Half Year Results Presentation

Presentation Transcript
15 November 2023

Christopher Hunt

Good morning, and welcome to ICG's results for the six months ending 30th of September, 2023. I'm joined by our CEO and CIO, Benoît Durteste, and our CFO David Bicarregui, who will give an overview of our performance during the period and will then take questions. The slides along, with the accompanying results announcement, are available on our website. You could submit questions through the webcast messaging function or by telephone, and you can find details of these on the online portal. As a reminder, unless stated otherwise, all financial information discussed today is based on alternative performance measures, which exclude the consolidation of some of our fund structures required under IFRS. At this point, I'll hand over to our CEO and CIO, Benoît Durteste.

Benoît Durteste

Good morning everyone, and thank you for making the time to be with us. It's a very solid first half we are reporting on. In a complex environment, our broad waterfront of differentiated products, our leadership position in private credit, and our longstanding focus on diversification and generating long-term growth have enabled ICG to report today on a successful first half. We have made progress across our flagship, our scaling, and even our seeding strategies, and are reporting notable increases in our fee-earning AUM, fee income, profits, and NAV per share.

There are substantial tailwinds for private markets. LPs are overwhelmingly reporting that the current environment, while creating temporary constraints, has not affected their long-term goal of increasing allocations to alternatives in general and to private debt in particular. To capture this opportunity, managers will increasingly need to combine breadth of product offering, scale and investment track record. Long-term organic growth has been our strategic priority for many years. Few managers have launched as many new strategies organically as we have, and continue to do. As a result, there is substantial growth embedded in ICG today, and I'm pleased to say that we have the right strategic and financial resources to continue to execute on those opportunities. And that is visible in our performance over the last six months, delivering growth today and enhancing visibility on the future.

I want to first spend a moment on the investment environment and how our breadth enables us to succeed across economic cycles. From a macro perspective, over recent months it has become more likely that we will experience a longer period of slower growth, although probably not a deep recession with higher inflation and higher rates for longer. This had been our central case for some time and it has a number of implications for our markets. For one, it is difficult for a consensus to emerge on enterprise valuations, and as a result, M&A activity is at its lowest point in years, possibly since the GFC for buyouts, and I see limited near-term catalyst for a structural resurgence. This in turn translates into depressed levels of distributions to LPs who find themselves capacity constrained, resulting in turn in a subdued fundraising environment.

Alternative asset managers do not, however, all fear the same in this environment. As always, the reality is more nuanced and particularly for a platform as broad as ICG is today. This slide, 3 in your pack I believe, sets out on the right-hand side some examples of where we see opportunities today and the strategies within our waterfront that enable us to capitalize on them. On structured capital, any product with a debt or structured component with downside protection, and where you can either bridge views on equity valuations or help mend an over-leverage structure or simply refinance a maturing debt, is attractive in the current market. Our pipeline in these strategies is growing, both in terms of size and actionability, and I am quietly confident we'll be deploying significantly more here in the coming quarters.

Floating rate senior secured debt is obviously attractive today. It's continuing to deliver double-digit returns to client. We are currently underwriting gross all-in IRs on new transactions of approximately 12%. That is unprecedented for senior debt. And more broadly comparing the terms today to those 18 months ago, leverages down, margins are up, and documentation is increasingly lender-friendly. I have mentioned that most LPs are capacity constrained and therefore providing to LP with liquidity is highly valuable, and we happen to have the world's largest dedicated GP-led secondaries business with strategic equity. We're currently raising its fifth vintage, and we're also raising the first vintage of our LP-led secondary strategy.

And finally, real assets both infrastructure and real estate continue to present some interesting opportunities. Our first infrastructure fund has benefited from its focus on renewables, has quickly developed a very strong track record, and is currently raising its second fund. And you may have seen that Infra Fund II has already made its first investment, again in the sought after renewables space. And within real estate, our move to optimistic equity investment was impeccably timed. We can focus on taking advantage of a stressed, if not distressed, market, unencumbered by a legacy portfolio. This gives us an opportunity to grow into a new asset class and perhaps even to enter the US market with that product, which would be incredibly difficult and expensive at any other point in the cycle. I think the merits of a diversified product offering are evident here as we can always rely on several strategies to thrive at any point in the cycle.

A few words on private debt or direct lending as it is very relevant for us. As a recognized leader in private debt with well-established strategies, with long-term track record in senior debt, in subordinate debt, in Europe, in the US and in Asia, we are fortunate to be very well positioned to take advantage of what many are calling the golden age of private debt. I'm indeed convinced that we are at the beginning of a cycle which will prove much more favorable to credit as an asset class. And this is true of deployment opportunities, of investment performance, as well as fundraising as most LPs will look to rebalance the relative under-allocation to private debt. We have raised over $7 billion for SDP 5 so far and we're still fundraising. We're also raising for our US Mezzanine Fund, and for our European Mid-Market 2. All three of these funds could end up being larger than the previous vintage, a rare achievement in the current market. So in a nutshell, we have the right products for the current cycle and we're clearly taking advantage of this.

Now moving to ICG performance, we had a strategically and financially successful first half of this year. Our core business, which is raising, deploying, and realizing capital on behalf of our clients has performed in line with our expectations. AUM has grown and we are well on track to meet our medium-term fundraising guidance, which we have not had to change and indeed have accelerated since we initially announced it in May, 2021. No mean feat given the changes in the environment since then. Our resilient fee-earning AUM, combined with sustained business activity and strong fund performance, has led to year-on-year financial growth for ICG across the board. So underlying management fee income up 5%, fund management company profit before tax up 13%, and NAV per share up 9%. This operational and financial strength enables us to focus on the long-term strategic objectives of the firm through cycles. We have scaled up and scaled out, we've invested in our people and platform, and we're pursuing ways to leverage our breadth and expertise to further grow our client base into the wealth channel. So over this short period and in the context both of our own fundraising cycle and the macroeconomic environment I feel quite good about these results.

Slide 6 provides some perspective. We're obviously a long-term business. We have to think in 5 and even 10-year cycles. And looking at the past 10 years, our third party AUM has grown by over five times and the fees we generate have grown by over six times to roughly half a billion pounds on an LTM basis. As a consequence of this, our balance sheet has reduced from some 18% of our total AUM to 4% today. So we have executed successfully on what we set out to do then, using the balance sheet as a powerful strategic tool to organically grow our client capital and fee income. A decade ago that growth trajectory was not entirely obvious. We needed to build an infrastructure, a marketing platform to diversify our product offering, no small task. Today we have high visibility on our levers of future organic growth.

Starting at the right of this graph are four flagship strategies, today represent approximately three quarters of our AUM and just under that in terms of management fees. They are established, scaled, profitable, and well-known, and we expect them to continue to grow significantly, in part benefiting from LPs consolidating relationships. The middle buckets are scaling strategies, are additional accelerators of growth in the coming 3 to 7 years. They account for a quarter of our AUM today, slightly more than that as a proportion of our management fees given their fee profile, and over a third, that's $1.8 billion, of our fundraising in the last six months. And finally, on the left, strategies we are seeding from our balance sheet, which today, in aggregate, represent about 10% of our balance sheet investment portfolio. These represent long-term incremental growth potential.

Our expertise and track record in launching first time funds is both unusual in our industry and a major asset. In an environment where first time funds are deemed impossible to raise, we have had a first close for our LP Secondaries fund and a first close for our real estate optimistic fund, which we call Metro. And I'm hopeful that we will have a first close for our life sciences strategy. Nothing that will move any needle in the short term, but clear evidence of the strength of our marketing platform and extremely valuable future organic growth potential. On this point, I'd like to take this opportunity to invite you all to our seminar on the 21st of February, 2024, where we will precisely deep dive on our scaling out strategy.

Now, digging into the last six months in more detail, we raised a total of $5 billion in line with our expectations and we are on track to meet our accelerated target of at least $40 billion fundraising by March 2024. The majority of the fundraising in absolute terms was driven by our flagship strategies, and specifically Strategic Equity and SDP unsurprisingly. Within our scaling strategies, it's notably great to see European Mid-Market 2 off to a very strong start. Looking ahead, we have today over $22 billion of dried powder to deploy, and judging from our pipelines, we are likely to experience an acceleration of deployment in the coming months as growing, financing, and refinancing needs mean that we are not dependent on M&A and primary deal flow for most of our strategies.

Portfolio companies and funds have continued to perform well. This underlying strength, combined with appropriate conservatism on valuations, is driving stable to increasing NAVs across our funds, and we show here a selection. What this demonstrates is substantial and resilient value creation for clients over time. DPI, one of my favorite topics, remains highly relevant, and even more so in this environment given the liquidity constraints of most LPs. And during this period, we have been able to crystallize value, including a very attractive early realization for Europe 8. We made over three times our money in two years on this first exit for the fund, and a number of exits within Strategic Equity, for instance. But proforma, for recent acquisitions, Strategic Equity 3 is at roughly 50% DPI, which is a very good performance for a 2019 vintage. And within our European Corporate Strategy, we've been top decile for DPI in every single vintage. So our strategies are continuing to build strong track records, which is key.

The efforts we have put in these past years to expend our client base have paid off, and our of particular importance in the current market. The number of clients, again, increased in the past six months to over 660, and broadly diversified geographically and by client type as you could see on this slide. We have spoken before about being net beneficiaries of clients focusing on core GP relationships, and as an example of that, SDP 5 today has over 20 clients that had not previously invested in ICG funds. That's a notable success in attracting a substantial number of new clients in an already established flagship market leading strategy.

We continue this year to invest in our marketing and client relations team with recent hires in London, continental Europe, and in the US. We also continue to explore ways to broaden our client base, including strengthening our US marketing presence, where we still have significant white space, as well as exploring ways to distribute products in the wealth channel, building on the success we have had, for instance, with Strategic Equity. As a reminder, approximately 15% of the capital raised so far for Strategic Equity 5 comes from this channel. And of course there is significant runway within our existing client base.

This brings us back to a longer term perspective and the strength of the business model, which I think is all the more apparent in this more challenging phase of the cycle. Investment excellence is at the heart of ICG. It's a crucial ingredient and one that we are recognized for. It all starts with investment performance through cycles. Scale and breadth are then increasingly instrumental in enhancing relevance to LP clients and more broadly business counterparties, and is generating synergies such as a wider and deeper dataset and therefore an information advantage. We have built, over the years, an incredibly powerful marketing-We have built over the years an incredibly powerful marketing and distribution platform. Few managers are able, as we are, to constantly and concurrently be raising for 10 to 15 different products, sometimes more. And we have gained a real expertise, with a successful track record, of launching first time funds organically.

To support this growth, as we scale up and scale out, we continue to invest in a sophisticated infrastructure, and importantly, in our people across all aspects of the business. Finally and crucially, we have the financial resources necessary to execute on this growth strategy with proprietary gross assets of approximately 4 billion pounds and over a half billion pounds of annual fee income. It's a very powerful platform built on over three decades of investment performance with significant embedded future growth and a very difficult to replicate business model. This is why I am fundamentally confident in the prospects of ICG.

At this point, I'll hand over to David for his first formal set of results.

David Bicarregui

Thank you, Benoît. And thank you all for your time today. It's great to be here for my first results of the CFO and I've enjoyed meeting with many of you over the last six months.

Firstly, a couple of observations on our economic model holistically. Our visible and recurring management fees, long duration, locked in capital, almost no mark to market exposure on that fee income are very powerful. Against a volatile economic backdrop, our management fees remain very stable. Combined with a high operating margin, our guidance have been over 50% and a reported margin of 55%. In this half, we generate substantial and durable capital from our fund management activities, which gives us the financial strength and confidence as a management team to make long-term investment decisions through cycles.

That operating business is hugely supported by our robust balance sheet. 4 billion pounds of gross assets at the end of September, robustly capitalized and with substantial available liquidity, which we use to grow fee earning AUM and generate additional recurring fee income. You'll recall that over the last decade we've been very successful in doing this. So there's a lot to like here from an economic model perspective.

For a moment, let's just take the concept of visible and recurring management fees to the extreme. At 30th of September, we had $64.2 billion of fee earning AUM as an average management fee rate of 91 basis points. If business activity completely stopped for a year, that would generate roughly 480 million pounds of management fees, almost irrespective of what fund valuations did. On top of that, we had a $14.3 billion of AUM not yet earning fees. Largely within direct lending. If that was all deployed, it would earn us roughly 110 million pounds in management fees annually. In practice, in that scenario, there will be also be some realizations, so you can't really add up the two numbers together, but it's a useful reminder of the visibility we have on our management fee stream potential, simply based on what we have in the system today. Combined, they provide a solid baseline from which to build a view on how our management fees may progress under various assumptions of business activity.

Now turning to how we've performed in the last six months. Fee earning AUM grew 4% on a constant currency basis with inflows into funds that charge fees on committed capital and deployment from funds that charge fees on invested capital. Each contributing just under $3 billion of gross increase, which was partially offset by some realizations, FX and other moves.

It's worth bearing in mind that in an environment of slower realizations, we earn fees on our AUM for longer, which results in an asymmetric growth profile of our management fees. Simply put, when there's a lot of fundraising deployment and realizations, we grow quickly; and when things slow down, we grow a bit more slowly, which is what we're seeing in the current environment.

Recurring management fees are the main driver as you can see clearly from this graph. You will recall that in H1 of last year we had 29 million pounds of catch-up fees due to the timing of fundraising for strategies that charge fees on committed capital. We had no catch-up fees in this period. Excluding catch-up fees, therefore to be comparable, the 4% growth in fee earned in AUM, I discussed on the previous page, resulted in underlying management fees growing by 12 million pounds year-on-year, or roughly 5%.In addition, we recognize 15 million pounds of performance fees, largely due to the inaugural recognition for Europe VII.

Stepping back for a moment, we've generated nearly half a billion pounds of fees from an increasingly diverse range of funds over the last 12 months. So looking ahead to the second half, on the basis that we will continue to fundraise for strategies that charge fees on committed capital, and we'll see net deployment in SDP, it is reasonable to assume that management fees will be modestly higher in the second half than in the first half. Not materially, I'm talking the second half being potentially mid-single figured percentage points higher.

Regarding performance fees, assuming no valuation or timing changes, performance fees will accrue just given the passage of time, which accounted for 15 million pounds in the first half of this year. The fund management company generated profits of 163 million pounds for the period compared to 144 million pounds in the first half of the last financial year. FMC operating expenses grew 18% year-on-year. This growth was broad-based and is a function of our increased business activity, travel expenses, as well as increasing our scale and investments in people. We're doing that to support future growth. In particular, we've invested in our marketing and client relations team. Headcount there is up 16% year-on-year, as we mentioned earlier. And have made selective senior hires elsewhere in the firm. Our current outlook is that the 18% year-on-year growth is likely to be broadly what we see for the whole of this financial year as we continue to invest in people and platform.

With a margin of 55% for the period, we are running ahead of our medium term guidance and we have ample capacity to continue to invest in the business while still generating substantial long-term operating leverage for the business. So turning to the balance sheet, and I wanted here to give a holistic view to reinforce how well capitalized, robust and valuable it is from a shareholder perspective. On the asset side, we have 1 billion pounds of available liquidity and an incredibly diversified balance sheet portfolio that is invested alongside our clients and in seed investments. This asset base is supported by a substantial equity cushion of 2 billion pounds, representing NAV per share of 714 pence at the end of September, and an attractive debt stack with a diversified maturity profile and weighted average cost of just over 3%. All of which is fixed rate.

More broadly, we have the financial flexibility we need in the form of access to capital markets. Our corporate debt has an attractive maturity profile, a low fixed rate coupon and its investment grade. You'll recall that we were upgraded last year to triple B with a stable outlook by S&P. When we talk therefore about financial resources at our disposal, this 4 billion pound balance sheet is a very powerful asset to sit alongside our fee generation capacity.

Over the last five years, the balance sheet investment portfolio has generated average net investment returns of 11%, demonstrating its long-term compounding earnings power. For this half, we're in line with that average with positive NIRs in all asset classes. That's the financial value of the balance sheet.

From a strategic perspective, looking at how we have deployed the balance sheet this half, we invested 102 million pounds alongside clients in our funds and invested 170 million pounds in seed investments including on behalf of LP secondaries, life sciences, real estate equity and Infrastructure Asia. A number of these seed investments are public and include $50 million investment in Amp India, a renewables platform, by our Infrastructure Asia team and investments in Metropolitan, which is our last mile pan-European distribution and industrial platform. We also generated 138 million pounds of proceeds from seed investments during the period. The net results within seed investments is that real estate was cash generative and the majority of the net deployment was within LP secondaries and Infrastructure Asia.

Our business model of making investments on behalf of new strategies to give them a track record, and then recycling that balance sheet capital remains an important differentiator. The power of our balance sheet will be a topic we explore in more detail in our seminar in February, that Benoît mentioned earlier. So I look forward to discussing that further with you then. In these six months I've been struck by how much our 4 billion pound balance sheet can help drive the growth of the business, and I'm focused on ensuring we use that as efficiently as possible to drive further shareholder value.

As we come towards the end of the formal presentation, it's well worth reminding ourselves of the financial track record that we have. We've got a track record of proven profitable growth. And this half sees growth across all key financial metrics. Over the last five years, substantial growth in absolute terms has been driven by increasing our AUM, management fee income and FMC profitability. So looking ahead, we are confirming our financial guidance more broadly, and in spite of the uncertain macro environment ahead, I'm confident that we have the financial resources and the economic model to enable us to execute on the opportunities ahead as we continue to scale up and scale out.

So with that, I'll turn back to Chris and we look forward to taking your questions.

Chris Hunt

Thank you very much. And we have a number of questions online. First, to start with Oliver Carruthers from Goldman Sachs. I believe you have a question, Oliver, please go ahead.

Oliver? Okay, while we're waiting for Oliver to reconnect, we have another question that's come in.

David, you referenced that you are six months broadly into your tenure here. Could you give a bit more color please on your first impressions and also on your areas of focus?

David Bicarregui

So, a few things... And I actually did a brief introduction, you remember, at the full year results? And so some of this is building on my early observations then. Firstly, and evident from the results, the business is in good health and really well positioned for the future. I think that really comes through in the numbers.

I think the second observation is this is a long-term game, so we're performing well in the environment but we're also laying down seeds for the future. And I think that's really important to emphasize that the decisions we take now will pay back in 5 and 10 years. It's a long-term game. We feel really good about both of those characteristics.

The structural tailwinds on the business remain. If you look at any analysis of the growth in private credit, in particular, trillions of dollars of structural tailwinds. And we're very well positioned to take advantage of those.

And we also have multiple levers for future growth. Benoît touched on wealth channels, we've touched on Asia, we've touched on other aspects of the business which will in turn play through as future leaders of growth. And I think, personally, I'm really excited to be working with this group of leaders. And as you can see, we've started to make some organizational changes and it's all in the spirit of scaling up and scaling out for the future.

Chris Hunt

Thank you very much. There is another question online from Nick Herman at City. Nick, please go ahead.

Nick Herman

Yes, three questions from my side please. One on fundraising, one on deployment, and one on the balance sheet.

On fundraising, it seems like you are incrementally more constructive on the outlook. You are well on your way to hitting that target of the more than 40 billion target fundraise by the end of this financial year. Just why not increase the guidance there? That's the first one.

On deployment, so pretty strong in SDP, which I think you flagged Q1. And, Benoît, you just indicated that you expected to deploy a significant amount of capital in structured capital funds in the coming quarters. Should I just push you for a bit more colour here? Where do you see the biggest opportunities, more specifically [inaudible 00:32:39] type of deals, regional mix and so on? And as part of that, how do you see fund cycle duration now across your flagship strategies?

And then the final question, just for David, on the balance sheet, you talked up the power of the balance sheet quite a lot there. ICG previously had a high targeted reducing net gearing down to zero over the medium term. Can I read into that, that that's no longer the case? And as part of that, where do you see gearing and leverage going down to in the coming years? And if my interpretation of that is correct and you're not going to run it down quite as aggressively as you may have intended to in the past, what is ICG going to do with that additional flexibility or balance sheet capacity that it was not going to do before?

Chris Hunt

Perfect. Thanks Nick. David, do you want to do the balance sheet first and then we'll go to the fundraising and deployment from Benoît?

David Bicarregui

Yes. Morning Nick. So you're right in terms of the gearing question leading to a conclusion that we want to be flexible about the way we manage the balance sheet. We're in an uncertain operation environment and so you'd expect us to want to be flexible. There's been a lot of progress made over the years, as you know, to bring down the level of debt on the balance sheet. We've gone from over three turns of leverage down to half a turn of leverage. So from a personal perspective and organizationally, I think we're quite relaxed at the levels that we currently operate at.

And I mentioned in my remarks, we have access to the capital markets as well. So flexibility means we can have a range of options. But we're still investing in the business, as we said, we are still seeding certain strategies. There will be other demands I'm sure for capital in the coming year. And so you put all that together, I think we want to keep our options open and be flexible.

Benoît Durteste

On fundraising, you're right, we're delivering on target despite the more difficult environment is how I would phrase it, which is very good news. I think it would be a tad provocative if we again revised upwards our guidance, given the current environment. You remember that we have already revised it upwards once. We're coming to the end of a four-year cycle. By the end of the year, I think we'll need to think about and discuss with you what does the next four-year cycle look like. It's clear that in the current environment it's more difficult to form a view because essentially you're trying to get a view on how long this cycle will last.

Long- term, there's no doubt that our fundraising numbers will increase. The question is more one of timing. On deployment. So deployment is interesting. If you look at our numbers, you particularly look at the SDP numbers. Essentially, we are deploying exactly at the same pace we were when the market was buoyant. It's just that we're deploying different types of transactions. So, as I mentioned during the presentation, the level of M and A activity is quite low, which means there is limited primary-activity is quite low, which means there is limited primary deal activity. However, there is significant and growing activity in refinancings, and in companies across the board, not just private equity owned companies, but looking for additional financing in this environment. And so, all in all, they balance each other out. So, we're not investing less, we're also not investing more. We're exactly as we were if you look at the numbers in, say, 2019 or 2020, for instance.

And it's quite similar for structured product because the big advantage of these structured products is they're hybrid products, they're extremely flexible, which means they can pivot to debt when it's the right time to do so, and it is right now for obvious reasons. And so, we're experiencing the same thing. It might be more with subordinated type instruments or pref type instruments, but it's exactly the same dynamic. And the comment I was making about seeing a growing pipeline is that the longer this situation lasts, the more pressure is building on market participants to either refinance deals or optimize their capital structures. Sometimes try to find some liquidity options because they need to improve their DPI numbers if they are going fundraising. And all of that is creating a growing set of opportunities.

So, that's putting us in a pretty good position because none of this is dependent on the M&A market reopening. There could very well be a period, but I don't think it's in the near term, but there could very well be a period where we will get both, i.e. you are still going to have that refinancing wave or additional financing wave in addition to the primary market reopening. So, there could very well be a period where we have quite a high level of deployment activity. But, again, I'm not seeing that in the coming few quarters. It will happen, but I don't think in the near term.

And finally, you mentioned fund cycle direction. I mean, all in all, I don't see much of a change, certainly in terms of deployment. It may be that, for all strategies that have a debt component, that the duration of deals themselves is longer, which is highly beneficial to these strategies. But I'm not sure this is a long-term trend. We may benefit from that from one vintage, maybe two. I'm not sure it's a long-term trend, so we'll take it while we can. But in terms of deployment, which is really what matters most here when we're thinking about future fundraising and growth of the EUM, I don't see a huge change if we think about our planning, our agenda, if you will, for fundraising for various strategies, whether it's when we're thinking about the next large European fund, we're essentially right on what was our initial target pre this part of the cycle.

Chris Hunt

Thank you very much. We have a question from Luke Mason, from BNP. Luke, please go ahead.

First one on fundraising, just the flagships, like the strategic equities in European Cooperate. I guess, do you expect those kind of flagship funds to be able to increase in size despite the difficult market? I think you mentioned SDP, US meds and mid-market can continue to increase in size, so can the other flagships as well?

Second question is just on FMC cost growth, which is guiding to fairly elevated at 18% for the full year versus underlying management fees up 5% year-on-year. And I appreciate that you're still running well ahead of your operating margin guidance. But could you break down the different elements of that 18%, and how we should think about run rate FMC cost growth beyond this year, please?

And then, thirdly, just on portfolio company fundamentals, if you could give any update there in terms of revenue goal of EBITDA, any pressures you're seeing anywhere across the portfolio, that'd be appreciated.

Benoît Durteste

Sure. Thank you for that. I'll take the flagship prospects, the portfolio and, David, you can dive into cost.

So potential for fundraising for the flagships, can they grow to be larger than the previous vintage? I always prefer to be cautious, but deep down my hope is yes, absolutely. If we think about the flagship strategies that we have in the market right now, that's essentially SDP strategic equity, and you could add the mid-market fund because it's an extension of the large cap European corporate, so you could add it even in that flagship category, even though it is still a scaling strategy. I mean, I think all three are in very good position to raise more than we did in the previous vintage.

Now, I'm being cautious because I'm sure you're well aware of the market environment and what's been reported elsewhere. That's uncommon. I mean, very few managers are increasing the size of their funds these days. But it looks as though... I mean, for SDP, we already know it's going to be larger. Strategic equity, we still have quite a long way before we finish the fundraising, but it's looking reasonably good. And for the mid-market corporate fund, we already know it will be larger. So, I'm not going out on a huge limb here when I say this. I mean, looking ahead, that's more difficult to say. I mean, yeah, at some point we'll be back with Europe IX, but what will be the market environment then? I mean, we're going into crystal ball gazing. But I think it's fair to say that we're fortunate because all of these strategies work well in the current market environment. So, they resonate with the LPs and obviously clearly it helps.

On portfolio, yes, portfolios overall are doing well. And this is not specific to ICG. I mean, if you look at the overall market, and obviously we're involved in secondary, so we have quite a broad view on the whole market across the world, by and large, of course always a few exceptions, but by and large private equity funds and private debt funds are doing very well because by and large companies in the buyout space, you have to remember that in buyout there's a skew towards services, it's rare that you have a lot of retail. So, there is a bias there if you look at the buyout world, but by and large portfolios are doing quite well. By and large, you're still seeing double-digit top line and EBITDA growth.

Now, that doesn't mean we shouldn't be cautious, and particularly with our downside protection hat on. I'm always paranoid and thinking, "Okay, that's great. 2023 is largely in the bag. What does 2024 look like for all these companies and what does that mean?" But I have to say, even as we're going into the budget period for portfolio companies, I think what strikes me is, well, two things, is budgets for 2024 typically look pretty good, but I think it's also fair to say that by and large, there's lower visibility, that management teams find it more difficult to budget for the coming year. But up until now, broadly, and it's true for our funds, but again, I think it's broadly true for the entire market, companies are still doing well. They've adapted.

I think it's important to remember or to highlight the fact that this crisis is quite unusual because, if you think about it, pre-COVID, everyone was expecting some sort of an economic correction. We certainly were because the cycle was getting long in the tooth. So, we were certainly having a discussion with management teams in our portfolio was, "How do you prepare to the cycle turning?" That was pre-COVID. Then, COVID happened, and then there was a short period of respite, but then the Ukraine and the economic crisis happened.

So, it's been a long slow process where any decent management team will have had time to adjust, look at cost, look at working capital, and that's exactly what they've done, which is why I think you are seeing those performance levels across the board in the market.

David Bicarregui

Yes, so maybe pick up on your question on cost for the FMC, Luke. There is a breakdown, as you know in the RNS, it gives you a little bit more detail, but maybe I'll just go through three primary categories here. So, salaries, incentives, and then admin cost. You're right, it's 18% up as an aggregate, salaries' increase was driven primarily by headcount and inflation. Our staff numbers are about 6%, if you look at the same period last year. The incentives costs reflect discretionary bonuses and stock awards and other things that were currently accruing for. Obviously, there's some discretion around what we actually do for the full year, but this is our best estimate at this point in time as to where we will land for that broad set of incentives, again, driven by higher headcount. We mentioned earlier, MCR for example, has been up 16%, which tends to skew towards potentially more experienced hire-in. And then, in terms of the administrative costs, that's really activity based. As I said earlier, we've got more travel and expenses through there. We've actually started to build a team, a partnership in India, which goes through that line item. That's an investment for the future. So, you can characterize all of those as investments in people and platforms. We do think 18% or thereabouts is reasonable if you want to pull through to what the annualization looks like.

But then, if we look forward, I'm not sure we're going to run the place at 18% increase. In fact, we'll have other levers in the future to bring down cost and, more importantly, improve operating margin. So, I'd characterize this year as more about the year of investing in people and platforms is what you're seeing here.

Benoît Durteste

Thanks, David.

If I can add, I mean, we're clearly in a growth mode. We remain in a growth mode. There's very significant runway for ICG to grow. And as we know in this industry, you're making investments for the long term. It takes quite a while for new teams to become profitable. So, as we look to launch a real estate equity strategy in India, an infra strategy in India, whatever, the life science team and on and on, these teams take a long time to become profitable. Once they do, it's an incredibly powerful fee generating stream. But today we're still in a phase where we're not trying to milk what we have. That would be easier, and we could still grow for quite some time because the flagship strategies still have a lot of growth potential. But we're thinking further ahead. I think size matters more and more. We want to be a leader in this space. We're already seeing some of the benefits of scale where LPs are consolidating relationships. So, we're squarely in a situation where we want to invest more to gain market share and further the advantage that we think we have in the market.

Chris Hunt

Thanks, Luke. There's a question from Hubert Lam, Bank of America. Hubert, I think your line's now open.

Great, thanks. Thanks for taking my questions. I've got three of them.

Firstly, in terms of fundraising, as you mentioned, there's been strong tailwinds in private debt near term as rates are rising and banks are not lending. But do you see demand for private debt slowing if trends start to reverse and rates start to fall? That's the first question.

Second question is on competition. Do you see a rising competition now in both fundraising and deployment, and particularly in private debt and credit, like many of the alternative firms and also traditional asset managers are extending into the asset class? So, just wondering if you think the environment is getting tougher on both the fundraising and deployment side.

And lastly, on catch-up fees. I know you said that, in the first half, there were none. But what should we expect over the next 18 months as some of the flagship funds start to close? Any guidance around catch-up fees would be appreciated.

Benoît Durteste

Thank you for that. So, question demand on private debt and how that could evolve with interest rates. I always find it quite amusing because, when interest rates rise, there's a question about, "Will alternatives still be attractive?" And then, we're starting to worry about, "What if they come down?" I think what we're experiencing is it's a structural shift that is being accelerated. If you think about it, the whole direct lending private debt space is relatively new. I mean by that, in our industry, it means it's probably a decade old, really. But in our industry, that's new. Most LPs have limited allocation to private debt. Some still don't at all.

And so, what we're experiencing now is our market and our clients being more sophisticated, they're expanding also, they keep on expanding their allocations to alternatives, and they find themselves generally under allocated to private debt. What's happening now is private debt is so attractive that it's accelerating the shift, but I don't see that reversing at all. I just see this as an acceleration because fundamentally, most LPs are under allocated to the asset class. A typical LP will start into alternatives by going into secondaries because it's easiest, it's diversified, and then they tend to move into private equity, and then maybe in real assets. But private debt historically was not the first port of call. That is changing. But there's still a lot of runway. There are still many areas where LPs have very small allocations to private debt. So, that's only demand for private debt. In terms of competition, I mean, it's always highly competitive. Do I see a big shift? Not really. I mean, yes, everybody is talking about private debt because it's flavor of the year, maybe the decade. But in reality, it's not so easy to enter the market. It's even more difficult to run it efficiently and profitably. You need significant volume. And so, well, to your point, I mean, you're seeing many market participants making noise about private debt because it feels attractive. And on paper, people think it's easy.

In reality, we're actually not seeing new players coming into the market. Actually, we've seen a few disappear, in Europe in particular, because they just couldn't make it work. And so, particularly at our end of the market, remember, we are one of the largest in Europe, and actually two players, including ICG, are very large. And then, it drops down in size considerably. And so, where we operate, we're not seeing much of a change at all. It takes time. By the way, what's true in private debt, is true in most asset classes and alternatives. If you look back, you look back 10, 15 years and you look who the key market participants are, they haven't changed all that much. I mean, the change is very, very slow in our industry. So, I don't see that. But having said that, I don't want to make it sound as though it's all low hanging fruits. I mean, it's still incredibly competitive both to deploy and to fundraise. It's just not more so in my mind. As for catch-up fees, David?

David Bicarregui

Morning, Hubert, I'll take the catch-up fee questions.

So, reminders, people, catch-up fees is the phenomenon where you have an initial first close on a fund and then, in the next financial year, you would catch up fees and recognize those fees on committed strategies. And so, this year, none, as we've said in our results. But if you look at the three funds that actually did have their first close in this financial year, strategic equity five, mid-market two, infrastructure two, they'll all have the potential to generate catch-up fees in FY25.

And so, if you want to think about it just in terms of indicatives, $1 billion in SE and 500 million in each of mid-market two and infrastructure two would get to something like £30 million-... to an infrastructure to would get to something like £30 million of catch-up fees, which indicatively is what you saw last year. So just to give you a little bit of a framework for how to think about catch-up fees. But none this year, but certainly the potential for catch-up fees next financial year.

Chris Hunt

Perfect. Thank you very much, Hubert. We have a question from Angelique at JP Morgan. Angelique, please go ahead.

Good morning and thank you very much for taking my questions. First of all, on Europe VIII deployment, I was actually looking at the deployment versus March. I think it's still around the same levels of around 43%. So I was wondering if you can please talk a little bit about the deployment opportunities in the mezzanine space and are those hybrid instruments perhaps a little bit too costly in the current environment. How do you see the deployment of Europe VIII progressing in the rest of the year?

Then a second question on the deployment in Senior Debt Partners V, I heard you with regards to the opportunities outside of the primary buyout space. But I was wondering, can you give us some more color on what those 1.4 billion of deployment are financing, if you can split it in terms of refinancings and perhaps what percentage of that 1.4 is financing sponsor-backed corporates versus other corporates that are not owned by private equity? Because my impression was that when we're talking about direct lending, that is primarily financing sponsor-backed corporates. So it will be interesting to see if you're taking market share from the banking channel, from corporates that are independent from PE.

A third question with regards to the SDP a bit more broadly. Would you be looking to expand this direct lending strategy with a higher share of deployment in the US and perhaps also Asia down the line, perhaps as part of the next flagship of the next vintage? Thank you.

Benoît Durteste

Thank you for your questions. On Europe VIII, yes, you're right, if you look at the six months, because I don't think we ... I think we signed two deals, but we didn't close them during the period. But it's hard to draw any conclusions over such a short period because it's quite lumpy. So I wouldn't draw too many conclusions.

To your question, is mezzanine debt too expensive? It's always expensive. It's always very expensive, particularly ours, because we always look for ... I mean we're looking for upper teens returns, so we're looking for very high returns. And, incidentally, we also look for money multiple, so we also look for long non-call protections. I mean we don't do deals if we don't have at least three years non-call protection. Actually, these days we're looking more like ... For four. So, yes, clearly, it's very onerous. But that's what makes this strategy different. It's not plain vanilla mezz. These are for Europe VIII. A lot of the transactions are non-sponsored. So you were asking the question about SDP for Europe VIII. Most of the transactions are non-sponsored and are looking at very specific situations where we're helping a family-owned business or management-owned business, restructure their capital, grow, and where we can achieve these sorts of results, where they're looking at more for a long-term partner and the non-call, for instance, feels less onerous to them than it might to a private equity sponsor.

So Europe VIII deployment, it's actually looking pretty good. If I look at the pipeline, if I look at what we've signed and not closed yet, it's looking fine. So in terms of timing, and we're on track with the normal timing deployment for that fund. It's too early to call about .

Obviously the question beneath that is when are we going fundraising for Europe IX? What we're telling our LPs is very likely next year, and we leave it there because, again, it's lumpy. And so, you do two deals and suddenly you might need to accelerate or it slips by three or six months. In the end, it doesn't matter all that much for us in the long run. On SDP, you're asking about what sort of transactions we're seeing. I mean I don't think a percentage breakdown makes much sense over such a short period. It doesn't tell you much because it's all idiosyncratic. The deals tend to be quite large.

There is one deal that is a corporate deal, but you're right, it's not a big feature in this space. Are we going to see more? Maybe. But in this space, a lot of the volume, historically, has been driven by PE type transactions. What's happening is because there are very few exits, private equity sponsors need to create or recreate value in their portfolio companies. So they need additional financing, a lot of additional financing. And so, you're seeing a lot of additional financing for M&A as private equity sponsors try to do ... Hopefully value creative add-ons. That's all good news for us. It means the debt is outstanding longer and we can put more in companies that we know, at leverage levels that we like, and typically that's accompanied by the private equity reinjecting even more money in the deal. So in terms of risk return, we quite like those situations. So there are a lot of those. Yes, to your point, I think you mentioned that there are fewer primary deals. I mentioned that as well in the presentation. That's still the case.

There are a few. For the large one, actually there aren't that many players that can actually serve them. So we benefit from that. But all in all, that's not a significant part, and I don't see that changing in the near term. Again, that all depends on what your view is as to when the M&A activity will come back to a more normal level. When it does, SDP will clearly benefit, so will Europe VIII, by the way. You'll get a bit of both, both the primaries and the refinancings. But I don't see that in their near term. I think certainly for the end of this financial year, our financial year, but I also think well into '24, we're going to see more of the same, which is a lot of additional financing for existing businesses and refinancings for deals.

You may have seen ... I'm sure you're aware that some deals that were financed by broader syndicated loans have moved to private markets. That creates opportunities for us. In the end, the market is not so deep in private credit because we're raising relatively well. But if you look around, only the top managers are raising well, and certainly very few are increasing the size of their vintages as we are. And so, the actual debt capacity in the market is not that deep. Obviously it works in favor of those who have some dry powder.

Finally, you mentioned expanding in the US and Asia. So our SDP has the ability to invest outside of Europe, and we take advantage of that. Could we do more maybe with a US-dedicated sleeve or fund? Possibly. But the comment I made about barriers to entry and size also apply to us if we're looking at new areas. I mean for that to work, I mean you'd need a very sizable fund in the US. Easier said than done. So are we looking into this? Yes. Would it make sense for us? Yes. Would it move the needle for us on a profit basis? No, not for years. So I don't know if that's the answer you were looking for.

As for Asia, senior debt in Asia is tricky. No one's really managed to make that work for a whole host of reasons. It's a very broad market. It's a series of very different markets. So it's quite onerous to operate there. You need teams on the ground in every country, which for a senior debt strategy is not necessarily that profitable. Also, the legal environment in a number of countries there is not yet strong enough for a senior lending activity. So that market is still in front of us. I'm sure it'll open up at some point, but it's not there yet.

There are other areas that could be interesting such as some asset-backed. There are some interesting asset-backed lending activity in Asia. So that's something that we could look into and that could be interesting.

But, overall, I mean there is no lack of ideas for us to grow into. The question for us is we have to choose our fights, because even though we have a pretty good track record at launching first-time funds, I mean there's only so many you can do. I mean the fact that we have three first-time funds in the market right now at a time when most LPs will tell you, "Forget it, you just can't raise for first-time funds," I mean that's already relatively brave. We need to be mindful that there's a limit to how many new strategies we can launch. But, yes, there are areas where that ... In debt where we could expand geographically. We just need to make sure there's enough scale with any reasonable timeframe for that to make sense.

Chris Hunt

Thank you very much, Angelique. Then, finally, this question is from Oliver Caruthers. I think he's back on the line now. Oliver, I think your line's open.

Oliver Carruthers

So the first one, any color you can give on size expectations for Strategic Equity V? If I look at the presentation, it looks like the expected money multiple performance of SE III and IV is continuing to tick up nicely. I think a big part of your focus here is GP sector deals north of €500 million. As you say, Benoît, M&A activity is low at the moment. So I would've thought the theoretical fund size here could be north of 5, 6 billion given this growing deployable universe, or is that the wrong way to think about the strategy? That's the first question.

The second question is a follow-up. So you've got this new slide 18, which I think gives you helpful context on your balance sheet. Perhaps not your base case, but say we are in an environment next year where a net investment return picked up further and we see more realizations in addition to the interest income you're getting. I'd be keen to hear a little bit more about what could happen next.

Following up from Nick's question, it sounds like you're pretty happy with your current capital structure, which means it's really seeding corporate M&A or capital return to shareholders, or am I missing something here? Thank you very much.

Benoît Durteste

Thank you for your question. On strategic equity, no, you're absolutely right. On strategic equity, the constraint on strategic equity is clearly on fundraising, not necessarily because of the current more challenging environment, but because this is a relatively new asset class. I mean the mere fact that ICG is the world leader in this asset class should tell you something. And so, the potential is there. Yes, clearly there's a need for liquidity to be returned to LPs. A lot of private equity sponsors would love to improve their DPI numbers, and short of a full exit, doing a continuation vehicle makes a lot of sense.

So there's huge demand. If you ask any private equity fund out there, they at least have one, typically two and sometimes more, portfolio companies that they would love to do a continuation transaction on. So the limit is not the demand. The limit right now is the supply. So we could be investing a lot more. We are incredibly selective. This is the one strategy where we don't have to do any origination. The phone keeps ringing. And so, the constraint is really on fundraising because this is really new. I mean, interestingly, it's being portrayed in the market as a subset of secondaries, whereas really it's not a secondaries activity at all. It's much more of a private equity activity.

And so, I think the market is still trying to find its footing. We have a few LPs who are real fans of this strategy, including some large US pension funds who were not investors in ICG before. Then you have a number of investors who are still not quite sure whether they like it or not and where they should put it in their asset allocation.

So it will take time. In a sense, we're a bit trailblazing in this, and that makes it, as a result, very difficult to put a number on where could the fundraising be? Because, again, we need to convince new LPs here. This is unlike ... If I look at Europe VIII and we're thinking Europe IX, and then you're starting to think about existing investors, how much could they reup, where do we think we could be, you have more visibility because there's a history and it's a well-trodden path. Here, this is new. So that question mark. Obviously we'd love to raise as much as we can, but it's more difficult to have visibility on this one.

What we do want, and I think we're already there, but we are I think more than twice as large as our nearest competitor in this strategy. I'd love to preserve this because that gives us a huge advantage in the market. If you want to do a GP-led to the end of the market, essentially you have to call ICG. That's a good position to be in. So that's what I really want to preserve is to keep that headroom so that we remain by some margin the largest player globally in that ... It's still a niche, but in that space. David.

David Bicarregui

Yes. Oli, so picking up on your point about balance sheet, you're right, we've included two slides here to really show the balance sheet in terms of the structure, how it's capitalized, but also give a better sense maybe of the flow of cash and capital that goes around the balance sheet. This period has seen a significant amount of recycling of capital. That might not have been obvious coming into this period that you'd see that happen. But if you look at real estate, and we called it out earlier, it's actually generated cash back to the balance sheet over this period and is now effectively onto Vintage II of the metropolitan strategy.

So there is a significant amount of recycling that happens as a regular matter. Obviously we're dynamically managing the balance sheet too, so we're making decisions about how much more seeding we want to put onto the balance sheet and how that's going to support eventual fundraising of different strategies. So very dynamic picture. I think next calendar year will be interesting for the reasons we discussed earlier. There could be significant realizations occurring. Inevitably, that would mean more cash coming back to the balance sheet. I think as a result of that, we will have even more financial flexibility to make decisions from there.

You called out a range of different options. There are probably others. And so, we'll keep them all under review. But for now, I feel we're in a prudent place. We're balancing, as I said, the amount of seeding of new stuff with existing strategies. We run a projections process to look at things under a base case and also under a stress case. So I feel good about where we are at the moment.

Chris Hunt

Perfect. Thank you ever so much for everyone's time. There are no more questions. So with that, we will end the call. Thank you.