GCM Grosvenor Second Quarter 2022 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 second quarter 2022 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 factor section of our 10-K, our other filings with the Securities and Exchange Commission and our earnings release, all of which are on the public shareholder section of our website. We'll also, refer to non-gap measures that we view as important in assessing the performance of our business. A reconciliation of non-gaap metrics to the nearest gaap metrics can be found in our earnings presentation and earning 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. 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: Thank you, Stacie. Against the volatile market backdrop, we had another solid quarter in Q2 with continued growth in net income, fee related revenue and fee related earnings. We also enjoyed strong fundraising and added value to client portfolios. In particular, our private markets verticals continue to perform well with another quarter of strong growth. Going forward, we are confident in our growth prospects and our ability to deliver value to shareholders. During the quarter, we grew fee related revenue by 8%, fee related earnings by 19%, adjusted EBITDA by 15% and adjusted net income by 14%, all compared to the second quarter of 2021. Importantly, our fee related revenue growth consisted of private markets management fee growth of 19%. We continue to enjoy operating leverage with a fee related earnings margin of approximately 36% in the quarter, up from the second quarter of last year.

Private markets now comprise 67% of our total assets under management and 61% of our fee-paying assets under management, up from 59% and 55% just two years ago. Over the two-year period, our private markets business has seen a meaningful mix shift with secondaries and co-investment assets growing as a percentage of private markets AUM from 39% to 47%. Based on the composition of our contracted not yet fee paying AUM and our fundraising pipeline, we see this trend continuing. Our persistently high separate account re-up rates of 90% are worth noting and are an important indication of the fundamental strength of our business.

During the quarter, we raised $2.1 billion, 95% of which was for private market strategies. Our second quarter total fundraising was a step up from the first quarter and brings our year-to-date fundraising to $3.4 billion with $732 million raised for specialized funds so far this year.

Last quarter, we talked about expecting a couple of quarter slowdown in general fundraising due to the macro environment with no change in ultimate demand or our ultimate growth trajectory. Our only specialized fund in market, for which the fundraising period ends in ‘22, is our secondaries fund. While that fund is already about 30% larger than its predecessor fund, it is the one fund for which timing may cause us to land below our original goal. All of our other specialized funds will continue raising capital into next year and all remain on track with regard to our goals.

Just as we said a year ago, we have a full pipeline and believe that our second half fundraising will exceed our first half fundraising. During the second quarter, infrastructure represented 50% of our capital raised seeing that vertical take the largest share of fundraising for the fourth quarter in a row. It's worth noting that infrastructure management fees have grown by 45% from a year ago.

Absolute return strategies has had a challenging year in 2022. In Q2, our absolute return investments performed well relative to public market indices and in line with expectations in light of the market environment, down 3.7% for the quarter. As of June 30th, with equity markets down 20% to 30% and broad credit indices down mid-teens, and with many high-profile hedge funds suffering losses far higher than our diversified multi-strategy portfolios, our hedge fund returns were not the primary area of concern for clients. As we said last quarter, we do anticipate modest net outflows for the year.

Despite current market conditions, we continue to believe we will achieve fee related revenue growth of 7% to 10% and fee related earnings growth of 13% to 18% for 2022. We continue to see double digit fee related earnings growth in 2023 led by strength and private market strategies. As you can see on slide four, we are conservatively planning for specialized fund closings in Q3 and believe Q4 will be stronger in that regard. As a result, we are not expecting catch up management fees in Q3. For Q3 2022 compared to Q3 2021, excluding the impact of catch-up management fees, we expect private markets management fee growth of 15% to 20% will drive overall fee related revenue growth of 3% to 5% with an FRE margin of around 35%.

As we have discussed before, absolute return strategies portfolio returns in ‘22 will largely eliminate performance fees for the year. In Q2, the slowed pace of private markets transactions reduced our investment realizations and carry revenue. Despite a modest markdown in the firm share of unrealized carry, we continue to enjoy substantial firm share of unrealized carry at June 30th of $383 million up 55% from a year ago. While we don't control the timing of realizations, the pace of realizations will normalize at some point, and we expect to see material growth in revenue from carry over time.

I want to quickly call your attention to pages 11 and 13 of our earnings deck. Despite the tough global environment, we feel very good about the trajectory of the business. Private markets is growing fast and becoming an ever larger part of our story. Our mixed shift to higher fee activities is private markets driving management fees at 18% growth versus FPAUM growth of 13%. And our new channels are working well for us and growing at rates well in excess of their current percentage of our AUM.

Similar to my comments last quarter, we believe that our stock represents good value to investors at today's levels. We enjoy an approximately 5% dividend yield and our dividend payout ratio is very comfortable providing room for growth over time.

Adjusting our enterprise value for our balance sheet and our unrealized carry, we trade at 10 times trailing fee related earnings with solid growth in front of us. We bought back $1.3 million shares and 2.4 million warrants during the quarter and have just over $40 million remaining in our share repurchase plan, which we continue to put to work.

With that, I'll turn it over to Jon.

Jon Levin: Thank you, Michael. Our strong capital formation this quarter, despite the market backdrop, is a testament to the strength of the alternative industry tailwinds generally and GCM Grosvenor’s value proposition specifically. As Michael noted, private markets has been a key driver of our growth and now represents 61% of our fee-paying assets under management. So, I want to spend some time digging deeper into that area of our business.

Private equity represents the largest vertical within our private markets capabilities, representing $28 billion of AUM as of quarter end. Within private equity in the private markets business generally, our growth has been driven by a meaningful mix shift. Over the past decade or so, investor appetite for co-investments and secondaries has grown considerably. Our capabilities around these strategies and in certain areas direct investing also, are well developed and drive a strong value proposition for clients. These investment types now represent $22 billion or 47% of our private markets AUM compared to $13 billion or 39% just two years ago, a 31% compound annual growth rate.

In the first half of 2022, co-investments secondaries and direct investments represented 66% of private markets fundraising. The continued shift towards these strategies will provide lift to our revenue and help expand our margins while delivering to clients what they want. To that point and as illustrated on slide 11, our private markets fee paying AUM has grown by a 13% CAGR over the past two years whereas the associated management fees grew by an 18% CAGR. Importantly, this trajectory is also embedded in our contracted not yet fee paying AUM where there's considerable secondary and co-investment capital yet to be deployed.

Another significant contributor to our growth has been the impressive scaling of our infrastructure business, which now has $10.5 billion of assets under management, up 33% from just one year ago. Part of the growth in infrastructure is attributable to the market's increasing appetite for this strategy due to its cash yield generation, long dated capital appreciation opportunities, inflation protection, and ability to implement sustainability objectives.

Another contributing factor is our significant and broad experience in the space. Our infrastructure practice began in 2005, making us a pioneer in the asset class and an early mover amongst the solutions providers. We have a cycle tested track record with deep global relationships. In the past two decades, we've expanded our infrastructure offering on all fronts. We still consistently serve as the core infrastructure allocation for clients through our diversified infrastructure offerings and the depth of our capabilities also, enables us to increasingly work with clients to solve a discrete need within their infrastructure allocation. For example, strategies specific to secondary and co-investments, strategies specific to a region, strategies specific to ESG and impact goals.

The best example of our infrastructure innovation is our labor impact strategy, where we deploy capital on a direct basis and believe we can provide attractive risk adjusted returns by working in close partnership with skilled, organized labor. Our second labor infrastructure fund will begin to generate revenue next year.

Finally, our real estate business is also, enjoying strong momentum with assets under management growing by 24% year over year to $4.2 billion. Our real estate practice has a highly differentiated approach in the market in that it focuses on supporting operators and managers in the earlier stages of their platform growth, primarily through seed investments, joint ventures, and co-investments. This approach allows us to create strategic partnerships that scale over time while investing for our clients on a cost-effective basis. These investment activities command a premium fee akin to co-investments and secondaries. We believe we have an exciting opportunity to meaningfully expand our real estate platform going forward.

We would be remiss not to mention that today's environment provides attractive opportunities to deploy capital. We're excited about our $8.5 billion of dry powder and our ability to source and execute on unique deal flow given our platforms open architecture model, covering the wide spectrum of alternative strategies.

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

Pam Bentley: Thanks, Jon. Our second quarter results demonstrate the stability of our business. Fee related revenue increased by 8% over the second quarter of ‘21 and 9% on a year-to-date basis. Private markets is our key driver of growth with fee paying AUM growing 16% over the last year. Private markets management fees were $50 million in the quarter, an increase of 19% from the second quarter of ‘21. This is inclusive of $2.3 million of catch-up management fees from specialized fund closings. Based on our pipeline, we do not expect material catch-up management fees next quarter, and instead anticipate a higher amount in Q4.

Private markets fee paying assets under management now comprise 61% of our fee-paying AUM as of quarter end. This capital is long duration providing a high degree of visibility for our business since management fees are generally charged on commitments or invested capital, which are not impacted by changes in investment valuations. As of quarter end, around 65% of our private markets AUM had a remaining program life of more than seven years. Private markets fee rates have been stable over recent time periods. And we also, are experiencing a mix shift towards higher fee rate activities, including co-investments, direct investments and secondaries.

Absolute return strategies management fees were $40 million in the quarter, a 1% decline from Q2 of last year, but a 3% increase on a year-to-date basis. Our ARS quarterly management fees are generally charged on fee paying assets under management as of the first day of each quarter, meaning ARS fee paying AUM as of the end of the second quarter will drive a relative decrease in third quarter ARS management fees.

Incentive fees in the quarter were $10.5 million primarily from private markets carried interest. As Michael noted, we generally don't control the timing of investment exits and realizations, and realizations were lower given current capital market conditions. However, we have significant long term carried interest earnings power with $840 million in gross unrealized carry across almost 140 programs, $383 million of which is net to the firm. We expect the firm share of accrued carry will increase over the longer term as most more recent funds, where the firm also, retains a higher share of gross carried interest, move into accrued carry positions.

In addition to our accrued carry, our balance sheet investments in our funds remain stable at $147 million. In the near term, given that our accrued carry and balance sheet investments are marked on a one quarter lag, market conditions may impact these balances at the end of the third quarter.

Turning to expenses, fee related earnings compensation in the quarter was $40.5 million, effectively flat compared to the first quarter of the year and the second quarter of ‘21. As noted on our last call, we expect fee related earnings compensation to be relatively stable in the coming quarters while we continue to make investments necessary to sustainably grow the business over the long term.

Non-gaap, general administrative and other expenses were $18.5 million in the quarter. This is relatively consistent with the first quarter and we anticipate it will be similar in the third and fourth quarters of this year. Our embedded operating leverage is driving earnings growth and margin expansion. Our fee related earnings increased 19% to $32.6 million and our fee related earnings margin expanded to 36% from 32% a year ago. Given the operational scalability embedded in our business, we anticipate continued long term FRE margin expansion.

Finally, one of the attractive features of our business is consistent visible cash generation. Our annualized dividend of 40 cents per share is less than 70% of our last 12 months fee related earnings less our cost of debt. We prioritize returning capital to our shareholders through a combination of dividends and buybacks spending $25 million of our $65 million buyback authorization through the end of this quarter. And we continue to put that to work.

Reiterating the themes that Michael and Jon highlighted, while we are not immune to the impact of the current market environment, our breadth, diversification, and the strength of our platform alongside our team's focus on delivering value to clients is fueling our business performance. We remain focused and are excited by our future earnings power.

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

Operator: Thank you. Your first question comes from the line of Chris Kotowski with Oppenheimer.

Chris Kotowski: Yeah, good morning and thank you. First of all I guess, I’m wondering we're halfway through the third quarter and the market has rebounded. And I wonder if that has flowed through to the performance in the absolute return strategies?

Michael Sacks: July was a profitable month for absolute return strategies. It was not profitable to the degree that the market was, but we did make some money in July. And we'll see how the rest of the quarter goes as we move forward.

Chris Kotowski: Okay. And then, I guess, I’m trying to square the circle a little bit. In that, in private markets, we see fundraising of around $2 billion, and the fee-paying AUM were up $900 million. And then the contracted, not yet fee-paying AUM was up around $200 million if I’m doing my math right. And so that means roughly, it seems like a $1 billion in either distributions or outflows. And it kind of didn't look like that big on the AUM roll forward table.

Michael Sacks: I think, Chris, why don't we get those numbers and get them tight. And just, we'll give them to you when we speak to you one on one to tie it out.

Chris Kotowski: Okay.

Michael Sacks: Obviously, the numbers that we've given of the $2 billion of fundraising, that's what that number was, distributions and the deployment, and the change in AUM has a performance component to it so, let us kind of break that out and build the bridge for you.

Jon Levin: Yeah. And don't forget, Chris too, when you're pulling down from contracted not yet fee paying AUM, there's more factors than the one you cite. Because a part of your fee-paying bridge will be a function of your contracted not yet fee-paying AUM change as you're calling capital. So, there's a number of factors there.

Jon Levin: Maybe something we would say just in general on your observation, we did have just over $2 billion of capital raised. We did talk about having the second half of the year we're looking and seeing that being stronger than the first half of the year. In light of the realization environment, which both Pam and Michael mentioned, those were a little bit slower. But generally speaking, from a capital-raising perspective in terms of what you saw in the second quarter, and you mentioned even a more improved market starting in the third quarter. We feel pretty good about the capital raising picture as we enter into the second half of the year.

Chris Kotowski: Okay, great. That's it for me. Thank you.

Operator: All right. The next question will come from the line of Ken Worthington with JP Morgan.

Ken Worthington: Hi, good morning. Thanks for taking the question. So, that segues well into my first question. You talked about secondaries falling short of expectations. We've sort of seen broadly the challenging fundraising market environment, but secondaries to some extent seems to be a port in the storm.

So, maybe if you have any color, what's happening on the secondary side? And you do have a couple of funds with final closes in the first half of 2023, I think it's like CIS and MAC. So, why are you so confident that you hit targets there given sort of the challenging markets and help us get confidence here too?

Michael Sacks: So, a couple of things, and just a couple of comments. First, the secondaries fund that we're in market with now is already like 30% larger than the last fund and we're going to continue to raise money for that through the end of the year. And so, that fund is going to be a success relative to its prior fund, and that franchise is successful and growing. We feel very good about that.

The only reason I mentioned it is because it is the only fund that closes this calendar year -- that we're in market with now that closes this calendar year. And to the extent that the market environment of ‘22 created a delay, the denominator effect etc., to the extent that that creates a delay, that's the only fund that doesn't have time in market after the end of the year to catch up as people are kind of getting back to deploying capital at the pace that we expect they will. And so, that's why we mentioned that.

But I want to be crystal clear that that fund is going to be a successful fund that's significantly larger than the prior fund. As far as the other funds that we're in market with and that will roll into next year, still in market with those funds, we're optimistic with those -- regard to those funds, we have full pipelines. They have good track records. And we think that demand is there. And that time that we have to raise into next year to make up for a lost little bit of period of time due to market volatility and market environment in ‘22 is helpful.

Ken Worthington: Okay, fair. And now I guess, good cop, insurance. So, I believe that you broke out at least in one of the charts, insurance explicitly in one of the fundraising tables. So, if you could, could you update us on the insurance initiative, how it's progressing, and any update on the outlook there would be great.

Michael Sacks: We're just very pleased there. And if anything, we're probably seeing better results there faster maybe than we even thought we would. We've further invested in the team. We've had 14% of our last 12-month flows come from the channel versus 3% of the AUM. I think, that's probably what you're referring to, we included that on a slide in the deck. And it's a very large market with a lot of opportunity, and we have a lot of activity there. So, we think that's going to continue to grow and continue to prove to be a very good investment for us.

Ken Worthington: Okay, great. Thank you.

Operator: And your next question comes from the line of Michael Cyprys with Morgan Stanley.

Michael Cyprys: Hey, good morning. Thanks for taking the question. I wanted to circle back to infrastructure, where you have raised substantial amounts of capital that you alluded to earlier. I was hoping you could maybe elaborate a bit on your approach to infrastructure. It seems like it's a mix of investing with third-party managers and also direct. So, I guess more specifically with respect to investing with third-party money managers, can you talk about your approach to how you source, and identify the best infrastructure managers and funds to be in? What that funnel looks like? And then on the direct investing side for infrastructure, can you talk about your approach to sourcing investments? Thank you.

Michael Sacks: Sure. Jon, you want to take that one.

Jon Levin: Sure. So, I would say a couple of things when we mentioned some of this in the prepared remarks, Michael. But infrastructure's an interesting asset class, and that infrastructure assets are as old as the world. But the infrastructure asset management space in the grand scheme of looking at the different private market strategies is actually still relatively small or relatively new. And so, our 20 years of experience there makes us quite experienced in the space. And I think, I speak to that experience because it is what creates the global and the deep relationships that enables us to source manager talent.

When we're allocating capital to other people's funds, we're doing that globally. We're doing that in some larger funds, but predominantly in middle market funds or smaller funds, and predominantly with infrastructure managers that are focused on a specific niche within infrastructure. And our ability to cover that universe in light of the time we've been spending in it is successful, and drives, I think what's been a successful allocative business in that space.

As you pointed out, we also are active in co-investing in infrastructure and active in direct investing. The co-investing business is obviously closely related to what you're doing from a primary fund standpoint, and that a lot of your co-investments are alongside the partners that you've backed from a fund perspective.

And then, our direct business which I noted a little bit in my remarks is a bit unique. That's a North America-focused business. That's a business that's predominantly being invested out of our labor impact fund. And it's a business where we believe that we've been able to attract – generate, I should say, attractive risk-adjusted returns through partnerships with skilled organized labor. That's helped us both on the sourcing front in terms of unlocking infrastructure assets by partnering closely with all the constituents involved in infrastructure assets, as well as on the execution of those or the ownership of those infrastructure assets by making sure that we've got a solid relationship with those constituents that are going to help build the project and operate the project.

And so, we have a team of professionals that is focused on sourcing those direct investments, like you would see with any direct infrastructure firm. And as we noted, we will be commencing with our second fundraise in that space towards the end of this year with revenue turning on next year.

Michael Cyprys: Great, thanks. And then just a follow-up question on retail, it's a smaller portion of your AUM today. So, it looks like it's starting to generate some flows as well. So, maybe you could just update us on some of your new product initiatives in the retail space, and talk about the buildout of the distribution and sales organization? Where are you along that journey relative to where you'd like that to be? Thank you.

Michael Sacks: We're growing faster there, again similar to insurance, that we're seeing more fundraising there than we have historically, and then it's represented in terms of our AUM. The bulk of that is through the distribution of product with appropriate support on various high-net worth platforms, mass affluent platforms at the banks and brokerages. We see that enabling us to continue to grow within that channel at a faster rate than - or with more percentage of our funds raised than represented in our AUM as we look forward.

Where I think we have the opportunity is to find the right product for a more broadly distributed RIA effort. That's something that we're working on. And we hope to be able to succeed at that in the future. But for the time being, the success that we're enjoying there is largely on the bank brokerage platforms. And it's essentially more platforms and more product per platform.

Michael Cyprys: Great. Thank you.

Operator: And as I'm not showing any further questions, I'd like to turn the call back over to Stacie Selinger for any additional or closing remarks.

Stacie Selinger: Thank you. Thank you all again for joining this quarter. Thank you for the questions and engagement, we really appreciate them. We look forward to connecting after the call, and again next quarter. Have a nice day.

Operator: And that does conclude today's conference. Ladies and gentlemen, thank you for participating. We hope everyone has a great day. You may all disconnect.