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Analysis of Public US PE Firm Earnings: Q4 2021

Capping off a record-shattering year

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Key takeaways

- The largest PE firms—publicly traded and private—had a phenomenal 2021. Nearly every important metric, including AUM, fundraising, fee revenue, total profits, deployment, and more, broke records. Fund performance was also healthy, which bodes well for future growth as a flurry of flagship offerings hits the market. Additionally, billions in net accrued performance revenues may be realized as firms exit profitable investments.

- The winning strategy for maximizing shareholder returns is becoming clear. Shareholders continue to reward a balance-sheet-light, high-payout ratio strategy. Blackstone and Ares epitomize this and trade well above their peers. Brookfield Asset Management hinted it may be taking steps to rectify its low trading multiple by spinning out the asset manager. If this is successful, it could pressure KKR, another firm with a massive balance sheet relative to its market capitalization, to alter its approach.

- The year also cemented the move away from evenly distributing management fees and carried interest to shareholders as public investors favor the steady distribution of fees over the less consistent payout of carry. TPG restructured its payout, vastly favoring paying investors fees and keeping carry in-house to incentivize investment professionals. KKR made similar changes, and reports suggest other major firms will pursue comparable restructurings.

- More firms are likely to go public in 2022. Several names are expected to publicly list on both sides of the Atlantic, including CVC Capital Partners, L Catterton, and more. Additionally, firms including Blue Owl and TPG will become regular members of this analysis once they have been public for a full four quarters.

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Introduction

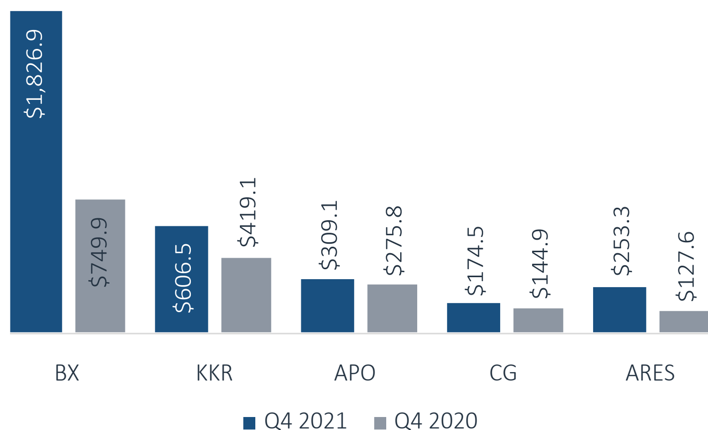
The end of 2021 brought in another record-breaking quarter for the big five public PE firms—Blackstone (NYSE: BX), KKR (NYSE: KKR), Apollo Global Management (NYSE: APO), The Carlyle Group (NASDAQ: CG), and Ares Management (NYSE: ARES). These managers recorded high-water marks across most—if not all—important metrics, including AUM, fee-related earnings (FRE), fundraising, deployment, fund performance, strategy expansion, and more. Other players in the space, including Hamilton Lane (NASDAQ: HLNE) and StepStone Group (NASDAQ: STEP), posted similarly healthy results as their advisory practices, in addition to their secondary and co-investment offerings, continued to gain traction. Blue Owl (NYSE: OWL) also reported healthy gains, and its permanent capital and fee-heavy platform expanded via organic and inorganic means. Lastly, the long-awaited public listing of TPG (NASDAQ: TPG) capped off the busy quarter. How TPG and Blue Owl trade over the coming quarters could influence whether other asset managers in the $50 billion+ AUM range go public in 2022 or delay that decision another year or longer.

M&A activity played a pivotal role in changing the composition of several firms. KKR and Apollo completed mergers with sizable insurance institutions Global Atlantic and Athene, respectively. This balance-sheet-intensive approach provided each with over $100 billion in permanent AUM and pushes these two managers away from the purer-play asset management businesses of competitors, including Blackstone. Blue Owl, Ares, and P10 (NYSE: PX) were also acquisitive in 2021, tacking on other asset managers and building out the scope of their offerings. Ares was the most active; it acquired or agreed to acquire Landmark Partners, Spring Bridge Partners, Black Creek Group, and AMP's infrastructure debt unit. Heading into 2022, it is likely the big five will be less acquisitive, though KKR is expected to use inorganic means to build out a secondaries offering. However, the next cohort of managers, including Blue Owl, TPG, Bain Capital, CVC Capital Partners, EQT Partners (STO: EQT), Advent International, and several others, may pick up the slack and use M&A to build out their offerings.

Financials

Fees and distributable earnings (DE) shot upward across quarterly and annual figures in 2021. However, there are some notable issues regarding how managers report FRE. The annual crystallization of performance fees for certain funds are looped into FRE, which typically happens in the fourth quarter. While this has occurred in previous years, the massive growth in Blackstone's non-traded REIT and credit product has led to a massive increase in FRE in Q4 2021. As these products expand at Blackstone and other managers, these annual spikes will likely become more pronounced. The fervent fundraising environment is also likely to boost FRE through increased AUM and associated management fees.

Quarterly FRE ($M) by manager

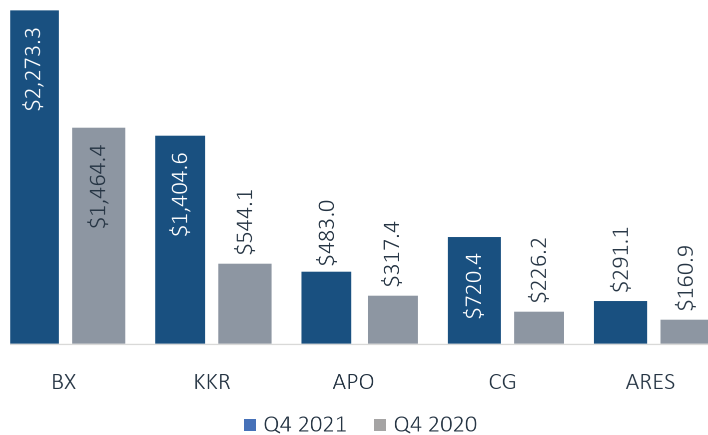


Source: Public filings | **Geography:** US
*As of December 31, 2021

TTM FRE ($M) by manager

Source: Public filings | **Geography:** US
*As of December 31, 2021

Quarterly DE ($M) by manager



Source: Public filings | **Geography:** US
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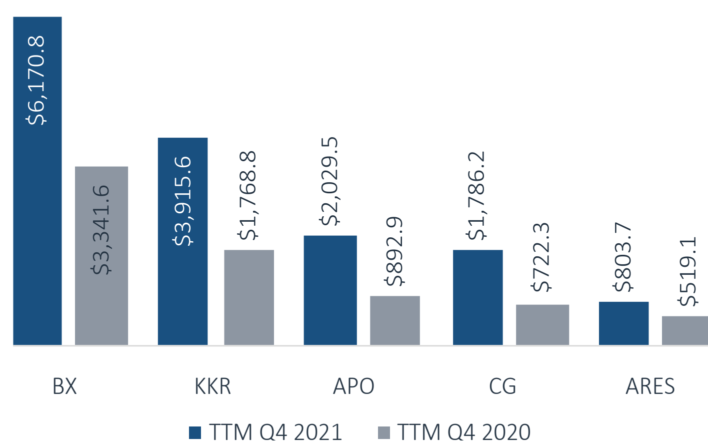
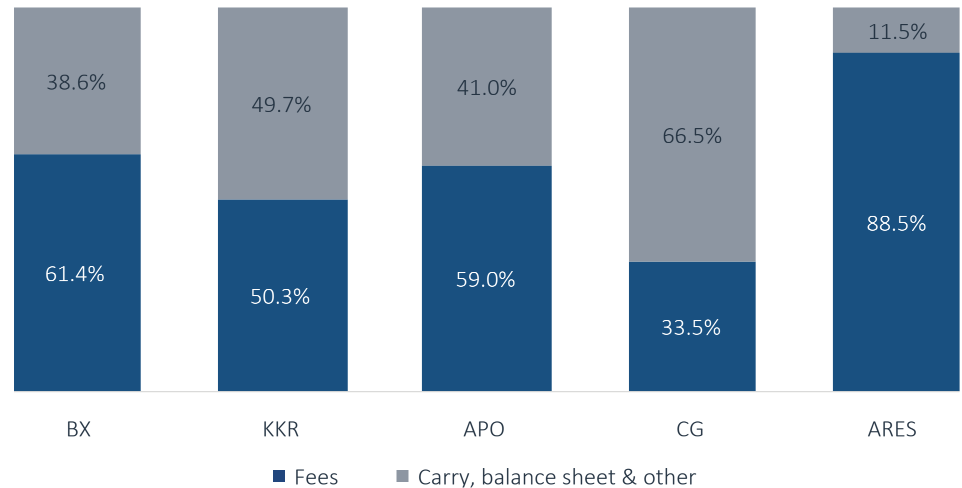
TTM DE ($M) by manager



Source: Public filings | **Geography:** US
*As of December 31, 2021

In 2021, all firms outside of Carlyle saw FRE account for at least half of the firm's annual DE figure. Ares led the pack, with nearly 90% of the firm's DE coming from fee earnings. Over the past decade, fees have continued to account for a higher percentage of DE as many of these managers have evolved beyond buyout-only shops. The drive to boost perpetual capital and focus on yield has hastened this move toward fees. For example, Blackstone has dramatically expanded its real estate and credit platforms while also building out its infrastructure offering. These strategies all offer the firm a diversified mix of income that tends to earn proportionally more from fees than buyout does. Apollo and KKR have substantially built out their yield offerings as insurance acquisitions brought in hundreds of billions in perpetual capital. However, KKR's PE-heavy investment mix and sizable balance sheet prevented fees from accounting for a higher percentage of the overall DE mix.

DE by source

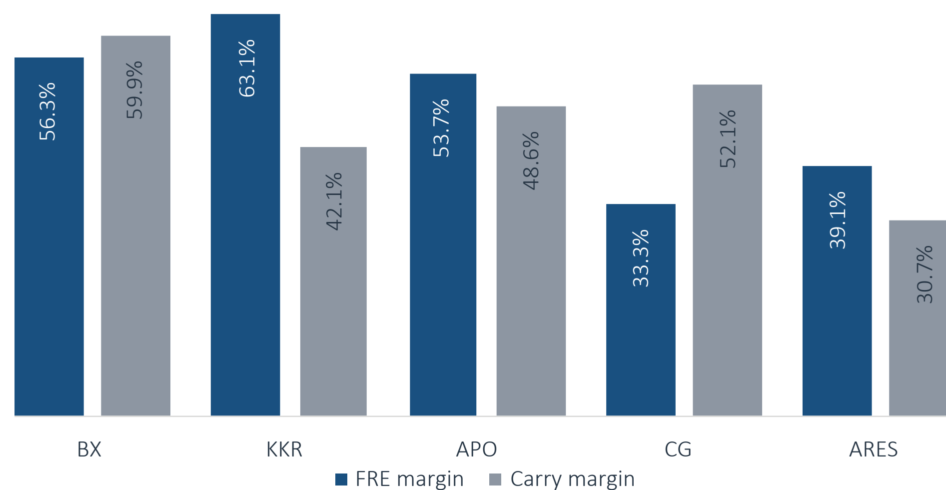


Source: Public filings | **Geography:** US
*As of December 31, 2021

This broader shift toward fees accounting for a higher proportion of DE is leading to changes beyond strategy expansion into yield strategies; public firms are allocating a higher proportion of the fees they collect to shareholders and retaining a higher proportion of the carried interest they earn. This is readily apparent in TPG's S1 filing, which details that less than 15% of TPG's DE was derived from FRE in the first nine months of 2021. This more fee-light income balance is common for many PE managers that thrive on carried interest. However, TPG decided to alter the distribution of its fees and carried interest to shareholders and employees. Rather than receive half of the carry at the GP level, the firm and shareholders will receive just 20% of the realized performance income. TPG will also be allocating a higher proportion of fees to shareholders. The pro forma balance for the first three months goes from FRE accounting for 13.9% of DE to 56.1% when those changes are made. Other relatively new public managers, including Blue Owl and EQT Partners made similar changes by paying out approximately 15% and 33% of their realized performance incomes, respectively.

The big five public GPs have either already made similar changes or plan to do so. KKR will pay only up to a quarter of its management fee-based income to employees but up to 70% of its performance-based revenues. Apollo announced a comparable structure, and indications suggest Blackstone could follow a similar path. The firms that have not yet made or announced such changes are still likely to do so. While there is an element of taking from the left pocket and placing it in the right pocket, public market investors clearly value a fee dollar higher than a carry dollar. These changes also drive alignment of incentives between the firm, dealmakers, and LPs.

Full-year margins by type



Source: Public filings | **Geography:** US
*As of December 31, 2021
Note: Does not include equity-based compensation

Assets under management

AUM skyrocketed for nearly all the largest PE managers—publicly traded and private—because of organic and inorganic means. Cumulative AUM leaped $687 billion for the five largest public PE firms in 2021, and cumulative inflows hit $587 billion. The fundraising environment benefited the mega-managers that sought larger-than-expected step-ups on funds and returned to market sooner than anticipated. On several earnings calls, company executives emphasized the current LP appetite for yield and real assets in this inflationary environment. This trend will likely bolster much of the fundraising in 2022. Fundraising for several flagship vehicles—across buyout, real estate, infrastructure, growth, and more—will also likely drive inflows in 2022. Blackstone, for example, has 17 flagship funds either in the market or soon to be launched that are targeting a combined $150 billion, though they will likely close on significantly more capital than that figure. The firm is expected to be the first alternatives manager to surpass $1 trillion in AUM in 2022, while KKR and Apollo are each on pace to breach $500 billion.

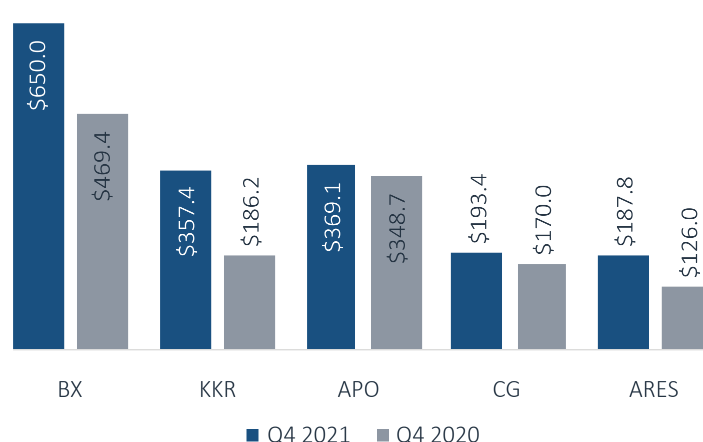
The continued push into the retail market was another major trend that echoed throughout many earnings calls. Allocators are using a barbell approach to portfolio construction, allocating capital to low-cost passive

options and alternatives. This trend is also occurring within alternatives, with mega-managers and niche specialists securing substantial funds. As stated on Blackstone's Q4 call, the retail market is valued around $80 trillion and has just a 1% to 2% allocation to alternatives.[1] All the majors, as well as Blue Owl, StepStone, and Hamilton Lane, are targeting the retail/wealth channels with new and existing products. Brookfield Asset Management (TSE: BAM.A) is launching a private REIT; Blackstone debuted its European non-traded REIT; and Apollo launched a nonlisted business development company (BDC). Blue Owl's results illustrate just how meaningfully retail can contribute to overall fundraising figures, with the manager pulling in approximately 40% of its inflows from the retail channel in Q4 2021. Other managers are targeting similar figures. KKR manages over $50 billion through its private wealth channels, which typically account for 10% to 20% of assets raised for a given fund. The firm is aiming to raise this to 30% to 50% over the coming years. Apollo's five-year plan is to raise approximately one third of its capital from the broader wealth channel. The wealth and retail channels are becoming even more important, and this trend likely has decades to run.

AUM ($B) by manager

Source: Public filings | **Geography:** US
*As of December 31, 2021

FGAUM ($B) by manager



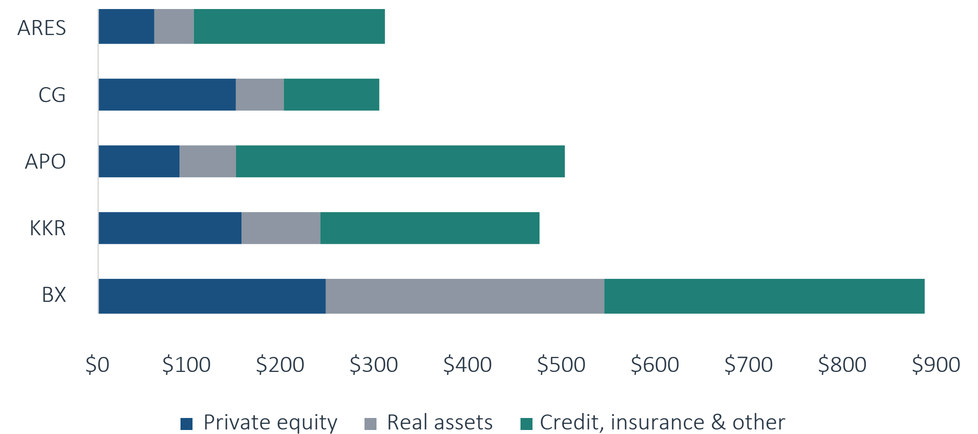
Source: Public filings | **Geography:** US
*As of December 31, 2021

M&A was a major driver of AUM growth in 2021. Building out real estate was an important issue for Carlyle, which agreed to purchase iStar's net-leasing business for $3.07 billion, and for Blue Owl, which closed Oak Street Real Estate, a triple net leasing firm. Ares completed a number of tuck-in acquisitions, and KKR closed on its deal for insurance company Global Atlantic, which brought in more than $100 billion in assets. Insurance M&A and block buying will likely continue boosting perpetual AUM for the largest firms. However, Apollo brought up an issue that begins to plague firms that cross a certain AUM threshold: Raising capital is no longer the limiter to growth. Instead, it is finding enough assets with an attractive risk/reward profile in which to invest. The firm has a surfeit of perpetual capital and is now working to build out perpetual origination. Others are building out origination capabilities in line with their new asset levels as well. Blackstone deployed $144 billion in 2021, more than 3x its 2018 rate, while KKR deployed $73 billion in the year, up 2.5x YoY.

1: "The Blackstone Group (BX) Q4 2021 Earnings Call Transcript," The Blackstone Group, January 27, 2022.

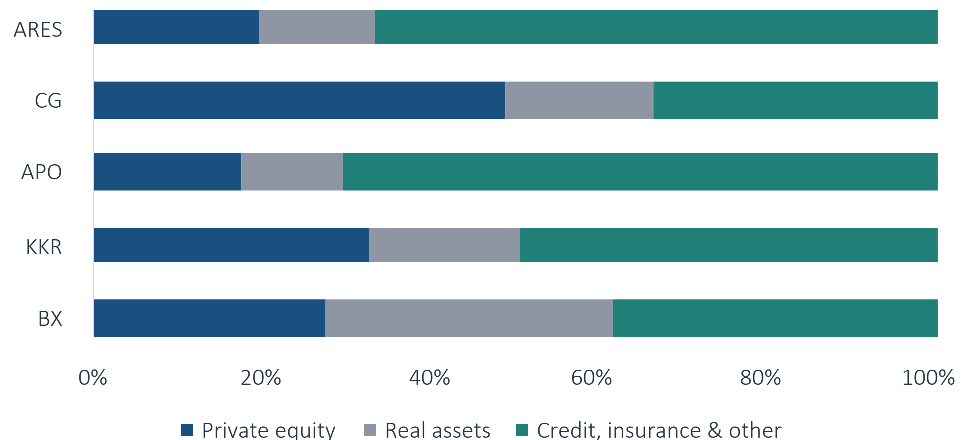
Secondaries also drove M&A in 2021. Ares purchased two secondaries managers, Landmark Partners and Spring Bridge Partners, while TPG is organically building out its practice. TPG's CCMP deal in early 2022 illustrates how the firm is looking to expand into the space. Secondaries remains an obvious hole in KKR's strategy mix, and numerous reports have pegged the firm as actively looking to acquire a firm in the space—Coller Capital, which is reportedly seeking to sell itself, seems the likely target. The strategy offers plenty of capacity for all the largest managers to grow organically and through M&A. AUM in private markets has surged past $10 trillion, yet only 1% to 2% of net asset value (NAV) trades per year. The system is growing and needs more liquidity. We may see a sizable amount of LP secondary activity in 2022 as allocators exit certain fund positions to free up capital for the plethora of mega-funds ($5 billion+) currently fundraising. Blackstone's vehicle currently fundraising will be the largest secondaries vehicle ever if it hits its $20 billion target. Carlyle's AlpInvest is also expanding quickly as this area of the market matures. The trend should benefit Hamilton Lane and StepStone's efforts as well.

AUM ($B) by type



Source: Public filings | **Geography:** US
*As of December 31, 2021
Note: PE includes secondaries. Real assets includes real estate and infrastructure.

Share of AUM by type

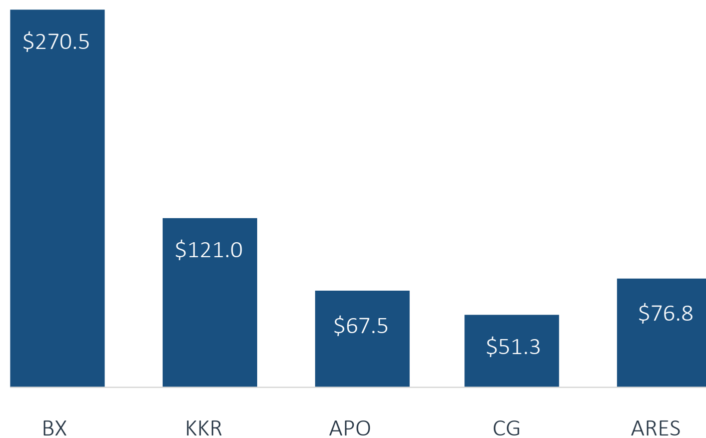


Source: Public filings | **Geography:** US
*As of December 31, 2021

Looking ahead

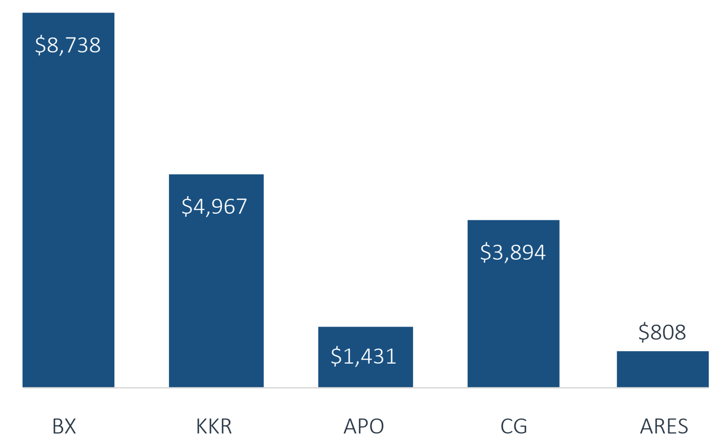
A few key metrics help investors understand what the coming quarters ought to look like for the largest public PE firms. Gargantuan inflow figures are certainly worth noting. In 2021 alone, Blackstone raised more than the combined AUM of CVC Capital Partners and TPG. Full-year financials for 2022 will reflect the sheer mass of capital brought in. Additionally, huge sums of net accrued performance revenues sit on these firms' balance sheets. Much of this amount will likely be realized in the coming years and flow through to DE as the firms successfully monetize embedded gains. However, the current sell-off in public markets could delay and/or dampen the amounts realized. Lastly, stellar fund performance across all asset classes—though just PE is shown in the accompanying charts—sets these firms up for another year of fundraising success.

2021 inflows ($B)



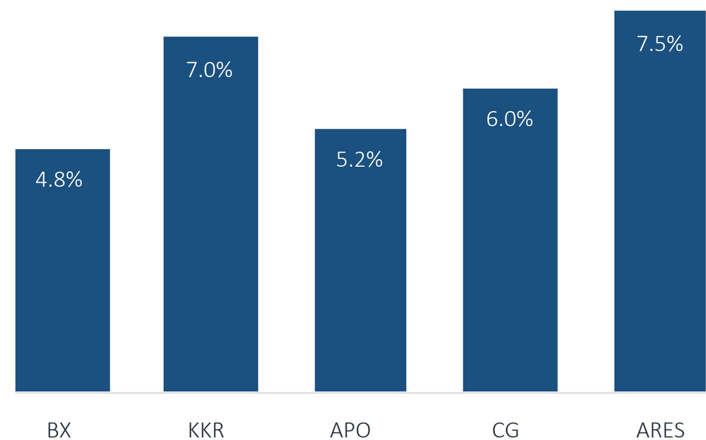
Source: Public filings | **Geography:** US
*As of December 31, 2021

Net accrued performance revenues ($M)



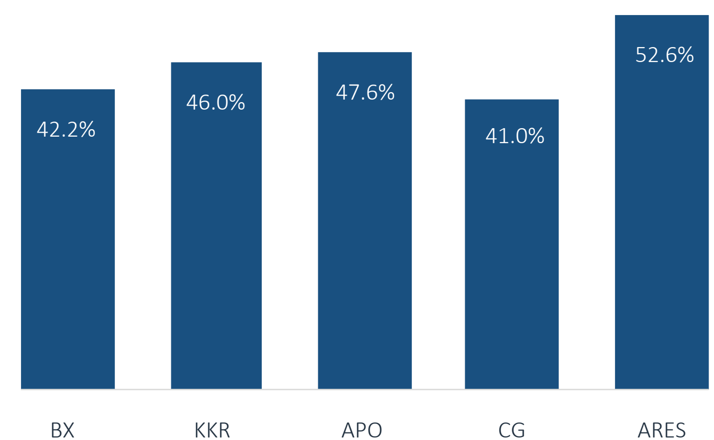
Source: Public filings | **Geography:** US
*As of December 31, 2021

Gross quarterly PE fund performance



Source: Public filings | **Geography:** US
*As of December 31, 2021

Gross annual PE fund performance

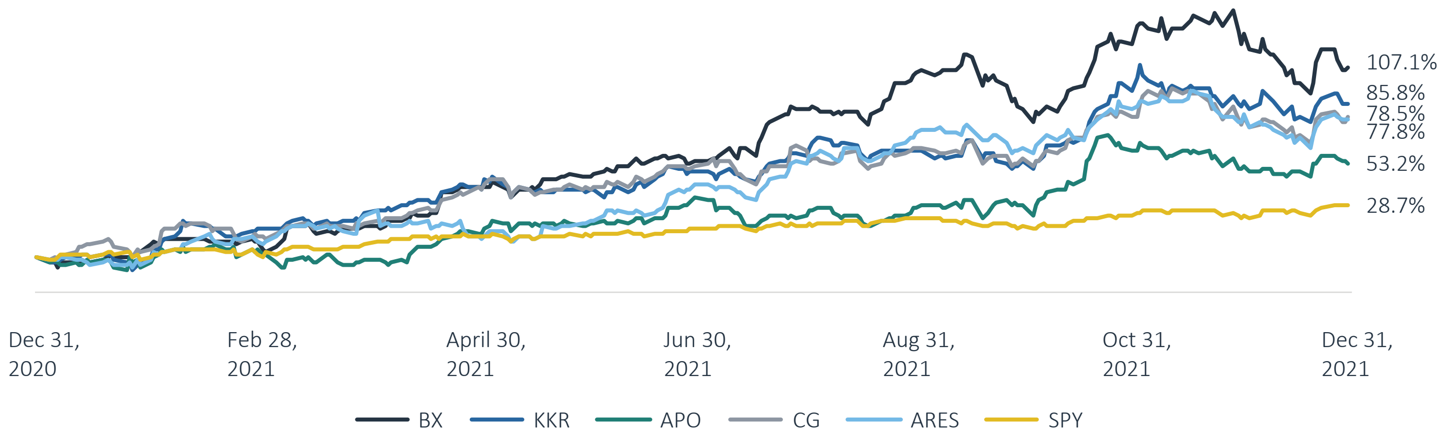


Source: Public filings | **Geography:** US
*As of December 31, 2021

Share price performance

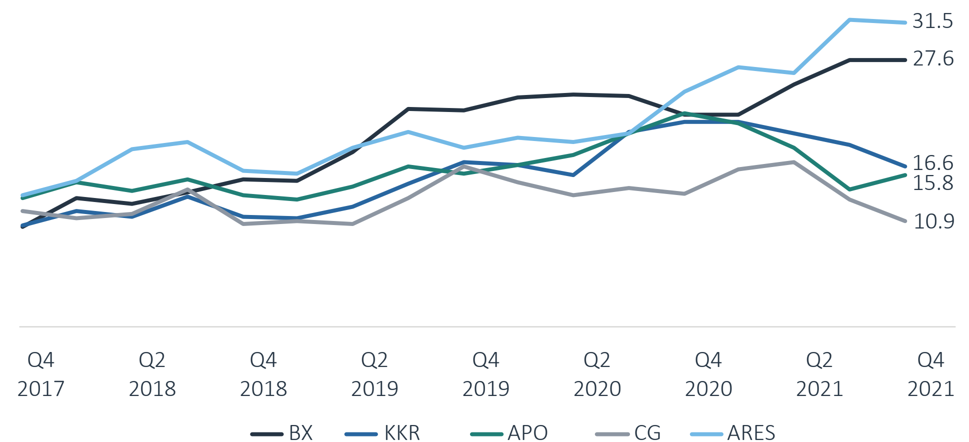
Concurrent with a year of stellar fundraising and fund performance, the share price of the five largest US public PE firms healthily outperformed the broader US equity market. Apollo, the worst performer in the year, still returned approximately 1.85x of the S&P 500's return. Nearly everything continues to be going well for the largest alternative asset managers. Part of this has been due to alpha added by some management teams, but much is likely attributable to these managers riding the wave of the large getting larger and assets rotating out of private markets. Indeed, these managers have been in a "rising tide lifts all boats" environment for over a decade, wherein the market conditions have benefited all firms. This trend shows no signs of slowing over the coming three to five years. However, the way to deliver higher multiples is becoming clear, and simply being a quickly growing alternative asset manager does not appear to be sufficient. Blackstone and Ares trade at multiples that dwarf their direct competitors.

One-year total return



Source: Morningstar | **Geography:** US
*As of December 31, 2021

Price/DE by manager

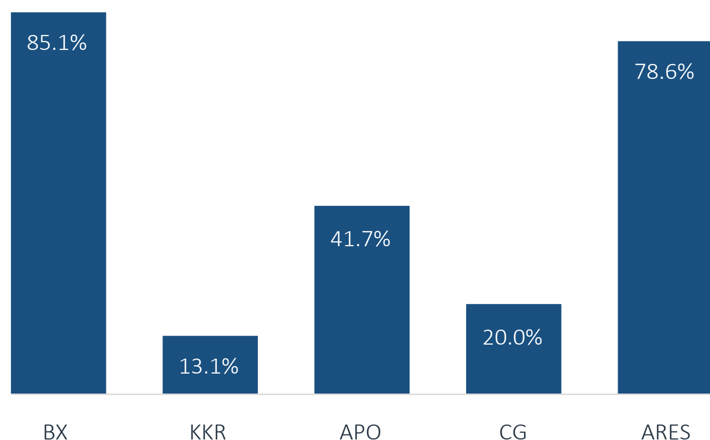


Source: Morningstar, Public filings | **Geography:** US
*As of December 31, 2021
Note: Quarterly price is averaged.

The balance-sheet-light and high-payout approach that Blackstone and Ares use is clearly favored by public market investors. Although these two have consistently traded at higher DE multiples than their competitors, that minor valuation gap has grown into a canyon in recent quarters. On their Q4 earnings call, Ares executives discussed the firm's balance-sheet-light model and mentioned that, over time, the firm's GP commitment is expected to proportionally diminish as employees take on a more significant piece of the commitment.[2] Conversely, Apollo's merger with Athene and the low payout ratios of Carlyle and KKR appear to be at least partially responsible for its lower trading multiple. Although no changes are expected at this time, we will be watching to see whether these three make any strategic decisions to lighten their balance sheets and/or boost their payout ratios in an attempt to trade at higher DE multiples.

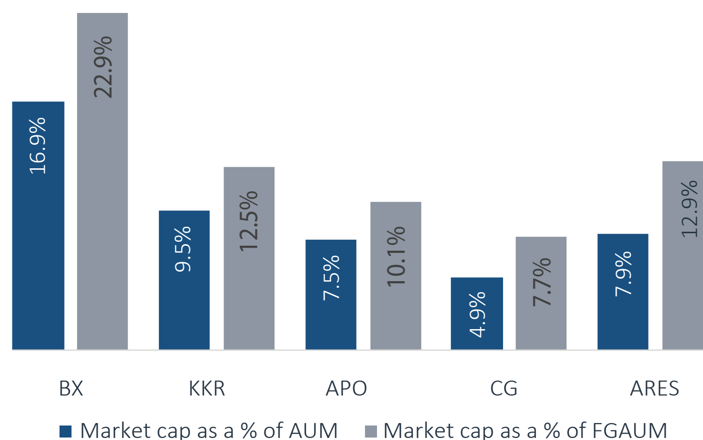
In this vein, Brookfield is actively pursuing structural changes that are designed to unlock value for shareholders. The firm has over $500 billion in AUM spread across real estate, infrastructure, credit, buyout, and more. Brookfield also has a convoluted ownership structure, trades at a depressed multiple, and has a significant amount of capital on its balance sheet. Many, including company executives, believe these points are related. On the firm's Q4 earnings call, Brookfield executives discussed that they were considering separating the asset manager to trade on a standalone basis and hopefully achieve a much higher valuation.[3] Their internal estimates suggested the pure-play manager could achieve a $70 billion to $100 billion market cap based on comparable market multiples. Brookfield has another $50 billion in investments on its balance sheet. Shares traded up nearly 10% on the news, thereby suggesting investors have a bullish view of the spin-off. Additionally, any changes to the proportion of management fees and carried interest split between the public shareholders and employees could further boost the slimmed-down manager's trading multiple. If a Brookfield spin-off were to achieve its stated objective, it could pressure other alternatives managers that have taken a balance-sheet-heavy approach to follow suit.

Payout ratio



Source: Public filings | **Geography:** US
*As of December 31, 2021
Note: 2021 dividends as a share of 2021 DE

AUM figures as a share of market capitalization



Source: Public filings | **Geography:** US
*As of December 31, 2021

2: "Ares Managment Corporation (ARES) CEO Michael Arougheti on Q2 2021 Results - Earnings Call Transcript," Ares Management, February 11, 2022.
3: "Brookfield Renewable Partners L.P. (BEP) Q4 2021 Earnings Call Transcript," Brookfield Renewable Partners, February 4, 2022.