Group offering has performed quite well in tough markets and has really added value. And so, we are optimistic that we can see some growth in that offering, and you've all noticed that the fees in that space have stayed stable for some time now. And obviously, this SIG group, the Strategic Investment Group offering in the ARS space it's a higher fee offering. So, we're not moving off our base-case assumptions. We are obviously, to your point Ken, working all the time to drive flows and grow assets there through additions and new hires. But we're staying with that base case assumption, and we think we generate good growth with the base case assumption.

Ken Worthington: Great. Thank you.

Operator: And our next question, come from Chris Kotowski with Oppenheimer & Company.

Chris Kotowski: Yeah. Good morning. Thank you. On this call last year, you mentioned about raising $7.5 billion of assets across six funds. And I'm wondering, are those – when you were talking about that, are those the six funds that we see on page five? And when I add the numbers up there, you're at about $2.5 billion so far. And is that kind of on pace to that expectation in the way you were looking at it last year?

Michael Sacks: Yeah. We generally, Chris, we feel really good about our overall fundraising. We feel good about our specialized fund fundraising. We feel good about our separate account fundraising. I mentioned our pipeline is bigger than it was a year ago. We have significantly more boots on the ground than we did a year ago. So, we feel pretty good there, and we are – and that is the fund set. And we just wanted to provide a little bit more detailed information after having been asked for it. So you could kind of piece that together better, but these are the funds and from our perspective, things are going quite well.

Chris Kotowski: Okay, great. And then last year you were saying, expect the fundraising to be backend loaded. And if I understood your comments right, you kind of thought this year is going to be more ratable across the quarters. Did I get that correctly?

Michael Sacks: Well, I think that – I want to make sure we focus on this well, I think the fundraising itself it is highly dependent on when you have specialized fund closes. We said on the call, we don't anticipate significant closes if any, in Q1. So, you'd expect to see more fundraising in Q2 obviously, but it's really the – when we talk about the backend loaded, it's more the revenue bill than it is necessarily the fundraising. So even if you were raising your funds ratably throughout the year, the way that the map works on revenue, you're going to have a revenue bill that favors the back half of the year and the third and the fourth quarter. So even with a ratable fundraise. Therefore, we will have a revenue bill just like last year that is tilted towards the back of the year as Pam said.

Chris Kotowski: Okay. And then, I guess last thing on the fundraising looking at slide five, which is really interesting and just from all the companies we look at generally, private equity is bigger than infrastructure. Is this what you would have guessed at the beginning of last year that infrastructure would be significantly larger than private equity? Or did it strike you, was that surprising to you?

Jon Levin: Yeah, I was just going to say, Chris, this is Jon. Entering the year, we felt pretty good about all the fundraising features Michael pointed out. And obviously, the year bore that out. Infrastructure in particular, for us over the last couple of years has actually just been a very active strategy. And we came into 2021 with a strong 2021, sorry, with a strong pipeline in that regard. We come into 2022 with a strong pipeline in that regard. So, I wouldn't say that it was surprising to us to see the interest in the space. And I think that you've seen for us as well as for some others. I do think our platform in particular is a great platform given its longevity, which I mentioned in my comments and the track record over a long period of time in the multiple ways to implement. And so, I suspect that we'll continue to see a pretty significant amount of activity in the infrastructure space

Chris Kotowski: And for you, infrastructure here it's, in particular, I should think US, I should think power, transmission, pipelines, that kind of thing?

Jon Levin: I think from a sector standpoint, you should think about multiple parts of the infrastructure space, sub-sector standpoint. So, transportation, social, renewable, etc. From a geography standpoint, you should think about it being roughly equally balanced between the US and Europe. But we've also actually seen a small pickup in Asia infrastructure activity in recent periods of time.

Chris Kotowski: Okay. Great. All right. That's it for me. Thank you.

Operator: Thank you. [Q&A instructions] And our next question will come from Adam Beatty with UBS.

Adam Beatty: Good morning. Thank you for taking the question. Wanted to dig into – and really appreciate all the disclosure, especially on slide five. Turning toward the separate account kind of channel, looks like the cadence of fundraising – I appreciate the full-year disclosure there. Looks like the cadence has been pretty steady. Just wanted to get your sense from what you can see in terms of the re-up outlook and level of client demand and what have you – whether that cadence will be maintained or maybe accelerate through this year? Thank you.

Michael Sacks: Thanks, Adam. So, as we've said, our pipeline is bigger today than it was a year ago. Our re-up rates have been terrific, and we see no – we see them continuing to be terrific. And so, I don't think there's any reason to see a different cadence at all in that space as we go forward.

Adam Beatty: Excellent. Thank you. And then just on the retail distribution, just wanted to get maybe a little more detail around your strategy there. What channels, and may be either third-party facilitators or intermediaries that might be important for your success there? Thanks.

Michael Sacks: Thank you. To date it's been predominantly high net worth and working with wealth management platforms, we think we've got a lot of room to drive that. And so we are super happy to see north of 10% of our fundraising coming from that channel as compared to 5% or so of our AUM with frankly, in our opinion, a lot of ability still in front of us to continue to drive that channel. And we, as we said, we think for 2022 and for 2023 and beyond, we think there's a lot of promise there.

Adam Beatty: Great. So, it's basically gaining share within Grosvenor. That's great. Appreciate that, Michael. Thank you.

Operator: And that does conclude the question-answer session. Ms. Selinger, I'll now turn the conference back over to you.

Stacie Selinger: Thank you. And thank you again to everybody for joining us today. We appreciate the continued interest. If you have follow-up questions or feedback, please do not hesitate to reach out. Thank you again.

Operator: Thank you. And that does conclude today's conference. We do thank you for your participation. Have an excellent day.