GCM Grosvenor 2023 Second Quarter Results
August 9, 2023

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 2023 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 Security and Exchange Commission and our earnings release, all of which are available on the public shareholder section of our website. 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 and in that spirit, we look forward to your feedback.

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

Michael Sacks: Thank you, Stacie.

GCM Grosvenor again made solid progress in the second quarter. Our Absolute Return Strategies vertical showed signs of stabilization and our private market verticals continued their solid growth trajectory. Our financial performance met our expectations, and our board increased our stock buyback authorization by $25 million. The quarter saw assets under management grow 7% year-over-year, driven by 12% year-over-year growth in Private Markets AUM. Our quarterly Fee-Related Earnings achieved the guidance we provided last quarter adjusted EBITDA and adjusted net income increased year-over-year, driven by a modest sequential and year over year increase in carried interest.

Importantly, during the second quarter, the fundraising environment began to loosen up just a bit. Our second quarter fundraising of $1.5 billion was up about 50% from the first quarter. Our fundraising was again concentrated in private markets with infrastructure being the biggest recipient of capital as it has been for the last couple of years. 73% of the capital we raised came from outside of the US, which is nice as we've been investing to expand our presence internationally. Based on our pipeline, we remain confident that second half fundraising will exceed first half fundraising.

In Q3 of 2023, we expect to see mid-teens year over year Fee-Related Earnings growth and our goals for the full year remain in sight. We continue to see strong growth in Fee-Related Earnings in 2024. Our ability to continue to grow our business in varied market environments is of course, in part a function of the attractiveness of the industry, which we have consistently said remains very healthy in terms of investor attraction, adoption and growth. But we also believe that our unique platform provides a lot of value to clients and leaves us particularly well positioned to the upside.

Our client first philosophy, the belief that we succeed when our clients succeed combined with a focus on our internal culture underpins everything we do. These priorities have impacted how we have structured our business, how we develop and manage client relationships and how we invest capital, and they've led to a stronger and more stable firm. For decades, we've been determined to build a process and team-oriented firm. We want to enable talented professionals to excel, but we intentionally avoid and manage against star systems and functional or perceived reliance on key persons. Client first, one firm, process driven and team oriented are completely consistent and complimentary with a solutions approach.

This approach has resulted in a sticky, customized, separate account effort comprising 74% of our AUM where client investment objectives and constraints are at the very center of portfolio construction. We think that the strength of the business can be seen on slides 8 and 9 of our earnings presentation. Over the last two years, private market management fees excluding catch-up fees have increased by a 15% compound annual growth rate and have had double digit year-over-year growth every quarter for the last nine quarters.

Our separately managed account solutions capabilities have contributed significantly to that growth, and you can see the strength of our separate accounts in our very substantial client longevity and our high re-up rates of 90%, where subsequent commitments have averaged an increase in account size of 40%. We expect all of these trends to continue into the foreseeable future. In addition to our separately managed accounts, we have a strong and growing group of specialized funds with approximately $20 billion of AUM as of quarter end.

Our collaborative culture and the breadth of our firm have led us to originate innovative specialized fund products that uniquely leverage our platform's capabilities to create a differentiated offering. Elevate our infrastructure advantage strategy, our strategic investments group, which manages our multi-asset class fund. Those are three examples of our track record of launching and scaling new initiatives. Together, those three strategies represent more than $7 billion of AUM as of quarter end, and we believe has have significant growth ahead of them.

From an investment perspective, we're pleased with the recent performance relative to peers of our absolute return strategies portfolios and our private market portfolios continue to deliver results that are appreciated by our client base. We've put more than a billion and a half dollars of capital to work so far this year and are enthusiastic about the prospects for deploying our roughly $10 billion of dry powder.

With regard to the various asset classes, it's no surprise that office real estate is probably the most challenging asset class we see today. Jon's going to go into greater detail on our real estate vertical in a minute, but we are fortunately very well positioned there.

We are enthusiastic about the opportunity set in credit where we have $12.5 billion of capital under management as the end of the quarter, and we're seeing investor demand and compelling opportunities to put more capital to work in that space.

For the industry broadly, there's been some political turbulence with regard to ESG and impact investing. Given our large custom separate account platform and the focus on investor choice, we have navigated that turbulence very well and our AUM in that space continues to grow. Despite the turbulence, we continue to see strong demand, product opportunity and growth in that arena on a global basis.

In closing, we had a solid quarter with some tangible signs of improvement in the environment. We remain confident with regard to fundamental demand and in the quality of our business and we're optimistic with regard to our growth trajectory.

And with that, Jon, I'll turn it over to you.

Jon Levin: Thank you, Michael.

We ended the quarter with $10 billion of dry powder across our strategies, which we look forward to deploying in an attractive investment environment, the highest concentration of dry powder is in our private equity business, followed by infrastructure and real estate. It's noteworthy that our real estate dry powder of $1.7 billion equates to more than 30% of our total real estate AUM, which was $5.5 billion as of quarter end.

Fortunately, our team will be deploying a significant portion of their total AUM following the reset in the real estate environment in response to higher rates and tighter access to capital. This quarter, we're going to dive a little deeper into our real estate vertical. Our real estate vertical has been our fastest growing strategy over the last year and stands to continue to grow nicely in the intermediate term. Our real estate AUM of $5.5 billion is 60% greater than just two years ago. $3.8 billion of that AUM is already invested and we have minimal exposure to some of the more troubled areas in real estate such as office and retail.

So, the current portfolio is well positioned and as noted earlier, we have a lot of capital to deploy relative to the total amount of capital we manage.

But it is our unique approach to real estate investing that I will dive deeper into today. We focus on value add and opportunistic investments in real estate sub-asset classes with favorable fundamentals. Our implementation approach is high value-add and unique. An outgrowth of our open architecture approach across the firm, our real estate platform focuses on investing in and alongside early-stage real estate platforms. We essentially provide an unpacked version of the typical opportunity fund.

We deliver our clients high quality value add and opportunistic real estate assets, often the same type of assets that client's access through some of the typical opportunistic real estate managers at an advantageous all-in cost and with additional upside potential. We accomplish this by providing various forms of capital to these emerging real estate platforms by acting as a strategic partner, by providing seed capital to the business or fund, by helping to satisfy GP funding requirements, or by entering into joint ventures to capitalize on individual deals or groups of deals.

Through this approach, our team has helped launch 44 new real estate platforms or new business lines for existing real estate platforms. The approach has provided access to differentiated deal flow and due to the catalytic nature of the capital. In addition to the returns of the physical assets, we often generate additional return through revenue sharing alongside our partners.

In simple terms, we find great real estate talent seeking to start their own platforms and share in their success. We often see the platforms we catalyze investing on behalf of other opportunity funds with our investors enjoying an enhanced risk reward profile.

Our real estate business is highly scalable, our team leverages our platform partners across all geographies and asset classes, creating a powerful and highly diversified sourcing network. The breadth of the network also enables our team to be nimble in rapidly changing environments such as the one we find ourselves in today.

Our team is currently looking at investment opportunities with its platform partners across real estate credit and in niche asset classes such as outdoor storage and affordable housing. Our highly differentiated approach and our strong track record, notably an 18% IRR for our realized and partially realized real estate investments, is increasingly resonating with new pools of capital. Our real estate offering has already attracted some of the largest and most sophisticated institutional investors in the world, and our practice is positioned for accelerating growth.

Looking forward, we expect real estate to be a meaningful contributor to our fundraising over the coming quarters. And with that, I'll turn it over to Pam.

Pam Bentley: Thanks, Jon.

Our management fee driven balance sheet light business and embedded growth and scalability have continued to serve us well. Amidst challenging markets, assets under management grew to $76 billion in the quarter, a 7% increase from a year ago total fee-paying AUM increased 5% year over year inclusive of 12% growth in private markets fee paying AUM, our private markets business now represents 70% of our total AUM and 64% of our fee-paying AUM.

Looking towards the third quarter, we again expect double digit private markets, organic management fee growth year over year, excluding the impact of catch-up management fees. There is upside to that growth rate depending on the timing and amount of fund closings. Absolute Return Strategies' management fees were stable in Q2, declining only slightly compared to the first quarter. We have seen our ARS fee paying AUM stabilize, and we are pleased with our investment performance relative to peers this year.

Our multi-strategy composite was up 2.3% on a net basis in Q2 and is up nearly 4% year to date. Q3 ARS management fees are expected to decline slightly from this quarter, but as the business stabilizes, we expect to return to year-over-year growth during 2024. Consequently, we believe our year-over-year Q3 Fee-Related Earnings will grow in the mid-teens. We realized $13 million of incentive fees in the second quarter, the majority from carried interest. This again is an improving trend line from the first quarter, and although there is quite a way to go for a full return to normal, we are seeing signs of life in the M&A environment.

We believe our carried interest is a valuable source of future earnings power. As of quarter end, we have $782 million in gross unrealized carry across 135 programs, the firm's share of which is $361 million. Our

unrealized carry has been growing steadily over the past two years, and we also have significant growth potential from newer funds that are not yet in a carry earning position as well as from future fundraising. We've raised more than $17 billion in new private markets capital in the last two and a half years alone. When transaction volumes return, we believe carry revenue will contribute meaningfully to our earnings.

Our annual performance fees are tied to ARS investment returns and typically crystallize in the fourth quarter each year. Given the impact of 2022 performance on high watermarks combined with our solid performance in the first half of the year, our 2023 performance fee earnings potential is approximately $13 million were we to achieve an annualized 8% growth rate of return for multi-strategy and 10% gross rate of return for opportunistic investments for the remainder of 2023. This compares to $28 million of annual performance fee earning potential if all portfolios were at high watermark. That number of course grows as ARS fee-paying AUM grows from performance or flows.

Turning to our expenses, our compensation strategy is rooted in fostering alignment between our employees, clients, and shareholders. Fee-Related Earnings compensation in Q2 was approximately $38.5 million, down slightly compared to the first quarter. We continue to be disciplined around our entire cost structure and we anticipate FRE compensation will be stable to decline through the back half of the year. As expected, non-GAAP general and administrative and other expenses declined slightly on a sequential basis from the first quarter to $19.5 million. We are tightly managing expenses, despite inflationary pressures, and expect this figure to remain stable in the third quarter.

From a capitalization standpoint, we are balance sheet light, and the vast majority of our debt is hedged, which gives us further cashflow certainty, and stability against a rising interest rate environment. Our dividend is based on Fee-Related Earnings, less our cost of debt without relying on net incentive fees for regular dividend payments. We are maintaining a healthy quarterly dividend of 11 cents per share or an average yield of 5.5% this quarter, and there is room for further dividend growth in the future.

In the case of share buybacks, we have repurchased more than $3 million in shares this year. We ended the quarter with 186 million shares outstanding, which compares to 188 million shares outstanding at the beginning of 2022. Despite our modest float, we are committed to prudently managing dilution from stock-based compensation programs over time. As of the second quarter, we had approximately $22 million remaining in our share buyback authorization and our board has approved an increase to this authorization of $25 million.

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. And 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. I'll pause for just a moment, and we'll now take a question from Ken Worthington with J.P. Morgan.

Ken Worthington: Hi, good morning. Thanks for taking the questions.

First, the FT reported a few days ago in an article indicating that private market asset managers are turning to fee concessions to win business. Are you seeing the industry challenges in fundraising that we've seen over say the last 18 or so months lead to more pressure on fees? And to what extent are you seeing any such pressure from new or existing investors at a different level than maybe you've seen in the past?

Michael Sacks: Thanks, Ken. It's Michael.

So, we're actually not seeing that. Our fees have been very -- they've been stable. They've been stable for a while. As you know we've talked in the past about our mix-shift, which is actually constructive for our fee rates and constructive over time.

I think the -- so we're not seeing that. I do think that what's happened in the industry, and it's not new, it's not a response to the last year or so. But what you have seen is sponsors, GPs, private equity GPs offering unpromoted or significantly reduced cost co-invest. And so, the average cost of accessing Private Equity for investors who can operate co-invest programs has probably come down, and it's possible that's somehow in the mix of what's been talked about.

We've been a beneficiary of that as more and more of our clients have wanted us to adopt co-investment programs for them in our diversified Private Equity separate accounts, and we're getting incremental fees on that, which is part of the stability and opportunity for our fee rates, but we're not seeing that today.

Ken Worthington: Thank you.

Jon Levin: And Ken, this is Jon.

I'm not sure if it's the same article you saw, but I did read an article in the FT on that topic. And one of the things that article talked about was structural creativity and structural innovation that we're seeing in the industry. Things like arranging Secondaries to get more liquidity back to investors to allow them to recommit or GP-led Secondaries around specific asset or groups of assets.

I think there was even a reference in that article to collateralized fund obligations, which is something that we've talked about in the past. Which are all different ways or methods to allow for people to get more capital return to them in an environment when realizations are slow. I think that trend is real, and it's been -- some of that was honestly real even before the slowdown of the private market capital raising environment and was more about just kind of continued innovation that you see in the marketplace, but some of that certainly is related to trying to drive greater liquidity.

Ken Worthington: Great, thank you.

And then the Private Markets business continues to hum along. The Absolute Return business still feels like it's struggling here. From a flow's perspective, even if we look sequentially in the Absolute Return business, the gross sales were down a little bit. The gross redemptions were up a little bit, means the net was down a little bit, but ultimately, I think the real issue here is on that gross sales side, and we're not seeing money come in the door.

Any thoughts on how to better market your capabilities or thoughts on product development that you can look into in the Absolute Return business that might generate greater client interest and perk up those contributions? I guess it starts with performance, and you've kind of indicated that the performance has bounced back here a bit, so maybe it's a matter of time.

But when push comes to shove, it seems like there might be more that needs to be done just to kind of better stabilize that business. And so, my question is as the pressure increases, how are you thinking about driving better flows into that area?

Michael Sacks: So, thanks for the question. I do think, Ken, that business has largely stabilized. And I think you're right that we are focused on the inflows, the gross inflows if you will to the business. Pam mentioned in her comments that we see that ARS management fees returning to growth next year, and that's kind of what we see evolving.

And we do have vehicles inside our Absolute Return Strategies that have very good performance. And those are, I guess it's obvious, but those are the vehicles that we're out talking about a lot in the market

now and trying to drive. We've had some recent success there, and we have a pipeline there that is up pretty considerably from where that pipeline was a quarter ago.

And so, we use the word stabilization because we think that's where we're at. And Pam did say that we do see that business is starting to grow again next year. And we are focused very much on making sure that the market sees all of our capabilities and offerings in the ARS space, and in particular is looking hard at the offerings that have had very good performance over the last few years that we think can grow significantly.

Ken Worthington: Great. Thank you very much.

Michael Sacks: Thank you.

Operator: Our next question will come from Michael Cyprys with Morgan Stanley.

Michael Cyprys: Hey, good morning. Thanks for taking the question.

I wanted to circle back to your comment, Michael, about the international presence raising a lot of money overseas. Maybe you can just give us a little bit of flavor for which are some of the top countries or regions where you were sourcing a lot of the flows overseas and driving a lot of the strength?

And then how would you characterize the build-out and pace of the overseas international business today? And what steps might you take over the next 12 months or so there?

Michael Sacks: Sure.

There was an article today I believe that talked about one of the large UK plans making an Infrastructure allocation to us, and we've seen some significant flows out of the UK. Recently, we have expanded our presence in Central Europe in the UK, in Canada, in Australia. And we have a strong presence as you know throughout Asia, and we're just pushing forward on all of those fronts and trying to stuff pipeline in all of those markets.

And our pipeline in general is strong globally. And we're pleased to see that pipeline filling as a result of some of the recent investments we've made. And we're obviously pleased to see to have results coming from outside the US as well.

I think the one place that we want to focus on in the coming -- focus more. We've grown our business in the Middle East some, but we think we're still not doing as good a job there as we can, and we think that provides opportunity for us and we are pushing hard on that.

So, I think that's kind of just a quick trip around the world, how we see the markets. And the overarching theme which I try to touch on in my remarks is that despite a slow period for the last four quarters, five quarters, the demand for Alts is still quite good.

And so, everybody's adjusted or adjusting to the new environment if things are loosening up, we're not declaring victory, but there's no question that the environment's loosening a bit. There are green shoots both on fundraising pipeline and on realizations frankly, and so we're optimistic about all of that.

Michael Cyprys: Great. And then just a broad question on the Secondaries market, given the challenges in fundraising and realization activity, there's been a lot of excitement around the prospects for a pickup in Secondaries transaction activity.

So just curious what you're seeing there, what your outlook is for that? What pricing levels are you seeing in terms of funds trade in the secondary market?

Michael Sacks: Right, so Jon talks about this a lot. We think long-term, intermediate term; we think the Secondaries market is a good one and a growing one. Jon, as mentioned before on these calls, Private Equity is one of the few places where your Secondaries market is smaller than your primary market, and we just see continued growth over time in Secondaries.

Secondaries have been dominated for the last year or so by GP-led secondaries. That continues to be the case. There has been more LP secondary activity. But to your question, I think discounts today are probably at the wider end of the range that they typically trade at throughout the cycle, and that's probably slowing the LP-led secondary evolution a little bit just because it's been a slow environment.

Rates are up, marks takes some time to adjust, and so the discounts are a bit wider now. I don't think they're outside kind of the typical range you see in a cycle, but they're towards the low end of that range or that the discounts are that towards the high end of the range. And therefore, LP-led activity is slower, and people are looking at some of the structural alternatives that Jon described a moment ago, and then GP secondaries have really taken off where the discounts are lower in those transactions.

Michael Cyprys: Great. Thank you.

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