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Craig Siegenthaler:

All right. Good morning everyone. This is Craig Siegenthaler from Bank of America, and it's my pleasure to introduce Martin Kelly. Martin is the chief financial officer at Apollo, and he oversees Apollo's technology, operations, risk, and audit groups and is a member of the firm's leadership team. Prior to Apollo, Martin was at Barclays and Lehman in leadership roles in finance, investment banking, and fixed income.

Martin, thank you for joining us. How are you doing today?

Martin Kelly:

I'm doing terrific, Craig. Thanks. I'm actually 18 of 21 of these sessions that Craig's hosting, so he tells me he's got some energy left.

Craig Siegenthaler:

It's all downhill here.

Martin Kelly:

Thanks for having us.

Craig Siegenthaler:

So Apollo was founded in 1990 with a focus on private equity. The firm has since evolved into a diverse global alternative asset manager with scale across all three channels, institutional, individual, and its leading retirement platform where it's number one in the world. Apollo pioneered the alternative insurance model with the creation of a theme, and many of its large cap peers have since replicated the strategy. The firm now manages more than 600 billion in AUM and is one of the five largest alt managers in the world.

And from 2018 to 2023, Apollo more than doubled its fee earning AUM. So it's been growing at a fast clip. All right. Let's get started. Let's start with the retirement channel. With Martin, it's your biggest business. So I wanted to start with how Athene is differentiated versus some of your closest comps and what do you see as its competitive advantages?

Martin Kelly:

Yeah. Athene is a terrific business. Athene is 15 years old and I think it's really, in that time, I think that itself is a competitive advantage because it just takes time to build a business and that itself creates a bit of a moat around the position that you have, which I'll explain.

So Athene has advantages on liability creation. On the asset investing side, accessing Apollo's mostly private credit origination capabilities, has a very efficient cost structure, and it also has plenty of capital. And I think each of those, we could go into. Athene, what many others are doing is coming into the space and buying blocks of policies and the price to do that is high. And then the question becomes what's next and how do you appropriately invest that capital?

Athene has not done an inorganic transaction now for four years. And so what Athena has been able to do is create a high credit rating and plenty of excess capital that allows us to access currently four different channels. And in some of those channels we're number one, in terms of market position, but the market is vast and growing. So I think Athene is able to differentiate itself in accessing retail flow.

Last year Athene did 65 billion dollars of top line growth. Over half of that was retail. Athene is and has been number one or two in the pension risk transfer business. Athene is developing reinsurance arrangements with other companies, most of whom are based in Asia. And then Athene has access to the funding agreement market. And so when you combine those four distribution channels, that creates a 60, $65 billion top line growth business, which we expect to be more in 2024. So that's the liability side.

The asset side, Athene has an average yield outperformance relative to the PSA of 40 basis points. And the way it's done that is Athene's balance sheet is roughly 55% CUSIP credit, what you'd expect to see on any balance sheet in the space. And then 40, 45% of investment grade private credit, all of which comes with a yield out performance relative to comparable CUSIP credit. And so having access to origination sourced by a number of platforms and businesses across Apollo has been the reason that the assets, and therefore the net spread has outperformed. And then, third points, the cost base, the thing's highly efficient, it has less than 2000 people. It's based in Western mine.

Its cost spread is 23 basis points and probably coming down. And then it has a highly efficient capital structure. Excess capital of two and a half billion dollars. A Plus credit rating, one of the lowest leverage ratios in the business. So we run it pretty conservatively because we want to make sure it's a fortress balance sheet and it's robust and it's able to be opportunistic when opportunities present. So we're really pleased with it. It's key differentiating point I think is the ability to grow organically, but fueled by everything I just mentioned.

Craig Siegenthaler:

Great. So Martin, Apollo targets a record 70 billion plus of organic inflows from Athene in 2024. That's up from 63 billion last year. What is the contribution from retail annuity sales embedded in that guidance and how sustainable is that if and when the Fed starts cutting interest rates?

Martin Kelly:

Yeah, it's interesting. So it's about half. About half of what the top line growth has been in each year is annuities, and we'd expect it to be about half, if not a bit more next year. And in fact, it was 35 billion dollars in the year that we just closed out. So I think yes, the market as a whole has benefited from higher rates, there's no question, but Athene has benefited by getting access to different distribution channels that have increased our market share. So if we look at the growth in Athene's annuity sales in the last two or three years, the total annuity sales are up almost 4X. But the bank contribution, the bank distribution channel contribution to that is our 10X.

And this comes back to the point I made earlier, which is a strong credit rating and strong capital gives you access to high quality distribution channels, which we didn't previously have. So I would expect that we'll continue to grow in those higher quality channels and take market share. And so, if and when there's a tapering of rates and front end rates come down, or the overall curve comes down, then that could be a headwind to industry growth, but I'd expect our position to continue to increase.

Craig Siegenthaler:

So Martin, there's been a very modest rise in industry defaults and losses across most asset classes, but from very, very low levels. How has the credit quality inside of Athene trended and relatedly, how do you get comfort around managing a $300 billion-ish portfolio with very large allocations to both structured and private credit?

Martin Kelly:

Yeah, big focus point. We've spent a lot of time on this. We actually publish a lot of information which stratifies the portfolio. I think we probably are more transparent than most, if not all others, including stress tests, including exposures to certain asset classes. There is a notion that structured credit is riskier than non-structured credit, and we don't believe that. We think that structured credit appropriately underwritten and put together and entrenched. If you own the investment grade pieces of that, which Athene does, then definitionally given diversification, underwriting quality and active management, that comes with a higher credit profile than non-structured credit.

What we've found is, and you can see we publish our credit loss experience against peers. It's all on the web. Our experience has been default rates are lower than the peer average over a long period of time. It's interesting where we've actually taken losses. It has tended to be in a single name credit, idiosyncratic, single name credit, including more recently some small amount of real estate exposure, but it's not structured credit. It tends to be a situation that happens at a company where its own credit is challenged. And that tends to be where we've taken the losses that we have taken over time. That said, it's been less than the industry average.

Craig Siegenthaler:

So on the liability side, we monitored a pickup in surrenders last year, but they declined again in the fourth quarter. So most of that I think was related to three year vintage annuities that exited their surrender charge periods. Was there anything surprising

Craig Siegenthaler:

On the surrender front, given the sharp increase in interest rates. Across my coverage, we saw liabilities in motion across financial services industries, including the banks and also the wealth managers.

Martin Kelly:

Yeah. No. No is a quick answer. This was a very topical area, nine, 12 months ago, and I think for the right reasons if you're on the outside looking in. We've had no deviation in our surrender experience at all, including last year and the year before. It's actually a very predictable behavior if you break it down into the parts of the portfolio that are surrenderable versus those that are not. So 80% plus of a Athene's liability portfolio is not surrenderable without charge, meaning it's either not surrenderable at all or it comes with either or of those surrender charges and other market value termination adjustments that the annuit needs to pay.

So when we look at the actual behavior and one of the reasons we've been very transparent about publishing it is we know when we're going to have upticks and downticks in surrenders based on business that we've written three years ago or five years ago, that's coming to a contractual maturity. So in Q2 or Q3 of last year we saw an uptick and so that was entirely predicted. If you break it down, the 10 to 12% annualized surrender rate is contractual maturities, which is a given very predictable income withdrawals from policies for people who are at that point in their lives where there's warring, also very predictable, surrenders on policies that are just coming out of surrender protection, also very predictable.

Then there's a last piece, which is the unplanned, the uneconomic surrenders by people who just need to access their policy and we'll do that in an uneconomic way. That's predictable and it's about 1% of annualized liabilities. The deviation you see in any one period to the next tends to come for the most part, from contractual maturities being higher or lower. We've just yesterday published our forecast for the year ahead. Again on the website, you can see the by quarter view of what we expect surrenders to be. The headline is it'll be down a bit, but with some quarterly deviation for the same reasons.

Craig Siegenthaler:

Great. So my next one is how have you used sidecar capital vehicles to reduce the capital intensity of the retirement services business? So how have you used them to grow FRE at a fast clip, but on a more capital like basis?

Martin Kelly:

Yeah, so really important part of the platform actually. So we have an equity sidecar to Athene that's called ADEP or ACRA. It goes by different names. We raised the first variant of that fund about five years ago. It was three and a quarter billion dollars. The original construct, actually back to your first question, was to help support the growth of Athene around the less predictable inorganic transactions. We quickly realized that ACRA could be used to support all growth of Athene. So what ACRA one has done is support on a proportionate basis liability growth across each of the four channels. The investors in that fund have had a very strong performance and a good experience. So we've been out raising the second variant of that fund, ACRA Two, which will be somewhere between four and 5 billion by the time we're done.

The benefit of that, there's multiple benefits. One is it effectively co-invest Athene in supporting asset growth. So while it doesn't create spread earnings for Athene, because the spread goes into the sidecar, it creates the same fee related earnings growth as any other dollar of capital coming from Athene. So you can take a dollar of ACRA capital and a dollar of Athene capital pair it together, which will support about 10 times that amount of liability growth and on the same management fees.

So I actually think it leverages earnings across both sides of the house. It also, I think, validates the fees that we own from Athene, because third parties step up and are willing to pay exactly the same fee rate that we charge Athene X ACRA. So it's a really important part of the future growth of the business. We're able to flex that up or down based on flow in the business at different points in time, but you'll see ACRA supporting a continuing or an increasing amount of business growth at Athene as we go forward.

Craig Siegenthaler:

Martin, let's move the conversation over to private credit. If we were talking about private credit five or 10 years ago, we were probably mainly talking about direct origination corporate credit, but private credit is so much more today. ABF infrastructure, real estate debt, it's really broadened. So I was wondering if you could summarize your private credit origination capabilities today and then also highlight if there's any significant gaps remaining?

Martin Kelly:

Yeah. Also, we spent a lot of time talking about this. I think even today actually, most of the market thinks of private credit as direct lending and thinks of... So think of a SoFi plus five to 700 loan, 10 to 12% at today's rates to a company that tends to be more middle market than larger. So like a 50 to a hundred million dollars EBITDA, five times leverage, that's the classic definition of private credit in the marketplace or direct lending. It's about a trillion and a half dollar opportunity if you add everyone up across the platform, across the industry.

What we've done is create the notion that private credit is a far larger investment grade opportunity. So we define private credit as all the platforms that we operate, including the CS business, Atlas, including mid cap and 16 of these platforms in total. It also includes investment grade origination, both corporate origination, sponsored origination that we do within the firm outside the platforms. So if the market thinks that private credit is today about a trillion and a half, we think as you go down all the asset classes that are investment grade but private, we think it's a 40 trillion opportunity, and so that's what we're focused on.

So the reason it's so important is the consumers of investment grade private credit are Athene, Athene's competitors, other insurance companies, other investors that just want access to investment grade private credit. It's also a great tool to syndicate to the market, to people that want private credit, which is less liquid, but well structured and comes with a yield out performance and are willing to pay for that. So that's another reason that we've been able to grow our syndication business from what it was to a $400-500 million business today, because we can offer a piece of origination in syndicated form to the marketplace, which then creates other opportunities to bring in assets for those investors.

Mark talks about this a lot. The only real limiter to our growth as a firm is origination. When we talk about origination, for the most part, it's private credit the way I've just defined it. If we can do that, we can grow Athene, we can grow Athora, we can grow third parties, we can grow the syndication business. There's multiple sort of uses of that production if we can continue to grow that with an appropriate risk return, but targeting a hundred to 200 basis points yield out performance relative to a similar credit profile in liquid Q support.

Craig Siegenthaler:

Martin, I wanted to dive a little deeper on the third party credit comment. This is a huge business inside of Athene. It's been growing really, really quickly. I think some people miss this. What are you doing for third parties across investment grade and non-investment grade? How much credit AUM are you managing today outside of Athene?

Martin Kelly:

So our credit business today is just under 500 billion. About half of that is third party. In that I count the assets that are supported by ADEP as third party capital.

Martin Kelly:

That's a spectrum of different risk-return businesses, but the majority of that is in investment grade. And so we're really focused on growing that business. But it comes back to the point I just made. You can only grow that if you have origination. And so that's why origination, both within the 16 platforms and within the other businesses that we operate outside the platforms in our credit business, is so critical to future growth. So I do believe that the market puts a premium on third-party capital and fees from third-party capital. And so that's a big focus.

Craig Siegenthaler:

Great. Let's move the conversation on to product innovation and private wealth. What is your semi-liquid product lineup in private wealth look like today? In which recent product launches is the firm most excited about?

Martin Kelly:

Yeah, so this is a massive, and again, multi-year opportunity. It's one of the three or four really big opportunities that sit in front of us. What we're trying to do is bring a product to market which is differentiated and, most often, leverages product that we also make available to institutional investors. So I think what you are seeing us doing is bringing retail-appropriate versions of institutional product to market. And I'll talk about how we distribute that. But AAA is one that we're excited about. ADS, which is a large-cap investment grade. BDC is one that we're excited about, and they leverage products that are made available to institutional investors. So we have about seven products in the market today. I think you should expect to see us bring a new product to market every quarter as we look forward. And ultimately, what we're solving for is, what does the buyer want? Who is the buyer? The buyer can be a qualified purchaser. The buyer can be an accredited investor. Not every product is appropriate for both. Some need to be more liquid, some need to be less liquid.

But the seven I talked about are semi-liquid, that made the definition of what an accredited investor needs. And then it's a question of, how do you bring that to market? And again, I would put the market or segment the market in a couple of different ways. There's family office, sort of sophisticated buyers that we cover ourselves. There are consultant channels, which are really important in a massive market that take a lot of time to get through diligence. And then it's distributing product into high-net-worth through money center, banks, and other warehouse methods, and paying for that in different ways through revenue share or through cost upfront. So we're, I think, early innings in what this is all about, but what we're really focused on is a product that's differentiated, a product that leverages our institutional capabilities, and then it's designed to be and structured to be appropriate for different segments of retail, but realizing retail is a number of different things.

Craig Siegenthaler:

So I wanted to hone in a little bit on your private BDC, ADS, had very strong investment performance last year. Net flow momentum continued. Finished the year with a strong finish. Do you think the net flow trajectory could build off of fourth-quarter levels?

Martin Kelly:

Yeah, I do. I'll describe ADS. It's an investment grade... It's a large-cap lending business that targets companies that have... It's not middle market, so it's about a $250 million average EBITDA company that's borrowing from ADS. Oftentimes, loans that go into ADS are also going elsewhere in our platform. To the point I made on institutional variance of what we have. ADS is now $8 billion of assets, and it really ramped as we went quarter by quarter through last year. So I would expect that that ramp will continue. That's what it looks like so far in Q1. And I think the important thing for us is to grow it sensibly over time so that we're investing throughout the course of a cycle. But that's one of the products that's in market today that's getting a lot of traction, and I think we have great aspirations for.

Craig Siegenthaler:

So coming back to AAA, which is the first one you listed, it's a very unique product. It's a multi-asset product. It targets equity-like returns but minimal downside. It also has a very long-term track record that was portable inside of Athene. How has feedback for AAA been inside the private wealth channel? Because it is different than what a lot of your peers are selling today.

Martin Kelly:

Yeah. This is another... To the same point, something that's differentiated and that has appealed to investors. And so AAA is a... I think of it as an S&P replacement product with much lower volatility than the S&P. So it's meant to be a hybrid vehicle. It has a lot of the investments that we make in our platforms, including Atlas and others, are funded by AAA. It also has a number of other investments around the platform. And so if you want more information on AAA, there's plenty of information on the website and in the origination session we did last fall, but take-up has been high. I think take-up... This gets to the point of how do you penetrate distribution channels. And it's been particularly attractive to family office as a buyer of that product. It's now on high-net-worth distribution channels through a couple of banks.

I think we're up to five banks that is distributing the product, and it's being distributed not just in the US but in Europe and Asia. So it has a global appeal, we think. And each quarter, the subscriptions are higher than the previous quarter. So it's another product that I think, over time, will build. It's attractive as a product. It brings with it management fees, but it also allow... It has a leveraging effect on earnings to the extent that it allows us to invest more capital in platforms, which themselves create product origination, which create SRE and FRE and syndication fees, and so on. So it's a really... I think that paired with ADIP, the equity sidecar for Athene, probably our two most important products because of... They're not just a product that's sold to an investor in its own silo. They have a synchronous effect around the platform.

Craig Siegenthaler:

So let's take a step back, and I have several bigger-picture questions for you. So Apollo's grown so much over the last 10 years, and I remember when you're about $40-ish billion of AOM, I forgot the year, but now you're at $600 billion. I mean, that was a lot of growth over the last 10 to 15 years. Just given the law of large numbers, how can you continue to grow at high growth rates?

Martin Kelly:

Yeah, none of us are good at looking back and sort of looking at successes. But I think, look, we're very pleased and proud of the growth we've had. And the growth was definitely fueled by monetary stimulus, low rates, and re-regulation in that period of time. And so, as we sit here today, we look at that and say, "That's unlikely to continue going forward." And whether it's a headwind or it's just a neutral, we'll see. But the change that's created the growth is unlikely to continue to be a benefit to us.

Okay. So then, how do we keep growing? We then look at the markets that are in front of us and see and just view ourselves in the first innings of many of them. So fixed income replacement, which I spoke about $40 trillion market. The retirement market, which has pretty unsophisticated products in it today that don't really serve people in retirement that well, that's a $40 trillion market. The high-net-worth market today is $100 trillion market. I think our industry is scratching the surface in that. And then the equity replacement products like AAA and others that we're working on is also a massive market of similar size. So we're aligning ourselves around those four big opportunities and how we access them. And so that's what the future looks like for us.

Martin Kelly:

And so, yes, we're really pleased with what we've done, but it also feels like it's all in front of us at the same time.

Craig Siegenthaler:

So Martin, have a capital allocation question for you. How should we think about the right mix of proceeds within your earnings, between organic needs, especially inside of Athene, dividends, buybacks, and even accretive M&A?

Martin Kelly:

Yeah. So I'd add compensation to that mix because I think what we're trying to do is you've seen it, is pivot our compensation to be paying people more in the less valued parts of our earning streams and less in the highly valued parts of the earning streams. And for certain senior leaders more in stock to make sure there's proper alignment.

We have a number of good choices. We've raised the dividend now twice since we closed the merger with Athene. Having a lot higher dividend rate is not part of our plan. Having an S&P 500 competitive dividend rate I think is what we should plan for and hire. So the dividend increases that you've seen, you should just assume will continue. Buying back stock even with the run that we've had is attractive at a mid to high-teens growth rate. It's pretty easy math to do the ROE on that.

Growing Athene is the most accretive part of use or use of capital. And so, one of the reasons we issued a mandatory convertible last year was to get more capital in to fund several years of growth into Athene, realizing that the capital constraints and the capital requirements of the business keep changing.

And then there's M&A, which we could do a small amount of M&A. If we ever did a large M&A transaction, it would probably be for stock, not for capital cash at the top of the house. We issued stock to employees to sort of set the next generation up and the next generation after that. And we've been pretty clear that we expect to buy that back and immunize it back to 600 million shares. Really that can only come once we have carry. The carry realizations are sort of the swing factor in having more or less capital at the top of the house and so that depends on the environment.

So I think what you should expect us to do now is to immunize the stock that we've issued but backended, not frontended over the next three years to continue to pay a competitive dividend and then we'll have excess capital to spend on growth where we see it, realizing that that's probably smaller than larger transactions.

Craig Siegenthaler:

So I have a few more questions here, but given time, I think we should check with the audience and see if there's any questions. So please raise your hand and we can get you a microphone. We have one up here in the front.

Speaker 1:

Thank you. Can you talk a bit about the competitive landscape in the retirement business, both on the retail side in terms of distribution as more people are entering that market, as well as in the pension space in the institutional side?

Martin Kelly:

Yeah, sure. So on retail, if you look at the companies that have formed in the last decade, there's very few of them that are organically growing. They buy blocks and then they manage the blocks. And so to the point I was making, it took us a decade plus to get to where we are and in that period of time, you make mistakes, you sort of chase loose ends and so there's tuition that goes into growing that business.

I think ultimately to be, like the market for buying business in the US is widely competitive and, therefore, rich and so you need to be... And it comes with product that you haven't underwritten, has partial surrender charges and it's just a very difficult piece of business to earn money from. So I think what we've done is create organic growth and sort of break into, if not be at the top of that market, when others have not and, frankly, probably are not able to. And so I think that's a real competitive advantage for us.

And then on the pension transfer business, both in the US and outside the US, it's an opportunity which there's about $50 billion of business traded last year, which was the same as the year before. I would've expected that to be more with plans being more fully funded and you would expect that that will change if we look ahead, but it's hard to predict. We look at what we know about that's in front of us right now, which is a pretty healthy pipeline. There are for anything but the small transactions, there's only a few competitors that can really compete in that marketplace. And so I think we're number one last year. We've been one or two in each of the last few years. I'd expect us to be around there.

If the market really cracks open and you see large either buyouts of plans or terminations of plans, then I'd expect we'd use the excess capital we have plus ADA, plus potentially other capital to fund that growth. But as we sit here today, we sort of assume a steady-ish type market size in the year ahead that could obviously be higher.

Craig Siegenthaler:

I have one up here. I wanted to talk about expense or operating efficiency and the F3 margin. Your F3 margins are already very high, but maybe you could talk about incremental margins from here and how you balance investing or spending for growth relative to driving operating leverage.

Martin Kelly:

Yeah, it's a constant topic. The number of ideas that are floating around at any time are high, and so it requires really disciplined prioritization of what we think is actionable and where we should be spending both our time and our money in terms of hiring new people. I think if we go back three years, we were, for sure, under-invested. And so I think one of the changes that Mark brought about when he came in as CEO was both a catch-up in investment of where we'd under-invested and a leaning into new growth. And a lot of the initiatives that we've been speaking about had been funded through OpEx and absorbed in the margin that we've been able to produce.

As we look forward, we see operating leverage. We're at 56% today that we've said that that will go to 60%. I would just look at that as a steady growth to 60% year-by-year over the next three or four years.

I think we know what we know in terms of businesses that we want to invest in. The reality is there's very little CapEx in our business. There's not much M&A, so most of what you do requires P&L spend.

And when you do that, you're spending costs before the revenues come, which tend to come two, three, four years later. So we're managing that glide path to get to 60 in the context of the revenue opportunities and growth that we see, knowing that we're going to have to spend more to set us up for the next leg of growth beyond the current plan.

Craig Siegenthaler:

Great. I think with that, we are out of questions. So Martin, on behalf of all of us at Bank of America, thank you very much for joining us.

Martin Kelly:

Thanks for having us. Thank you.