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Athene Holding (ATH)

Q2 Earnings Call

Corporate Participants

**Jim Belardi, Chairman, CEO and Chief
Investment Officer:**

*Chairman, CEO and Chief Investment Officer, Athene
Holding*

William Wheeler

President, Athene Holding

Martin Klein

Chief Financial Officer, Athene Holding

Noah Gunn

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Other Participants

Zach Byer

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ATHENE HOLDING LTD.
Q2 2021 Earnings Call
Moderator: Noah Gunn, Head of Investor Relations
August 5, 2021
10:00 AM ET

Operator:

Good morning. My name is Stephanie, and I will be your conference operator today. At this time, I would like to welcome everyone to Athene's Second Quarter 2021 Earnings Conference Call and Webcast. All participant lines have been placed on in a listen-only mode to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. If you would like to ask a question at that time, please press star 1 on your telephone keypad. If you should need operator assistance, please press star 0. Thank you. I will now turn the call over to Noah Gunn, Head of Investor Relations. Please go ahead.

Noah Gunn, Head of Investor Relations:

Thanks, Stephanie, and welcome, everyone, to our second quarter 2021 earnings call. As usual, joining me this morning are Jim Belardi, Chairman and CEO; Bill Wheeler, President; and Marty Klein, our Chief Financial Officer. Earlier this morning, we issued a press release, slide presentation and financial supplement, which are available on our website.

As a reminder, today's earnings call may include forward-looking statements and projections, which do not guarantee future events or performance. We do not undertake any duty to revise or update such statements to reflect new information, subsequent events or changes in strategy. Please refer to our most recent quarterly and annual reports and other SEC filings for a discussion of the factors that could cause actual results to differ materially from those expressed or implied.

We will be discussing certain non-GAAP measures on this call, which we believe are relevant in assessing the financial performance of the business, and you'll find reconciliations of these metrics within our earnings materials available at ir.athene.com. With that, I will now turn the call over to Jim.

Jim Belardi, Chairman, CEO and Chief Investment Officer:

Thanks, Noah, and good morning, everyone. We are incredibly pleased with our second quarter results, which were headlined by \$1 billion of adjusted operating income. This is a new record for Athene, underpinned by a powerful combination of strong organic growth, excellent management of both sides of the balance sheet and a robust quarter of performance from our investment in Apollo. These factors drove our adjusted book value to more than \$67 per share, which increased our compound annual adjusted book value growth rate since inception to 17% and represents 32% year-over-year growth.

As we draw closer to the completion of our merger with Apollo, which remains on track for January, I'm proud to say that Athene's business has never been more impressive. Our team has built a powerful platform that has proven in its ability to produce profitable growth through a variety of economic conditions while remaining disciplined and serving as a source of strength for our policyholders and business partners. I am more confident than ever that Athene's best days are ahead and that the momentum we have built will accelerate upon fully aligning our business with Apollo through the merger.

In the second quarter, Athene generated \$7.6 billion of organic inflows, marking our third highest quarterly total ever. In the process, we held leading market share positions in our retail, funding agreement-backed note and pension risk transfer channels during the quarter, which is a testament to the scale, efficiency and solutions-driven product suite that our team has built over the past 12 years.

Another important factor that propelled us forward in the second quarter was the attainment of a ratings upgrade from Standard & Poor's in May. We have discussed at length the benefits that credit rating improvements provide to Athene in terms of pricing our products, our product distribution potential and our cost of capital.

I'm very pleased to say that S&P raised its financial strength rating and issued a credit ratings on our operating entities to A+ from A with a stable outlook and raised the rating on our holding company to A- from BBB+ with a positive outlook. This achievement speaks volumes about the strength of Athene's balance sheet and our solid operating performance, particularly when facing volatile market conditions.

On the asset side of the balance sheet, we focus on generating alpha through asset selection while maintaining our risk discipline. With this in mind, we purchased over \$14 billion of investments in the second quarter, marking our second highest level of quarterly asset purchases.

Importantly, despite the low interest rate environment, the yield on our fixed income purchases was nearly 90 basis points higher, net of fees, than the BBB corporate bond index. This highlights the benefit that we were able to capture by investing across asset classes, including in structured securities, through our active alpha-generating investment management partnership with Apollo.

Most of our purchase activity for the second quarter fell into three primary categories. First, we found attractive opportunities in structured securities like CLOs and asset backs, which collectively accounted for 36% of our purchases as we fill our target allocations across the portfolio. As a reminder, we focus on the senior investment-grade tranches of these securities, which benefit from significant credit enhancements and enable us to pick up a substantial amount of incremental yield at a similarly high ratings profile to our corporate purchases. For example, the average NAIC rating of our structured security purchases was 1.5, solidly within investment-grade territory.

Second, despite the tight credit spread environment, we continue to find attractive enough investable spreads in public and private corporate bonds, which accounted for almost 33% of our purchases. And third, Apollo sourced significant volumes of commercial and residential mortgage loans, which accounted for 22% of our purchases.

Specifically regarding CMLs, we have invested more than \$1 billion year-to-date in attractive senior loans within the European real estate market and we have an attractive pipeline to invest more. These investments backing office and industrial properties outside the U.S. further diversify our CML portfolio while offering attractive yields.

Regarding the Jackson redeployment effort, with our asset purchases in the second quarter, we have invested more than 94% of our targeted redeployment amount, effectively completing redeployment of the fixed income portion of the portfolio and successfully raising the yield on the portfolio by approximately 180 basis points in roughly one year.

This is a noteworthy achievement, especially considering the interest rate and credit spread dynamics since the time of the transaction. We expect that the remaining portion of the Jackson redeployment will be accomplished through funding of alternative investments that we've already sourced and allocated to the portfolio.

Our total portfolio of alternative investments posted its fourth consecutive quarter of above-average performance with an annualized net return of approximately 17% in Q2 and 24% over the last 12 months, following robust performance in some of our larger positions as well as favorable market tailwinds. These results support our long-term track record for alternative investment performance of low double digits annually with lower volatility than equity indices. In the second quarter, we saw broad-based strength across the portfolio, highlighted by strong returns from our natural resources and private credit allocations as well as our investments in Venerable and Athora.

Regarding Venerable, we saw a valuation increase, driven by the recently completed reinsurance agreement with Equitable, as well as the pricing of a third-party investment in Venerable's business. Meanwhile, Athora's appreciation during the quarter was driven by the ongoing strength of their operating performance.

As we have discussed in the past, our approach to alternative investments is differentiated relative to traditional hedge fund and private equity strategies. We make alternative investments that tend to have a defensive orientation and are less prone to binary outcomes, such as in strategic, well-hedged operating businesses, which possess attractive cash flow characteristics and may offer the additional benefit of sourcing directly originated investments that are well suited for various parts of our portfolio.

In July, we announced a notable transaction with Foundation Home Loans that fits into our model of alternative investing. FHL is a specialist U.K.-based mortgage lender, which we acquired from funds managed by affiliates of Fortress Investment Group. Like the Donlen and ADNOC deals that we completed in 2020, this transaction continues our long-standing strategy of working alongside Apollo to identify and invest in attractive businesses, which also add direct origination asset sourcing capabilities to our alpha-generating investment portfolio.

I would note that Athene's existing residential mortgage portfolio exceeds \$13 billion. And we expect that the acquisition of FHL will augment our existing expertise, add geographic diversification in this asset class and help us source additional high-quality investments.

It goes without saying that Athene would not have been able to complete this transaction without the unique sourcing and diligence capabilities provided by our partnership with Apollo, an advantage that we will only look to capitalize upon further after the completion of our merger.

Now I'd like to turn the call over to Bill for an overview of our origination activities.

Bill Wheeler, President:

Thanks, Jim. Athene's organic growth engine continued to perform very well in the second quarter. As Jim mentioned, we generated \$7.6 billion of total organic inflows in the second quarter, driving \$15.8 billion of total organic inflows year-to-date. This resulted in annualized net organic growth of 5% and 7% in the second quarter and year-to-date, respectively, which compares favorably to other comparable financial services companies.

The blended underwritten return on our inflows in the second quarter exceeded our spread and profitability targets, which we have characterized as mid-teens or better even with the persistent low interest rate environment.

Turning to each of the channels. In retail, we generated \$1.7 billion of inflows, which is roughly in line with the level we attained in the first quarter and in the prior year quarter. I'm pleased to say that our retail inflows through the first half of 2021 are 15% stronger compared to the first half of 2020, and there's also several positive dynamics that are becoming increasingly evident within our retail business.

First, like last quarter, over 90% of our retail inflows were generated by FIAs. This resulted in Athene's second quarter FIA sales roughly matching the first quarter's level. This is a product of the ongoing competitive dynamic that we have observed in the MYGA market since the end of last year. In response to this environment, we chose to maintain our pricing discipline by emphasizing more profitable FIAs, which resulted in a continuation of lower MYGA volumes.

Second, the momentum we have built in our FIA business is impressive. LIMRA data released in May for the first quarter highlighted that Athene was able to maintain the #1 industry ranking for FIA sales for the fourth consecutive quarter and held first place of market share in the IMO channel for the second quarter in a row. With our strong level of FIA sales in the second quarter, we once again expect to hold on to our leading market share position when the second quarter LIMRA data is released later this summer.

In terms of distribution, roughly 40% of our retail sales in the second quarter were generated through the bank and broker-dealer channel. While this represents a slight decrease from the first quarter and year-over-year, it also reflects the significant headway we have made in terms of selling more of our FIA product through the independent broker-dealer channel.

And third, the overall quality of our retail inflows has been very strong. We have a diversified mix of FIA products that allows us to maintain leading market share even though our products are more distributed in their relative rankings. Our highest single-product ranking by sales volume places just tenth in the lead tables, highlighting the fact that we are not relying on only one or two flagship offerings to drive results.

In addition, an increasing majority of our retail products are based on alternative indices, which have performed well recently and compare favorably versus standard indexes in many cases for our policy owners. In addition, most of our retail annuities do not carry guaranteed income riders, which allow us to manage duration risk more effectively.

Taken together, these characteristics illustrate that our retail franchise is very high quality in terms of product breadth, differentiation and profitability. Looking forward, we expect that our retail inflows will increase from second quarter levels through the back half of the year. However, year-over-year comparisons may still be skewed due to the particular strength in MYGAs that we saw in the second half of 2020.

Turning to the PRT channel. We generated \$1.5 billion of inflows driven by two transactions. We executed a \$900 million transaction with Sonoco, one of the largest diversified global packaging companies, where we were selected to provide annuity benefits to approximately 8,300 pension plan participants. The other transaction totaled \$600 million and was executed with a leading home improvement and building products company. Since the end of the second quarter, we have remained active and signed two more transactions in the third quarter.

In July, we completed a \$1 billion transaction with a well-known auto parts manufacturer. And in August, we closed our largest single PRT transaction to date with Lockheed Martin for approximately \$5 billion, another landmark deal that builds upon our position as a capable and trusted solutions provider for both plan sponsors and retirees. With these two transactions in the third quarter, we will have closed on approximately \$10 billion of PRT transactions year-to-date and more than \$25 billion in aggregate since we entered the business just four years ago.

Turning to funding agreement activity. I'm pleased to report that we generated \$4.1 billion of inflows in the second quarter. This marks our strongest quarterly results to date, having surpassed the previous record we set last quarter by 26% and represents a 55% year-over-year increase. This result also means that Athene was the number one issuer of funding agreement-backed notes for both the second quarter and the first half of 2021 and now has the third largest overall FABN program in terms of total issuance.

A significant driver of our success in the second quarter was the issuance of our first SOFR-linked funding agreement, which saw tremendous demand and reached a total deal size of \$1.5 billion. In addition, we continue to benefit from the expansion of our funding agreement-backed note program within the Canadian and European markets as we completed several foreign currency-denominated issuances during the quarter. Also, having issued \$7.3 billion of funding agreement-backed notes through the first half of 2021, we have already surpassed our full year 2020 issuance.

As we anticipated, the ratings upgrade we received from S&P in May resulted in increased demand for our funding agreements from the investor community and helped drive improved spreads and strong returns for much of our second quarter issuance. If accommodative market conditions continue, we expect new issuance to remain active in the second half of the year.

Lastly, in our third-party flow reinsurance channel, activity remains subdued, which corresponds to the market trends related to MYGA business that we have observed for the past few quarters. As we have stated, flow reinsurance activity can fluctuate depending upon the appetite of the counterparty to internalize the business or their willingness to accept pricing conditions that align with our target return threshold. As we saw in the first quarter, pricing dynamics relating to MYGA flows were a limiting factor and we prioritized our return targets over volume.

In terms of the outlook, we are continuing to make progress towards adding flow arrangements for FIA products as well as adding new clients. We recently signed a letter of intent with a new partner in the Japanese market, which we expect to launch by the end of the third quarter. This opportunity was cultivated by entering the Japanese market last year and having success adding value for our first partner in the country. In addition, we have established other new relationships to facilitate increased reinsurance of FIA flows, which we expect to come online early in 2022.

In summary, we have continued to manage our business channels through shifting market dynamics amid a persistent low interest rate environment and achieved our strongest level of total organic inflows through the first six months of the year since Athene's founding. With this level of performance, we feel that we will comfortably exceed our previous estimate of \$25 billion in total organic inflows for the year, and we now expect that total organic inflows will likely meet or exceed \$30 billion for 2021.

On the inorganic front, we were pleased to be able to source a unique and exciting transaction after the quarter ended, with our agreement in July to acquire a strategic minority economic interest of 18% in Challenger Limited from existing shareholders. Challenger is the preeminent platform in Australia for both annuities and investment management, making it very well positioned to capitalize on the evolving market opportunity there. Entering the Australian market through a long-term investment in a well-capitalized, highly rated established franchise with a strong local presence further diversifies our business mix and increases our global reach.

This investment represents an entry into a new market that we've been studying for some time. We intend to be supportive minority shareholders, and we are optimistic that there may be ways in which we can work closely together in the future. Athene committed \$225 million towards the minority investment in Challenger, which we expect will be included on our balance sheet as an alternative investment in the third quarter.

Regarding the overall market, as evidenced by the recent number of well-publicized transactions, the insurance industry restructuring trend is continuing. In terms of the pipeline, we are continuing to track numerous opportunities that may come in the market this year. We remain among the best positioned solution providers in the retirement services landscape, given our expertise and robust levels of deployable capital, which can support \$100 billion of liability purchasing power.

With that, I'd now like to turn the call over to Marty, who will discuss our financial results.

Martin Klein, Chief Financial Officer:

Thanks, Bill, and good morning, everybody. This morning, I will provide context around our results and discuss our forward perspectives. We reported record GAAP net income of \$1.4 billion or \$6.97 per diluted share for the second quarter. Our adjusted operating income available to common shareholders was also a record at \$1 billion or \$5.04 per share. Excluding notable items of \$55 million as well as our strategic investment in Apollo, total adjusted operating income was \$572 million or \$2.88 per share, resulting in an adjusted operating ROE of 18%.

Our business model continued to deliver compelling levels of net spread with a consolidated adjusted operating return on assets of 160 basis points during the quarter, excluding Apollo. This particularly strong result benefited from various items within our NIER and cost of funds, which I'll discuss momentarily. But even excluding these items, the adjusted operating ROA of the business was very strong on a core basis.

Our large in-force business produces a mostly consistent and predictable fixed income yield. As we stated last quarter, we had expected that our fixed NIER, that is the net investment earned rate, would rebound somewhat from first quarter levels. Our fixed income portfolio performed generally in line with our expectations, but the 3.75% result was bolstered by an approximately 12 basis point nonrecurring uplift from prepayments related to our investments in Hertz and MidCap.

Looking forward, we clearly have experienced a large influx of cash, driven by our strong organic inflows in the first half of the year as well as \$6 billion of additional PRT wins so far in the third quarter. These higher cash balances, in addition to the current lower interest rate and tight credit spread environment, will create a slight turn -- will create a slight near-term drag on our fixed NIER.

Since these inflows were written to our target returns or better, we expect to see corresponding offsets over time in our cost of funds. We now expect our fixed NIER to be in the range of 3.55% to 3.6% for the remainder of this year versus our prior expectation of 3.6%. This near-

term drag can, of course, dissipate and turn into a benefit depending on the ultimate trajectory of rates and spreads as well as the speed with which we invest the cash. Our organic inflow results this year demonstrate the strength of our spread lending business model, which continues to generate attractive net spreads in line with or better than our targets, leading to continuing and substantial earnings and book value growth.

Turning to alternatives. As Jim mentioned, we experienced a fourth consecutive quarter of strong performance, generating a 17% annualized NIER. As we expected, we saw a significant benefit from the investments marked on a lagged basis as well as a continued strong benefit from our investment in Venerable. Performance from the portion of the portfolio marked on a real-time basis was more in line with our long-term expectations, supported by strength in our private credit investments as well as Athora, among others. Looking ahead, we expect our annualized Alts NIER in the second half of this year to be approximately 10% on an annualized basis, closer to its longer-term historical performance.

Moving next to cost of funds and starting with the cost of crediting component. Our reported crediting rate decreased to 173 basis points, down 3 basis points from the prior quarter. This was driven primarily by lower rates on new business, partially offset by a growing institutional liability mix. As we've discussed in prior quarters, all else equal, a growing institutional mix tends to push the crediting rate higher since essentially all the funding costs for PRT and funding agreement business are reflected within cost of crediting.

Looking ahead, for the full year, we now expect our cost of crediting to be closer to the low end of our previously guided range or approximately 175 basis points. This is driven by our expectation of strong growth in institutional channels coming in at lower marginal cost, which as Bill mentioned, has been partially helped by our recent ratings upgrades combined with continued rate actions on deferred annuity renewals.

Turning to other liability costs, or OLC, which represent the other component of cost of funds for our deferred annuities. Recall that we observed quarterly fluctuations that can occur as a result of factors such as market movements or DAC amortization impacts from higher or lower gross profits. In the second quarter, OLC came in lower than we expected at 63 basis points, down 27 basis points sequentially.

I would note that of this 27 basis point sequential decline, approximately 12 basis points was due to favorable equity market performance over the past few quarters. If not for these factors, OLC would have been closer to our prior expectation of approximately 80 basis points. Looking ahead, we expect that our baseline run rate for other liability costs will be around 70 to 75 basis points, subject to swings in profitability and market impacts.

Shifting to our platform costs. Our G&A expense ratio declined both sequentially and compared to the prior year -- quarter to 24 basis points on a consolidated basis as expected. Looking ahead, we expect that our operating expenses in the second half of the year will be roughly equivalent to what we saw in the first half in dollar terms as we continue to drive operating leverage across the business.

Turning to taxes. As a reminder, our tax rate is a function of the proportion of income we generate in our Bermuda subsidiaries versus the income in our U.S. subs. In the second quarter, our operating tax rate came in lower than expected at 3.6%. This is due to above-average performance from alternatives, which tends to drive our tax rate down and an adjustment to reflect our new expected full year tax rate, which is in the mid- to high single-digit area versus our prior expectation of approximately 10%.

Tying all of this together, it's increasingly apparent that the benefits of Athene's significant scale, combined with our strong management of both sides of the balance sheet and differentiated investment capabilities, are compounding to drive extraordinary momentum. Consider that our adjusted operating income, excluding our investment in Apollo, totaled approximately \$1.4 billion through only the first half of 2021, an amount that exceeds what we have earned through any calendar year in Athene's history. As I mentioned last quarter, we continue to be on pace for record annual earnings and are reaching impressive new highs in adjusted book value per share.

Before wrapping up our prepared remarks, let me comment on capital. Athene continues to be exceedingly well capitalized with approximately \$18.3 billion of aggregate regulatory capital and an underlevered balance sheet. We currently have more than \$8 billion of deployable capital, which is comprised of excess equity capital, untapped debt capacity of nearly \$3 billion and \$1.5 billion of available commitments for ACRA. Our priorities for holding this excess capital continue to be supporting strong organic growth, supporting and executing inorganic growth, supporting additional ratings upgrades and opportunistic share repurchases.

As you can see, we've continued to execute on the organic side. And as Bill discussed, there are numerous developments in the market regarding inorganic opportunities. We also are just starting to experience the benefits of our most recent ratings upgrade, which has served as a tailwind for a variety of areas across the business.

With that, I'll turn the call over to the operator and we'll open the line for questions

Operator:

At this time, if you would like to ask a question, please press star 1 on your telephone keypad. If you wish to remove yourself from the queue, you may do so by pressing the pound key. We remind you to please unmute your line when introduced, and if possible, pick up your handset for optimal sound quality. In order to ensure everyone receives a turn, we ask that you please limit yourself to one question on the first go-round and hop back in the queue if you'd like to ask a follow-up.

We'll now take our first question from the line of Zack Byer with Autonomous Research.

Zach Byer:

Just a quick question. On Apollo's recent earnings call, they mentioned a desire to develop a solution for, I guess, retail investors to access Apollo funds and have noted that they'll be launching two yield-based products in this channel kind of in the latter half of the year. Are there ways for you to incorporate Apollo funds into your retail products? And could this be a way for you to differentiate your products in the marketplace?

Jim Belardi:

Bill?

Bill Wheeler:

Yes, Zach. So it's something we've studied. The challenge is you need an index to -- if you think about our indexed annuities and using some kind of an Apollo fund, you need an index to kind of hedge those annuities or hedge those Apollo funds. And that's tricky, especially with the private investment. We are continuing to study this and see if there are things we can do.

And we're also, I would say, generally coordinating with Apollo's retail effort. They'll be selling their products through many of the same channels that we do or want to penetrate. So I see us

working together on this going forward. And it may be possible to put some kind of an Apollo fund in some product that has got some kind of an annuity [wrapped] around it.

Zach Byer:

Awesome. And my second question is on competitive dynamics in the PRT market. So you've obviously seen some great volume in third quarter with the Lockheed transaction. Just curious kind of what's enabled you to capture leading market share and a little bit more specifically on the jumbo transactions, kind of any color you have on dynamics in that size of the market?

Bill Wheeler:

Yes. Well, there's, I would say, sort of two things going on. One is we're a strong competitor. We have a really good mouse trap here at Athene in terms of our investment performance, our operating efficiencies. We, for instance, relative to the rest of the industry, chose to take an outsourcing of admin strategy with leading pension administrators who are much bigger than any of the insurance companies. That's lowered our cost, increased our capabilities. It was a good move. So we're a tough competitor in terms of pricing.

But the second thing is, I think Athene has been a lot more willing to focus on trying to figure out solutions to clients. Not every pension deal is just a nice simple vanilla retiree deal. A lot of them have issues that have to be solved. And I think historically, the industry was unwilling to tackle those and we have not been. And that was true in the Bristol-Myers deal. It was true in the JCPenney deal. And I think any time that there's any complexity, we're now easily the first call, right, in terms of, can you help us figure out the solution here? And so it's really the combination of those two things, I think, that have made us number one.

Look, it's -- yes, we've already had a remarkable year in terms of PRT. And the truth is we're only now getting into the heavy part of the season, okay, in terms of volumes of deals. So this could end up -- and I think what's interesting about that is it's clear to me that this year is sort of marking a step-up in terms of PRT size of market. And I expect this to kind of continue going forward because I see more plan sponsors who are going to get proactive about their old pension liabilities.

Operator:

There are no additional questions at this time. I would like to turn it back over to Noah Gunn for closing remarks.

Noah Gunn:

Thanks, Stephanie, and thanks, everyone, for joining us this morning and for your continued interest in Athene. If you have any follow-ups based on anything we discussed on today's call, please feel free to reach out to us as usual, and we look forward to speaking with you again next quarter.

Operator:

Thank you. This concludes today's conference call, and thank you for joining the Athene Holdings' Second Quarter 2021 Earnings Call and Webcast. Please disconnect your line at this time, and have a wonderful day.