GCM Grosvenor 2023 Third Quarter 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 third 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 securities and exchange commissions 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 metrics to the nearest GAAP metric 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.

For those of you that have seen our filing, you'll notice that we have a new look and feel to our earnings presentation. Stacie spent a lot of time on that. Stacie, I want to thank you very much. I think it's an improvement and we look forward to hearing your feedback on it.

Our third quarter results were in line with expectations. With fee-related earnings increasing 16% year Over year. Private markets were the primary driver of growth with private markets management fees Growing 10% year-over-year. This marks the 10th consecutive quarter of double-digit private markets Management fee growth, excluding catchup fees. In the fourth quarter, excluding the impact of catchup fees, we again expect double-digit private markets management fee growth compared to the prior year.

Next week is our third anniversary as a public company and we are proud of what we've accomplished

Over this period. We've seen our management fee centric business continue to grow while experiencing a material shift toward revenue coming from highly predictable, long duration private markets programs. As of quarter end, private markets capital comprised 65% of our fee-paying AUM, up from 54% at the end of 2020. Over the same time period, we have raised approximately $21 billion across our various investment strategies and we have nearly tripled our firm's share of carried interest at net asset value to $365 million. That number does not reflect any value for capital recently deployed or dry powder yet to be deployed. While the realization environment in recent quarters has been soft, our incentive fee opportunities should drive significant cashflow growth in the future.

Turning to this most recent quarter, we raised $1.2 billion. We continue to be confident that total fundraising for the second half of 2023 will exceed first half fundraising. On our last earnings call, Jon spoke about the positive momentum we've seen in our real estate business, and it was nice to see more than 40% of this quarter's fundraising accrue to our real estate vertical. Our infrastructure growth and momentum continues with that vertical representing the greatest contributor to fundraising at approximately $580 million.

Our infrastructure vertical has more than doubled over the last three years from $6 billion of AUM at the end of 2020 to more than $13 billion at the end of the third quarter of 2023. We've seen that growth in both separate accounts and specialized funds. This past quarter, a material portion of the infrastructure capital raised was for two of our specialized funds, CIS III and IAF II. CIS III had its final close with an ending fund size of $882 million, 37% larger than its predecessor, CIS II. Our infrastructure advantage fund, or IAF II, focuses on direct infrastructure investments that are enabled and optimized by a constructive collaborative approach to working with union labor. We have raised nearly $500 million since fundraising began earlier this year, and while we are still early in the fundraising process, we're encouraged by investor interest in the fund.

While investors are still not moving as quickly as they did two years ago, the broad commitment to alternatives remain strong and we're seeing a moderate uptick in activity levels. We brought a new credit specialized fund to market last quarter and just held a small first close last week. Our strategic credit fund, or SCF II, is an opportunistic credit fund, largely private credit that has the flexibility to invest across credit markets directly and through co-investments. There's a lot of demand for private credit investments. Our pipeline has more than doubled over the past year and we believe SCF II and our credit focused separate accounts will be meaningful contributors to capital formation going forward.

We believe that as the private credit market matures, institutions will develop programs in a similar fashion to private equity and infrastructure programs, and our open architecture flexible implementation model will be a beneficiary.

It's worth noting that we have remained disciplined with regard to our cost structure enabling us to grow margins. Our last 12-month fee related earnings margin was 37% up significantly from the end of 2020, and we believe we will continue to enjoy margin expansion into 2024.

We've continued to put clients first and that culture and approach are reflected in the high re-up rates of approximately 90% that we continue to enjoy. We remain confident in our ability to deliver for clients and to grow the firm for shareholders and team members in 2024 and beyond.

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

Jon Levin: Thank you, Michael.

The infrastructure advantage fund that Michael mentioned earlier is just one example of the work that GCM Grosvenor is doing around impact investing. Impact investments catalyze positive measurable outcomes that align with our client's goals while providing competitive investment returns. Critically, our definition of impact investing is non concessionary, meaning that everything we do starts with seeking competitive risk adjusted returns. Our experience is that financial returns and impact are complementary rather than competing objectives. Our impact track records such as in healthcare, education, renewables and energy transition, and diverse managers have delivered consistently competitive returns.

Importantly, the specific targeted outcomes and sometimes even the definition of impact can vary amongst client programs. The money is not ours. It is our clients, and it is our job to deliver competitive outcomes that align with their goals. As our custom account provider for the last three decades, we excel in delivering solutions that meet clients' varied objectives. Client interest in developing impact programs within their alternative allocations is rapidly evolving. Clients are increasingly identifying specific themes they want to address via their investment portfolios. These solutions require not only investment acumen, but also robust ancillary services, including in particular customized reporting on the relevant objectives.

With many institutions looking to not only generate return, but also to promote certain objectives in their investment portfolios, the industry must evolve so it can support impact investing at scale. The opportunity for what we are calling customized impact solutions is massive and perfectly suited to scale within our business.

We are extending the same flexibility that we have offered for decades to our custom separate account clients to impact programs. A client can opt to invest through co-investments, secondaries, direct investments, or through funds or a combination of these implementation styles. We create highly targeted programs that are focused not only on one theme or asset class, but sometimes a broad impact program that cuts across multiple themes in multiple asset classes.

We are leveraging our open architecture sourcing platform to broaden our funnel of impact investments. Our investment teams have been trained to identify impact opportunities that align with our various client programs regardless of whether they're originated from an “impact manager” or one of our hundreds of generalist managers. This enables us to both invest at scale and also have significant deal flow to successfully implement highly targeted impact-oriented programs. We have then built robust proprietary assessment frameworks using best in class practices to ensure that these investments meet the necessary impact criteria that our clients set, while also making sure that we are always focused on generating attractive risk adjusted returns.

Finally, we have combined the power of our existing data analytics with the impact reporting capabilities of leading third-party vendors. Through our systems, we capture detailed quantitative and qualitative KPIs across our investments. We can then deliver a portfolio wide view of impact to our clients. The quality of our customized impact solution is resonating with current and prospective clients, and we are seeing traction for our customized approach from a global investor base across numerous channels. At its core, our customized impact solution is an illustration of what we do best as a firm, leverage the breadth of our platform to achieve the unique objectives of each of our client partners.
Now I'll turn the call over to Pam.

Pam Bentley: Thanks, Jon. Our results this quarter were consistent with our expectations and once again demonstrated our earnings quality and scalability of the platform. Assets under management were $76 billion as a quarter end, a 5% increase from a year ago. Total fee-paying AUM also increased 5% year over year inclusive of 11% growth in private markets fee-paying AUM. Our private markets business now represents 65% of our fee-paying AUM and private markets management fees, excluding catchup fees, have grown at a 13% compound annual growth rate over the last three years.

Private markets management fees grew 10% in the quarter compared to a year ago. Excluding the impact of catchup management fees, we once again expect double-digit private markets management fee growth in the fourth quarter compared to the prior year.

As expected, absolute return strategies management fees were relatively stable in Q3 as compared to last quarter, and we expect ARS management fees to again be stable in the fourth quarter. Most importantly, we are pleased with our ARS investment performance. Our multi-strategy composite is up 6% year to date on a growth basis with very little correlation to broad markets.

We realized $26 million of incentive fees in the third quarter, the majority from carried interest. As a reminder, the firm retains 50 to 60% of the firm's share of incentive fees and as of quarter end, we have $778 million in gross unrealized carried interest across 136 programs. The firm share of which is $365 million. Our share of carry has nearly tripled in the last three years creating significant future cashflow potential. Consequently, we believe that when the M&A activity returns, the quality and diversification of our unrealized carried interest will have a significant positive impact on earnings.

Our annual performance fees are tied to ARS investment returns and typically crystallized in the fourth quarter each year. Given the impact of 2022 performance on high watermarks combined with our solid performance this year, our 2023 performance fee earnings potential is approximately $13 million were we to achieve an annualized 8% gross rate of return for multi-strategy and 10% gross rate of return for opportunistic investments for the remainder of this year. This compares to $24 million of annual performance fee earnings potential if all portfolios were at high watermark today.

Turning to our expenses, our compensation strategy is rooted in fostering alignment between our employees, clients and shareholders. Fee-related earnings compensation in Q3 was approximately $38 million, slightly below the second quarter, and we expect a similar level in the fourth quarter.
Non-GAAP general and administrative and other expenses declined in the quarter to $17.5 million as a result of reduced conference and travel-related costs as well as lower professional fees. We expect our fourth quarter non-GAAP G&A will be in line with or slightly below our first and second quarter level. We continue to exercise discipline expense management across our business while allowing for investment in strategic growth opportunities.

Pulling together these factors on a year over year basis, fee-related earnings grew a healthy 16% in the quarter while adjusted EBITDA and adjusted net income grew 5% and 7% respectively.

From a capitalization standpoint, we are balance sheet light, and the majority of our debt is hedged, which gives further cashflow certainty and stability against our 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 a yield of 5.2% as of last Friday, and there is room for further dividend growth in the future.

In the case of share buybacks, we have repurchased nearly 4 million shares year to date and we ended the quarter with 187 million shares outstanding. Despite our modest float, we are committed to prudently managing dilution from stock-based compensation programs over time. As of the end of the third quarter, we had $40 million remaining in our share buyback authorization and we continue to believe that our current stock price is at an attractive level relative to market value.

Looking ahead to next year, we feel confident in our solid trajectory with continued double-digit growth and private markets management fees, stabilization of ARS management fees, expanded FRE margins and significant growth potential in our incentive fee revenues. 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: 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 make sure your mute function is turned off. Again, that function is star one. Our first question comes from Ken Worthington with JP Morgan. Please go ahead.

Ken Worthington: Hi, good morning. And thanks for taking the question.

It looks like expectations in private markets last quarter was for four or so funds to have closes in this quarter including CIS III, MAC III, Infra III, and the new Elevate Fund. Did all of those funds actually have closes this quarter or did some of the fundraising in Q3 get pushed to Q4?

And then your comments suggested that or you reiterated your comments that the second half fundraising would be better than the first half? Which funds do you expect to close as we look towards the end of the year? So, thanks for that.

Michael Sacks: So, Ken. It's Michael. Second half fundraising will exceed, we remain confident it will exceed, the first half fundraising. Jon will give you in a second specifically which funds had closes and did not have closes but there's no doubt that some of the capital that we had hoped to close on in Q3 pushed to Q4. So in Q4 we're seeing things pick up and our pipeline is full, and our activity levels have clearly picked up.

There's no question that but it's not a return to the prior environment, transaction levels really have just picked up a little bit and we've been saying for a while that where we see that flywheel start turning again is when transaction levels pick up and that has certainly not fully happened yet, although we do feel like everything that we're seeing is encouraging.

Jon, you want to give the specifics on which ones did and didn't have a close?

Jon Levin: Sure. I think we had a small closing on MAC III. We had closings on CIS III and IAF. We did not have a closing on Elevate. I think when you step back, Ken, and look at it more broadly and I actually think you noted this in your last report, obviously, for us a significant part of what we're doing, 75% of the capital for customized separate accounts which is providing a tremendous amount of ballast to our fundraising picture and what gives us the confidence to talk about second half being greater than first half in the terms of the visibility of that pipeline on the funds in particular.

Obviously, we put out a release more recently on our infrastructure platform and the success of that franchise more broadly and Michael noted the CAGR of that franchise as a whole, not just on the

commingled funds and his comments on the script. And so feel good about that. And in terms of Elevate, we closed and put a note out on our first deal for that fund which we think is an exciting catalyst for that fund and the efficacy of the seating business. So, we feel good about stuff. It's a little bit hard to predict the exact timing of things as Michael noted, but overall, it feels like a picture that's improving with the days.

Ken Worthington: Awesome, thank you for that.

And then just maybe to follow up on the insurance channel, where are assets in your insurance business as of the end of the quarter? Maybe talk about how that business has grown this year and you highlighted, I think it was some new credit capabilities, assuming I interpreted that correctly. How do the new credit capabilities maybe further help you grow or are they going to help you sort of build out your insurance business?

Thanks for that.

Michael Sacks: Yeah, so I wouldn't necessarily say new capabilities Ken, from a manufacturing standpoint. I think these are capabilities that we have internally manufacturing capability that we have. I think there's clearly more demand for credit and for alternative credit and that demand is coming.

You see demand in the insurance channel for sure. We raised more money from the insurance channel last quarter than it represents in our balance sheet, maybe Jon or Stacie, we can get the precise number, but it continues to grow faster than its pro rata share. But the credit demand is sort of broad base demand, it's not just in the insurance channel. And we do believe which is why we mentioned it that you'll hear more about credit growth from us going forward and specifically that the type of diversified approach that you've seen be so successful in infrastructure and private equity. We're seeing a lot of interest in that type of approach for credit and we are hopeful that we'll be able to announce wins and growth and good news in that regard going forward.

Aside from just last quarter, we remain bullish on the insurance channel. There's a lot of activity there. We've been pretty effectively stuffing the pipeline there continuously and we continue to believe that will grow and take more and more of a larger percentage of AUM.

Jon Levin: Ken, I would just add one point to what Michael said which is really just going deeper on a point. He said, when Michael talks about it's not a new capability but it's a diversified approach to credit and we're seeing a lot of interest from clients, all different types of channels kind of globally. What we're really talking about there and the similarities that Michael also referenced between private equity and infrastructure is the ability to invest in primary funds, co-investments, secondary investments, direct investments.

And so, when you think about the evolution of the private credit sub-sector of the alternative industry and this has been noted on a number of the calls even this quarter, a lot of that has been focused on the sponsor direct lending kind of franchises and obviously credit's just a much bigger world than that. You have sponsor, you have non-sponsor, you have asset-backed, you have structured.

And so our ability as clients mature in that allocation to help them build out that allocation but also do it on a cost-effective basis by using co-investments in the same way they've been used in other alternative asset classes is something that we're excited about and think will be resonating nicely in the marketplace.

Ken Worthington: Great. Thank you.

Operator: Again, if you have a question, please press star and then one key on your telephone keypad. Our next question comes from the line of Michael Cyprys with Morgan Stanley. Please go ahead.

Michael Cyprys: HI. Morning. Thanks for taking the question.

Just wanted to ask on the absolute return business that you have, if you could maybe speak a little bit to the gross sales environment. It's been a volatile year in public equity markets, most stocks down on the year. If we look at the S&P equal late index, I guess, what's the scope for greater LP demand within your absolute return business? What strategies are resonating most today with LPs and how do you see that evolving as you look out over the next 12 months?

Michael Sacks: So, I think that we definitely have activity in that space. I'm actually calling in from Hong Kong, Michael, and was with our team here today. They think they see activity specifically talking about ARS.

I think our general budgeting approach hasn't changed. I don't think we're in a strong net inflow environment, but we do think gross inflows will pick up as was mentioned on the script. We're performing there and we're performing relative to expectations, we're performing relative to peers, we're performing relative to indices, and so we think that's important. There are a couple of funds inside absolute return that have good numbers that we are actively showing to the marketplace. And so, no change in terms of our net flow base case assumptions but we do see growth in the inflows area and it all starts with performance which is in line with expectations.

Michael Cyprys: Great, thanks. And just a follow-up question on secondaries. I was hoping you could speak to the deployment environment there, the discounts that you're seeing, how that's evolving as this seems like it'd be a hopeful solution for LPs facing liquidity constraints. What's the prospects for that activity in the secondary space to accelerate meaningfully from here?

Michael Sacks: So would tell you that not a lot of change from where we saw that a quarter ago which is pretty wide discounts relative to historical discounts, people not - LP-led secondaries not seeing huge volume increases and a little hesitancy to take those discounts and GP-led secondaries kind of continuing to be where most of the activity is.

I think in general without pretending to have any kind of a crystal ball, we do think that the pent-up demand for transaction activity, the pent-up demand for liquidity, and secondary, therefore secondary market activity we do see that picking up next year.

And this is something Jon has spoken about, and I think may have spoken about publicly recently, but we kind of see that spread between where the bid is, where the ask is waiting for to figure out where rates are. We just think we're getting closer. I guess it's definitional but to that resolving itself and we see activity levels picking up next year sort of one way or another.

Michael Cyprys: Great. Thank you.

Operator: Our next question comes from Chris Kotowski with Oppenheimer. Please go ahead.

Chris Kotowski: Yeah, good morning. Sorry.

I'm wondering, you've mentioned in the past that a good deal of your fundraising comes from high net-worth individuals and wealth management clients, but it seems like it's been more on the customized kind of accounts. And I'm wondering how high up on your list of priorities is a commingled retail fund vehicle.

Michael Sacks: Thank you, Chris. It's a good question. I think in general what you're referring to I think is the fact that our individual investor fundraising has, like insurance, exceeded in most quarters its representation in our total AUM. So, it's growing as a percentage of our AUM. We very much see that continuing and we want to bring more focus to our individual investor efforts. We want to bring more products to the individual investor channel. We want more internal resources dedicated to the individual investor channel and we look forward to reporting on that over the course of the next four, eight quarters, more than once.

Chris Kotowski: Okay. Thank you.

Stacie Selinger: Thank you again for joining us today. Please feel free to reach out with any follow-ups and if not, we look forward to speaking with you again next quarter.

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.