Apollo Global Management, Inc.
First Quarter 2023 Earnings
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Presenters
Marc Rowan, CEO
Scott Kleinman, Co-President
Martin Kelly, CFO
Noah Gunn, Global Head, IR

Q&A Participants
Alex Blostein – Goldman Sachs
Patrick Davitt – Autonomous Research
Glenn Schorr – Evercore
Rufus Hone – BMO Capital Markets
Michael Cyprys – Morgan Stanley
Michael Brown - KBW
Craig Siegenthaler – Bank of America
Brian Bedell – Deutsche Bank
Finian O'Shea – Wells Fargo
Ben Budish – Barclays
Adam Beatty – UBS

Operator
Good morning and welcome to Apollo Global Management's First Quarter 2023 Earnings Conference Call. During today's discussion, all callers will be placed in listen only mode, and following management's prepared remarks, the conference call will be opened for questions. Please limit yourself to one question and then rejoin the queue. This conference call is being recorded.

This call may contain forward looking statements and projections which do not guarantee future events or performance. Please refer to Apollo's most recent SEC filings for risk factors related to these statements. Apollo will be discussing certain non-GAAP measures during this conference which management believes are relevant in assessing the financial performance of the business. These non-GAAP measures are reconciled to GAAP figures and Apollo's earnings presentation which is available on the company's website. Please also note that nothing on this call constitutes an offer to sell or solicitation of an offer to purchase an interest in any Apollo fund.

I will now turn the conference over to Noah Gunn, Global Head of Investor Relations.

Noah Gunn

Great. Thanks, Donna. And welcome again everyone to our call this morning. Earlier we published our earnings release and financial supplement on the investor relations portion of our website.

First quarter results were strong and outperformed on a number of fronts which we believe few others can say amid this backdrop of market volatility. We'll discuss further over the course of the call, but it's quite apparent that our purchase price matters approach is shining, allowing us to be very front footed in executing our strategic objectives. The proof is in the numbers. We reported record quarterly FRE of 397 million or $0.67 per share, and normalized SRE of $811 million or $1.36 per share, which together increased a remarkable 45% year-over-year. This powerful combination of fee and spread related earnings, coupled with principal investing income, drove normalized adjusted net income of $942 million or $1.58 per share in the first quarter, up 18% year-over-year, which is indicative of the type of consistent, compound earnings growth we believe we can deliver to our shareholders.

Joining me this morning to discuss our results in further detail are Marc Rowan, CEO; Scott Kleinman, Co-President; and Martin Kelly, CFO. And with that, I'll turn the call over to Marc.

Marc Rowan

Thank you, Noah. And good morning to all. Noah started down the path that I'd like to pick up on and really talk about the two different bets we have made versus our industry. The first is an investment style bet. If you look across our approximately 600 billion of AUM, you never have to worry about what strategy we're following. Every strategy is purchase price matters. Purchase price matters is grounded in facts. It's grounded in cash flow. It's grounded in business prospects.

In the equity business, which Scott will talk about, it manifests itself in a maniacal focus on low purchase price for the quality of business that we are buying. In the credit market, it manifests itself at being top of the capital structure, senior secured, and floating rate. If I tick through just this quarter's results, and how purchase price matters plays into this amid this market dislocation and volatility, in our credit business, corporate credit up 3%, structured credit up 3%, direct origination up 5%. I hosted a webcast earlier this month for ADS and Earl Hunt. 98% of the book senior secured floating rate originated in ‘22 and in ‘23, great years in which to originate.

If I turn to our equity business, private equity up 5%, European non-performing loans through EPF up 2%. Literally across the board, against a backdrop of instability, purchase price matters has paid off. It is really hard not to chase the hot dot of momentum and liquidity, especially when it goes on for so long against the backdrop of money printing. But that in fact is what we did and why we are where we are today.

The second bet I'd like to talk about goes back to our investor day in October 2021. We told you at the time that we were going to make a different bet than almost everyone else in our industry. And if you look across our industry, some have bet on real estate equity, some have bet on infrastructure, some have bet on subordinated debt and BDCs, some have bet on growth. None of these in of themselves are bad strategies, and in fact, some of our competitors execute against these strategies quite well.

But these are not our strategies. The bet we told you at the time that we were making, if you looked at the vast majority of our AUM growth, was on fixed income replacement. Think of that as private investment grade. We made a really big push into private IG. Different than private credit is how private credit is normally talked about, which normally means levered loans and below investment grade. We are the investment grade version.

This quarter, our yield AUM was some 440 billion. And while that sounds quite large, and it is the largest of the private credit businesses, this is against the backdrop of a 40 trillion market that we estimate that we would otherwise be looking at. We are simply not significant in the market. And this is the best news, we are large, but not significant. That's a position I like to work from.

Think about who we compete with and who we don't compete with. The press likes to frame private credit as an enemy of the banking system. In fact, if we think about our businesses, and how we've positioned our private IG franchise, we want what the banks don't want and vice versa. So let me articulate that very clearly. Because I think it is important that it come out.

At the end of the day, we want the asset. We actually don't want the client because we are not prepared to cross sell the client anything. We can't sell them equity, we can't sell them M&A, we can't sell them FX, derivatives, hedging, payments, or credit cards. Ironically, for much of the banking system, the banking system wants the client, but not the asset. Particularly in a world of market stress, where many banks, particularly regional banks, are rethinking their strategy, I like where we sit in the food chain, I like what we're focused on, and I believe we are very well positioned.

In a time of market instability, against a backdrop of a good entry point for credit at higher rates, the world is looking for safe yield. Insurance companies, including our own insurance company, Athene and Athora, need safe yield. Competitive insurance companies need safe yield. Japanese banks need safe yield. Pension funds endowments, sovereign wealth funds need safe yield. Safe yield is as I suggested a potential replacement for fixed income, particularly publicly traded IG. Again, I like the hand we're playing and I like the bet we've made.

If I turn now to the two businesses. We told you for asset management that 2023 was going to be a year of execution and our recognition and achieving of all of the investments that we have made in prior years. In addition, we projected that we would grow some 25% year-over-year in FRE. I believe we will meet that metric. We are well on our track to doing it. We experienced 57 billion of inflows in the quarter, and we're on track to far surpass last year's approximately 130 billion. I would expect a near record, of asset management fundraising in Q2. I believe purchase price matters resonates now more than ever, and I expect a very strong year.

Equally interesting is capital deployment. Those who have followed closely over the past few weeks will see just how active we've been in the buyout business, a place we've not had tremendous amounts of activity during the run-up in purchase price. Scott will walk you through the market activity. We have been equally busy in credit as this is a perfect entry point for what we do in private IG.

An important part of our growth today, and in fact, as I've said previously, a limiter of our growth, is our capacity to originate assets that offer excess return per unit of risk. We do this both directly in terms of direct lending, but we also do it via platforms. Think of platforms as businesses whose only business is the production of credit. Today, we have 16 platforms. Three of the largest are MidCap, Wheels and Atlas.

Just to give you a feel for how business is progressing. MidCap did $3.5 billion of originations year-to-date. Normally, MidCap would produce about a 14% ROE. For the most recent period of time, MidCap's ROE approaches 17%. Wheels, which is our fleet lessor, has experienced no credit losses since the acquisition of Donlen. Again, Wheels would normally produce about a 13% to 15% ROE. In the most recent period of time, Wheels' ROE is approaching 19%.

Atlas, integration well underway, I appreciate whoever wrote Atlas hugs versus Atlas shrugs. And in fact, I think the timing for the purchase of Atlas could not have been better. What is better than being a lender to other lenders during a time of market stress from a position of secured IG, top of the capital structure, floating rate with wide spreads? We have a tremendous amount of work to do there, but we are very excited about what we've seen to date.

In short, the origination business is better because of the market stress. We are filling in where the market now is suffering certain lapses, and we are earning higher spread, we are able to underwrite with a negative credit mindset, we are able to protect the downside. Most of what we're doing is top of the capital structured floating rate and senior secured.

Let me turn a bit to our capital solutions business. In prior quarters, I've given you a little bit of our philosophy. We want generally in capital solutions, particularly in our debt business, 25% of everything and 100% of nothing. As we have become an increasingly large originator and an increasingly diverse originator, this business is becoming a recurring business. The vast majority of this business and the growth I expect in the future will be around this philosophy of we want 25% of everything and 100% of nothing. We are becoming people's favorite stop to fill out what they need in terms of yield in their IG book without compromising credit during a period of market stress and concerned about the economic future.

Save the best for last, retirement services and Athene. 2022 was the best year in Athene's history, record inflows in earnings. 2023, I expect to be better and has started off even stronger. Every metric worked in Q1. Normalized spread of 160 basis points, new business priced very attractively, leading market share, very strong sidecar capital formation, which we will update you as we have further closings. In short, inflows were approximately $12 billion in the first quarter, roughly about the same as 2022. And I see this a little bit as the golden age of annuities. Consumers simply prefer 5% to 2%. It's not more complicated than that.

We built and have continued to build our international insurance relationships. We now have three significant reinsurance relationships in the Japanese market, and I expect that to be five before year-end. I expect that we will generate some $5 billion a year annually of flow reinsurance from this market. And I expect this year in terms of flow reinsurance to be the single best year in our history, somewhere between $9 billion and $10 billion of flow.

Pension activity and pension buyout activity with higher rates is ramping. We recently announced an $8 billion solution for a blue chip client, and I expect second quarter inflows at Athene to be north of $17 billion. In short, we're on track to exceed last year's record annual inflows of $48 billion.

For the quarter, normalized spread was $811 million. This was, as we've said internally a bit of a Goldilocks scenario. Spreads were wider than expected, rates were higher than expected. We kept more business in-house, meaning that we did not give as much to the sidecar. That will correct itself in the second half of the year but will result in higher earnings for the year. Atlas was a net positive. In short, it all worked. In addition, as I'm sure Martin will walk through, conservative reserving methodology led to positive LDTI adjustments.

I think as we step back, we should not multiply 811 by 4, but relative to the 20% growth in SRE that we had projected at year-end, I would expect us to have upside to that target. That is even holding some $12.7 billion of cash at 3/31. We positioned ourselves defensively. We positioned ourselves to take advantage of wide spread, and now we are taking advantage of wide spread. When your book is in good shape, you are able to take advantage of opportunities offered in the marketplace.

Before I turn it over to Scott, and I'm anxious to turn it over to Scott because he has lots to say, I thought I would spend a minute on surrenders. Given the activity we've seen in the banking sector, we've received lots of questions about how this impacts or, in fact, does not impact the retirement services industry.

Let me start with the punch line, this does not impact the retirement services industry. People who own annuities are saving for retirement. This is not money they think is accessible. When they do surrender or move it, they're typically moving to another policy. Otherwise, they incur a tax burden and tax inefficiency.

Finally, from our point of view, we run our book and we invest against long-term locked-in liabilities. More than 80% of our portfolio is non-surrenderable or is protected by market value adjustments and surrender charges. This is not the first time we've confronted these issues. We've been doing this for a long time.

In the materials that we put out this morning, I asked the team to put out a table that really goes through the four different types of outflows that we experienced in terms of our book. The first and I'm referring to a table that is in the materials. The first is what we call maturity driven or contractual outflows. This is exactly what it sounds like. We enter into an FABN, it has a maturity. We originate a MYGA, it has a maturity. Those numbers are fully predictable, and you will see them from quarter-over-quarter. And I know when Athene does its deep dive call, you will see not just what has happened, but you will see Athene's projection for the next few quarters.

The next few categories are what I'll call policy-driven outflows or policyholder driven outflows, the largest of which is income-oriented withdrawals. Recall that for retirees, when they get to a certain age, they are required to take minimum amounts out of their policies. Those minimum amounts of the policies are, in fact, what come out on a planned and on a budgeted basis. We then are left with two other types of withdrawals from those out of surrender charges where we would expect to see more withdrawals, and for those in surrender charge, where we would expect to see very few withdrawals. In fact, that is what we are experiencing.

If I look at the weeks surrounding Silicon Valley Bank and the run on Silicon Valley Bank, when I compare call center volume, surrender activity or any other form of activity, simply no change. This business continues to be very, very predictable. We are matched in terms of duration; we are matched in terms of interest rates. And it gives us the confidence to invest against these liabilities and earn spread, which we then lock in for long periods of time. In short, 2023 for us is a year of execution and one where I believe both the strategy of focusing on fixed income replacement and the investment dynamic of purchase price matters will pay off.

For us, there is so much upside for executing the base business plan, but the simple shorthand for what we intend to do in 2023 is no new toys. The bar is extremely high to do something new given the opportunity in front of us. The three original growth drivers, origination, capital solutions, and global wealth, are well on track. Scott will detail the next six. We're driving toward operating leverage this year. It is a key point of our focus. It occupies a lot of our mind share. We achieved a little of it this quarter, but there's more to come. Today, we end the year or we end the quarter at approximately $600 billion of AUM, $500 billion of that in yield and hybrid. Team is in great shape, momentum is good.

And with that, I'd like to pass it to Scott.

Scott Kleinman
Thanks, Marc. This is certainly an exciting time to be in our business. As you can see from our results, purchase price matters is succeeding in this environment as demonstrated by strong investment performance in several strategies including flagship private equity, direct origination, and opportunistic credit portfolios. We believe we're one of the few firms who can play offense in these periods of uncertainty, which was quite clear by the level of deployment activity in the first quarter.

We signed four private equity deals since our last earnings call, and our current pipeline of opportunities is about 3x a year ago and growing. We announced the first acquisition from our latest flagship fund just last fall, and since then, Fund X has invested or committed approximately $6 billion of capital.

The strength of our relationships and ability to structure complex financing solutions are really what set us apart when traditional funding sources are limited. For example, in the wake of market turmoil surrounding bank failures in March, we announced an $8 billion acquisition of chemical company Univar Solutions, an industry vertical in which we have long-standing expertise. And just last week, we announced the $5 billion acquisition of aluminum products manufacturer Arconic by our private equity funds.

Our hybrid business is also thriving in this backdrop of higher rates, earnings pressure, and lack of appetite for bank-led syndicated credit. With corporates focused on deleveraging in the face of upcoming debt maturities and sponsors seeking exit alternatives amid tepid IPO markets, we're seeing increased demand for private market solutions via structured equity and credit. Accordingly, our investment pipeline for hybrid value is robust and we expect the deployment environment to remain attractive for quite some time.

With the dislocation we've seen in the banking sector over the past couple of months, we've been leaning into a wide range of investing opportunities across private credit platforms. We believe the breadth of our platform and the depth of our expertise puts us in a unique position to provide creative, flexible capital solutions to a range of borrowers, especially to those that may not be as widely serviced by traditional lenders.

We're able to generate a low double-digit yield for first lien debt backed by good collateral. As a recent example, we agreed to invest 1 billion Euros in a portfolio of high-quality assets controlled by Benovia, a leading global residential real estate company, which provided a long-term cost-effective solution for the company.

Inclusive of this investment, we've originated over $18 billion of high-grade alpha transactions since the start of 2022. The pipeline of these types of high-quality attractive investments is already significant today. And longer term, we think the opportunity to gain market share is even greater and spans an even wider range of asset classes from corporate lending to all sorts of asset-backed finance.

As it relates to fundraising trends, the long-term secular tailwinds driving growth in allocations to private markets remain intact and momentum across our platform is strong. While recent market disruption has caused some observable shifts in market behavior, particularly with U.S. and European institutional investors, investors based in the Middle East and Asia actually turned up their focus and seem to have viewed it as an opportune time to allocate capital. Individual investors were also quite level-headed and we saw no material increase in redemptions from global wealth offerings and a steady build in new capital in the first quarter.

On the product level, fundraising trends in traditional private equity are still facing some headwinds, but with a total of approximately 30 comingled and perpetual capital vehicles expected to be in market this year, we still feel confident in our ability to raise more capital than we did in 2022. We expect second quarter inflows to be particularly robust given the line of sight we have to several sizable mandates and fund closes in the near-term pipeline, as Marc mentioned.

On Fund X specifically, we've received total commitments of approximately $16 billion through the end of March. Throughout the marketing process, we've experienced solid demand from repeat investors off the back of very strong Fund IX performance, which appreciated 23% in 2022 and 8% in the first quarter.

Looking forward, we have a great queue of investors in the final stages of documentation and currently expect total commitments to be in the low $20 billion range with a final close expected over summer. The amount of capital positions us as one of the largest funds in the industry and with the flexibility to lean into a range of interesting opportunities in today's markets.

We're also making meaningful progress on the six additional growth initiatives we highlighted in February. These six areas: AAA, Athene Altitude, third-party insurance, sidecars, clean transition, and sponsor and secondary solutions position us to tackle huge white space opportunities. These initiatives are natural extensions of our three key growth pillars and therefore play to our strengths including complex product structuring, proprietary asset origination, and, of course, generating excess return per unit of risk. As these businesses scale over the next few years, we expect our third-party fundraising will grow in size, diversity, and consistency.

Here are some highlights. For AAA, an innovative core equity replacement vehicle, we're continuing to broaden distribution to both institutional and global wealth clients. In addition to the 40-plus approvals in place with independent distributors, we have a handful of new wirehouse and bank relationships geared to come online in the coming months, and conversations with family offices are also ramping up.

Just last week, we announced the launch of a Luxembourg-based product platform that provides individual investors in Europe, Asia, and Latin America access to two investment strategies, including AAA, in their local currency with lower investment minimums than traditional alternative product offerings. The proposition of equity-like returns with downside protection is proving especially attractive in this highly volatile public market backdrop, and we remain very bullish on the long-term outlook for this fund.

For Athene Altitude, an innovative tax-deferred annuity wrap product, we've received positive initial feedback from several retail distribution partners. We have a few firms in late stages of due diligence and expect to launch the product more broadly in the coming months.

Within clean transition, we recently announced the launch of Apollo Clean Transition Capital, or ACT Capital, with $4 billion to deploy into yield and hybrid investments in support of corporate transition to clean energy. Meaningful seed investment from a strategic partner and our aligned pools of capital should enable us to build a diversified portfolio and investment track record from which we can eventually raise additional third-party capital. We also expect to launch the Apollo Clean Transition private equity strategy in the third quarter, which will continue to expand the scope and scale of our activity in the sustainable investing area.

And lastly, we began raising third-party capital for our inaugural equity secondaries vehicle in the second quarter, which is part of our Sponsor and Secondary Solutions, or S3, business. As a reminder, we began investing for this strategy last fall with a chunk of seed capital from a long-term strategic partner and AAA to help anchor the broader fundraise. Deployment activity has been strong since then, and the vehicle has committed over $1 billion of capital in transactions led by S3.

Combined with our three strategic growth pillars, these next six initiatives provide significant runway for growth. We look forward to providing updates as these exciting initiatives develop.

So with that, I'll turn the call over to Martin to go through our financial results in more detail.

Martin Kelly

Great. Thanks, Scott, and good morning, everyone. So our asset management and retirement services businesses clearly continue to create recurring and growing income streams that demonstrate stability through significant market disruptions like we saw in the first quarter. Almost 60% of our assets under management is comprised of perpetual capital, with the remaining concentrated in long-term locked-up structures. And the funding source for our retirement services businesses, as Marc highlighted, is highly persistent with predictable long-term liabilities. Combined, this creates a very resilient earnings profile particularly when considering pressures on the broader financial sector.

Within our asset management business, first quarter FRE increased by 28% year-over-year, driven by strong growth in both management fees and capital solutions fees. These increases reflect the approximate $100 billion of asset management inflows over the last 12 months as well as the broadening of our capital solutions capabilities as several of the substantial growth investments we've made over the past couple of years are translating into top line revenue.

Fee-generating inflows in the first quarter included $20 billion related to an investment management agreement with Atlas, for which we'll earn a 10 basis point fee. Fee-related expenses grew by 26% year-over-year and 3% quarter-over-quarter. After several years of investment in our platform, the pace of headcount growth and the rate of increase in non-compensation costs will decelerate materially in 2023, making 2022 an inflection point for FRE cost growth. Altogether, as Marc suggested, we expect to deliver some operating leverage this year while targeting 25% FRE growth.

Moving to retirement services. Athene's performance to begin the year was stellar and exceeded our expectations. Part of the outperformance reflects a more favorable investing environment while part reflects more episodic gains or timing benefits. We reported normalized net spread of approximately 160 basis points in the first quarter, the highest level the business has seen in a decade.

In the first part of the year, the investing environment was very attractive and we were able to deploy incoming flows at higher on the margin yields than we had anticipated. The weighted average yield on total fixed income purchases exceeded the BBB corporate bond index by more than 150 basis points in the first quarter versus only approximately 25 basis points in all of 2022. The higher rate environment also drove net spread accretion from Athene's floating rate position and cash holdings.

Episodic or timing benefits in the quarter included fees related to financing arrangements for the Atlas transaction and some elevated fees related to certain fixed rate loans, SRE benefits in advance of the second vintage of strategic third-party sidecar capital, assuming its proportionate share of inflows from the first half of 2023 early in Q3, and we continue to expect sidecar capital to support approximately 40% of total Athene inflows this year in aggregate.

And then lastly, we expect an approximate $3 billion outflow in the third quarter related to the recapture of some older annuity liabilities by one of our affiliated partners. This will free up capital for Athene to redeploy in attractive investing environment while providing portfolio diversification for our affiliated partner, similar to the Catalina transaction in the fourth quarter of last year.

Due to the new insurance accounting standard commonly referred to as LDTI, last week, Athene recast SRE results for 2022. These new requirements drove a favorable impact to normalized SRE of $220 million in 2022, which was entirely reflected within cost of funds and translates to 12 basis points of normalized net spread benefit. We expect this benefit to persist in 2023 and the years beyond, although at an approximate 10 basis point in normalized spread terms. This effectively increases our normalized net spread target for 2023 from 135 to 140 basis points, up by approximately 10 basis points to 145 to 150.

In addition, there are a few other moving pieces that should impact the outlook for SRE this year. First, given the deployment opportunities we're seeing in the market today, we do expect to put new money to work at better yields than we had originally forecast. On the other hand, as Marc described, we prudently increased Athene's cash balance this quarter to provide an extra layer of stability amid heightened market volatility in March.

Normalizing for the benefit of LDTI, considering an improved deployment backlog with offsets from higher cash balances, we expect normalized SRE to slightly exceed $3 billion this year, with an estimated normalized net spread range of 150 to 155 basis points.

Let me spend a moment on capital allocation. We expect our free cash flow to be utilized to fund the base dividend, return incremental capital to shareholders through opportunistic buybacks and dividend increases, and to invest in strategic growth. In any given quarter or year, we determine how to best allocate capital based on its highest returning use.

We use the following framework in making this determination. For the dividend, we aim to generate a yield in line with or better than the S&P 500, which is currently yielding approximately 2% today versus our 2.8%. For opportunistic share repurchases, we target at least a high teens IRR over the medium term and that's signaling closer to 20% at current trading multiples. For strategic growth investments, we underwrite a target return equal to or better than opportunistic share repurchases with the potential for strategic upside benefits. And all of these HoldCo capital users are weighed against growing Athene. Even without using any third-party sidecar capital from ADIP, growing Athene is very compelling as it's generating an estimated low 20% pretax ROE today. This return profile is further enhanced with increasing utilization of ADIP.

In the first quarter specifically, we deployed $160 million of capital for opportunistic share repurchases, and our current orientation is to spend less on strategic investments given the large number of organic growth initiatives under development and the high bar in which we are using to consider these new opportunities. As we communicated last quarter, we expect to be a buyer of our stock on a more consistent basis as we move through our five-year plan.

In conclusion, our financial results in the first quarter have positioned us very well to execute on our strategic and financial goals for the year. We're busier than ever. We're highly focused on the significant opportunity in front of us.

And with that, I'll turn the call back to the operator for Q&A.

Operator
Thank you. The floor is now open for questions. If you would like to ask a question, please press star one on your telephone keypad at this time. A confirmation tone will indicate your line is in the question queue. You may press star two if you would like to remove your question from the queue. As a reminder, we're asking you to please limit yourself to one question and then requeue for any additional questions. Again, that is star one to register a question at this time.

Our first question today is coming from Alex Blostein of Goldman Sachs. Please go ahead.

Alex Blostein
Hi, good morning, everybody. Thank you for the question. So Marc, maybe we could start with the current environment. Apollo clearly built a really broad set of origination capabilities. We talked about that a bunch in the past, but the dislocation in the regional bank space is amplifying really the supply-demand in balance against what we see in the market. So given that backdrop, maybe spend a minute on areas you expect to be more active in. Among the existing platforms, are there any new asset classes in a way that you could further lean into? And then maybe talk a little bit about third-party fundraising that could get accelerated by what's going on in the credit space, call it, over the next 12 months. Thanks.

Marc Rowan
Okay. We are, as you know, broadly focused on scaling our private credit business. Our private credit business is different than most other private credit businesses in that the vast majority of it is fixed income replacement or private investment grade. This fits very well with the space that is currently in retrenchment by the banking system because the banking system historically was not a risk taker. They were an accommodation, top of the capital structure, senior secured. We, in fact, are top of the capital structure, senior secured, and floating rate.

If I step back, de-banking has already been happening across our country. Following Dodd-Frank, which essentially encouraged the development of bank replacement by investors, banks, we estimate are less than 20% of all debt capital in U.S. capital markets. Given what's happened in regional banking, I expect that to become more of an investor marketplace.

The way the U.S. banks today in the investment marketplace is indirectly through securitization. If you look at growth in CLO, growth in ABS, growth in other forms of securitization, you're seeing essentially how America banks today. Atlas, the Credit Suisse Securitized Products group, along with Redding Ridge, along with MidCap, along with the Wheels Donlen, and the other platforms we have built are all focused on this marketplace.

I would expect, Alex, that you will see a tremendous tick up in securitized product relative to traditional direct lending, and it's a space that I believe has a lot of white space and where we are incredibly well positioned. And I would expect in later quarters that we will see fundraising develop around this. Investors, particularly those who have essentially invested in the first round of private credit, are meaningfully underexposed to structured product and don't have great ways to have access to it. So I think this is actually a really interesting time for the platform and one in which we're well positioned.

Operator
Thank you. The next question is coming from Patrick Davitt of Autonomous. Please go ahead.

Patrick Davitt
Hey, thanks for the question. On that point, do you have any kind of updated thoughts on how much annual origination capacity you think will come online with Atlas? And through that lens, as we look to your doing more third-party insurance business, is there any risk that it will be harder for you to build that part of the business out as insurance companies might see Athene as too big a competitor? Thank you.

Marc Rowan
So Atlas -- it's hard to say on Atlas. Atlas had been a $70 billion book of business that I view as turning annually or every year and a half. At the time of acquisition, we purchased roughly a $40 billion book of business. And so I would expect you should see somewhere $30 billion, $40 billion of annual originations. We had, prior to Atlas, had originations running at close to $100 billion. As you know, our five-year target is $150 billion of annual originations, and I believe certainly with Atlas, but also with the growth of the platform and what's happening with banking generally, I would expect that we would exceed that $150 billion of annual originations well before the date that we had projected.

With respect to the competitive nature of our business, we really do honor this 25% of everything and 100% of nothing philosophy. Some of the people you would perceive as Athene's largest competitors are actually our partners in these origination platforms. Not only do we not want 100% of any transaction, we actually are prepared to share the means of origination with people who you would have sensibly viewed as our competitors.

If I step back and again think about our business, more than $500 billion of our approximately $600 billion of AUM is partner capital where we're essentially working with the marketplace. Yes, private equity and transaction-based businesses are somewhat zero-sum, someone wins and someone loses. But for the vast majority of business, if you are our competitor, either in asset management or insurance, and you want to build, for instance, a CLO business in competition with Apollo CLO business, not only will we give you equity, we'll give you warehouse, we'll warehouse collateral for you, we'll buy your liabilities, and we'll put you in business. If you want to start a broker-dealer in competition with our capital solutions business, we'll fund your broker-dealer.

We are simply not in competition with any one company. We are in a market where we are $440 billion of AUM, which sounds really large, but I assure you that the CEOs of the four big banks in the U.S. do not wake up every day wondering what the mighty Apollo is doing. We are fortunate to be really large, but at the same time, in a vast sea where we are not yet a relevant player.

Operator
Thank you. The next question is coming from Glenn Schorr of Evercore ISI. Please go ahead.

Glenn Schorr
Thanks very much. So I'm curious, you're in the business of capturing spread, obviously, but I'm curious if you think you benefited as much as you thought you'd benefit from this big move up in rates? And the flip side of that is, how are you thinking about what to do with the portfolios and your investment in

your deployment as the forward curve is now expecting some rate cuts along the way? Just curious on how you're pivoting as we might be pivoting on the rate side.

Marc Rowan
Okay. Thanks, Glenn, it's Marc. So first, rates in and of themselves do not fundamentally alter the shape of the business. They alter the attractiveness of the product, as I've said, because consumers prefer higher rates to lower rates. But in terms of our business model, our cost of funds pretty much adjust with the opportunities available in the marketplace, absent unusual events like in the first quarter, where we earned excess spread. So rate moves don't really affect spread in and of themselves.

We have had the luxury because we earned adequate spread on prior books of business of holding a large floating rate position. And I'll come back to this because it's important to know that. The floating rate position did exactly what it was supposed to do. It provided excess earnings during a period of low rates moving to higher rates. You should assume that we have maintained, but normalized, the floating rate position at Athene, reflecting the current market environment.

The important thing, I think, and you didn't ask the question, but I think it's important to understand our business. When we were building Athene, we built scale inorganically by buying books of business. When rates are low, buying blocks of business is actually just fine because the business that's on the books is generally has high guarantees in a low rate environment.

When you buy a block of business, it's generally outside or near the end of its surrender charge and market value adjustment period. And so you take a big risk doing inorganic deals, unless there's a huge differential between the rate environment and the guarantee and the policy. Spreads were so wide when we were building that business that we could actually afford to hedge that risk through floating rate.

What's happening today, we haven't done an inorganic deal in about three years. The cost of inorganic deals, given the competition in the marketplace exceeds meaningfully the cost of funds with newly issued, newly protected surrender charges and market value adjustments. What we are seeing today is the last desperate attempt of people in our industry trying to build scale.

Think about what's happening, all the concerns that investors have about surrenders and policyholder behavior, Someone who buys a block of business today, is buying generally old surrender charges, old market value adjustments that are burning off, and they're buying into a rate environment that is high where consumers have alternatives. So you would not expect to be able to hedge that block in a meaningful way.

And so I view this as kind of the interesting thing in our industry. I think it's going to be very hard to get to scale in this rate environment, absent a meaningful organic origination engine because you simply do not want to invest or put capital behind policies that are not protected by surrender charges, market value adjustments, or other contractual or economic incentives.

Operator
Thank you. The next question is coming from Rufus Hone of BMO Capital Markets. Please go ahead.

Rufus Hone
Great. Thanks very much. Good morning. I was hoping you could spend a moment on the ramp of AAA and maybe give us your thoughts on what you think the run rate inflows could be for that product around year end. And was also curious on Athene Altitude and the potential there for tax advantage products. Specifically, I suppose, what products can you house within one of these VA wrappers and what limitations are there? Because seems to me like a no-brainer to defer your taxes, if it's possible. Thank you.

Scott Kleinman
Sure. I'll start with the AAA question. So as I mentioned in my comments, we are really starting to hit the sweet spot of adding distribution partners to the AAA offering.

To your question of where this could be on a retail basis, we could be approaching $0.5 billion to $1 billion a quarter, I think, by the end of the year. Retail plus one of the surprises we found is that this is more attractive to certain institutional investors than we would have expected when we created the product and that, of course, is a little bit lumpier, but we're starting to see real progress on that.

So in due course we've said in the past, this could very well be Apollo's largest product. And I do really believe that over the next few years, this could be a product, $20 billion, $30-plus billion.

Marc Rowan
Maybe I'll hit Athene Altitude. So we've articulated previously, and I certainly have been quoted publicly stating that over the next five years, I expect that high net worth investors will be better than 50% allocated to alternatives. That always elicits certainly a look because it is not where the people are today. But I start with a definition of an alternative. To us, an alternative is nothing other than an alternative to publicly traded stocks and bonds. And I believe alternatives go from AA to equity. So when I say 50% allocated to alternatives, I do not believe they will be allocated to private equity or venture capital or risk, but to alternatives in the newer definition that I've suggested.

Today, you can buy from Apollo investment-grade only yield. You can buy total return, you can buy opportunistic credit, you can buy REIT, you can buy BDC, you can buy our credit strategies hedge fund, and you can buy AAA, all wrapped in an altitude annuity for an excess cost of 30 basis points with no further restrictions.

We, as an industry, are in the early stages of addressing the needs of high net worth and retail investors versus institutions. One of the key differences is institutions are not taxpayers. They generally are pension funds or endowments or other types of tax exempts so our industry has not historically been as tax sensitive. So if you think of the experience of a BDC investor in a high-tax state, an 8% dividend yield looks like 3.8% to the consumer. That's not as attractive as 7.7%.

But we are in an education phase and the whole growth of alternatives is about education. And retail investors and their financial advisers first need to understand the products. And they are getting an education in products, and we are doing our part and other firms in the industry are responsibly doing their part. This next layer of altitude and wrapping is yet another bit of education.

So we are selling this product today mostly to high net worth individuals and family offices, and this product will get increased amounts of traction as Martin or Scott in their remarks suggested. I believe we will have our first broad distribution of this at some point this year. And you should expect us, as new products come online, we will continue to build out the family of products under the altitude brand.

Operator
Thank you. The next question is coming from Michael Cyprys of Morgan Stanley. Please go ahead.

Michael Cyprys
Great. Thank you. Good morning. Just a question on the retirement services business. You mentioned an increase in cash balances, adding an extra layer of stability. How meaningful is that? And what do you see in the marketplace? And when you look at your outflow profile that's leading you to do that, we saw an 11% outflow rate in the quarter. So I guess the question there, how do you expect that to trend over the next couple of years and you mentioned a recapture of some older annuities coming up in the third quarter? What's the expectation to see more of those following Catalina that we saw last year?

Marc Rowan
So it's Marc. On a normalized basis, we hold about, $6 billion, $6.5 billion of cash. So this is about $6 billion of extra cash. For those of you I've seen in person or have attended a call with, I remember in the early days of the banking crisis, calling out to Jim Belardi and asking him to give me the benefit of some leeway. I was going to ask him to do something that had no justification other than feel, which was to massively increase our cash balances at the point of instability we were watching Credit Suisse and

Signature and SVB. And Jim did that. And ironically, it's positioned him to take advantage of wider spread. So in hindsight, I think it's been no harm no foul, and I would expect to see cash balances come down.

The question on outflows, I hope we answered better in terms of the table that we disclosed, but I'll come back to you and I'll speak philosophically first. When we construct a product, we put a lot of benefits into the product. We strip away the excess features that give rise to volatility that consumers really don't know how to value anyway and we put it into the price. And yet we create a very low cost of funds, and we've gone from a start-up to the largest provider and the largest market share in the U.S. market. That is no mean feat. But when a product comes out of surrender charge or its market value adjustment burns off, we take the product to its contractual minimum. We want the product to surrender because we cannot invest and earn spread against a product that is redeemable at any point in time.

This is true across the industry. It is not just us who follows this as a point in time. And recall, policies generally do not leave the industry, they recycle because otherwise, people suffer tax consequences, and this is a retirement product, this is not a demand deposit.

What's happening to us, and we are seeing the benefit of is we were a zero market share, and now we're the largest market share. We are the benefit of this recycling at a point in time in the industry when rates are higher, and therefore, consumers are more interested in annuities. And the whole industry is up, we're just up more than about anyone else.

So I come back to the specifics now in how surrenders work. The maturity cycle of contractual-based outflows will go up and down based on the business that we see three, five, seven years ago. We can tell you pretty much quarter-by-quarter, and Athene will do that in their deep dive, what's the contractual maturity driven outcomes will be. In some quarters, it will be up, but some quarters it will be down. You can actually look back to this quarter, that maturity driven was 3%. Q3 in 2022, it was 5.7%. You should expect to see a lot of volatility in that line based on business done three, five, and seven years ago.

Income policyholder driven outflows, the three categories, for income-oriented withdrawals, you should see this as a steady amount of money that goes out based on the age of policyholder and their proclivity or need or legal requirement to take income. This is also planned.

The next line is from policies out of surrender charge. This is also planned. This gets to the point I just made. We take contractual minimums on policies that burn off their surrender charges to as low as we possibly can, we want these people to surrender. This is a relatively small amount because the vast majority of policyholders surrender at maturity. 10% approximately of the people forget they have a policy, and some point in the future, they wake up and discover they have a policy that's out of surrender charge. And so this number, you can see bumps around back and forth. It's neither high nor low. It's a relatively small number.

The thing that we watch pretty closely because it is the basis of our business, we look at policies and surrender charges. These are, to some extent, unplanned. These are what I would call life issues. This is health issues, death, divorce, or other change in life circumstances. We generally don't see changes in these kinds of surrenders as a result of interest rates or financial markets activity. And if you go back and you look in time, this quarter, unexceptional. And you should expect and we budget that number to be kind of unexceptional on a go-forward basis.

So again, I step back and I look at this industry, and it's not the first time we've done this. This industry has been resilient over a really long period of time. You go back to the financial crisis and you think about how central AIG was to the in the financial crisis in 2008, really no move. You think about Genworth, who also had its troubles in the financial crisis, also no move. I don't see anything really going on here that changes the way I think about the business. And I think we will do the best job we possibly can to give you a prediction of outflows. And the primary thing that varies is maturity driven contractual-based outflows quarter-by-quarter.

Operator
Thank you. The next question is coming from Michael Brown of KBW. Please go ahead.

Michael Brown
Great. Thank you very much. So Marc, capital solutions has been running north of $120 million or so for the last three quarters. It seems like it's playing a more important role in the broader business here. Could you just expand a little bit more about what's driving on that growth here in this still very challenging backdrop? And is there potential to actually hit your $500 million target before 2026? It seems like you're certainly trending that way.

Scott Kleinman
Yes, I'll answer that. Look, it's exactly what we broadcast over the last year, year plus. As we've continued to scale that ACS business, right, it's about inputs and outputs. We've continued to grow the number of origination platforms, the number of products flowing into that, combined with, as we've scaled the ACS business and the number of syndicators we have, we touch more clients, more market participants, and so it's not surprising, we're seeing the steady progression.

As Marc alluded to, particularly on the credit side, we really do want to own 100% of nothing. And so by definition, that continues to feed our ACS platform. So directionally, this is heading exactly the way we would have predicted. To your point about hitting that target early, it's certainly possible that I think that five-year plan was a little bit conservative.

Operator

Thank you. The next question is coming from Craig Siegenthaler of Bank of America. Please go ahead.

Craig Siegenthaler

Thanks. Good morning, everyone. I wanted to better understand the quarterly valuation process for the equity stakes of your credit origination vehicles that are held in AAA, and then for the AAA stake that's held in the alts bucket of Athene. And my question really is it's driven by the fact that Athene no longer holds the equity stakes directly because it was swapped for AAA a couple of quarters ago.

Marc Rowan

So I'll do a start, and then I'll turn it over to Martin. It's Marc. So the valuation process, whether it was on Athene's balance sheet or in AAA hasn't changed and makes no difference. The vast majority of the origination vehicles are held or valued on a basis of book value and ROE. And as you would imagine, in this environment, they are on the margin moving up. But there's not a tremendous amount of volatility because these are, for the most part, book value-based entities that track how they're doing in ROEs, and ROEs have been very stable over a long period of time. And Martin --

Martin Kelly

I would just add, the only difference between the valuation in the alternatives portfolio, which was 6% for the quarter and what AAA shows is just due to certain positions that are not in AAA. But they can't be for various reasons. But otherwise --

Marc Rowan

Think of Athora or Catalina, other insurance companies can't be for regulatory and other reasons in AAA. And those positions are held out. Otherwise, 100% of the alternatives portfolio is, in fact, in AAA.

Martin Kelly

Yeah. So there's no difference in any way between the valuation methods. And then within the alts portfolio for the quarter, connecting back to the comments Marc made on the platforms, the platform has generated close to 10% return within that 6% for the quarter. So the origination business is healthy and high ROEs are translating into upward marks in that portfolio.

Operator

Thank you. The next question is coming from Brian Bedell of Deutsche Bank. Please go ahead.

Brian Bedell
Great. Thanks. Good morning, folks. Marc, if I can come back to a response you had to a question earlier on growth in securitized product and maybe just to compare it with direct lending. To the extent, obviously, if we get a substantial pullback over the medium and long term from the banking system, especially regional banks, can you talk about that opportunity in direct lending, but then obviously, contrast it with your sort of optimism on securitized product? And is that going to sort of take some of the share from direct lending? Or do you see them both growing pretty substantially? And your participation, obviously, in both?

Marc Rowan
Look, I'll start at the top of the ecosystem. I'll invite Scott to add as we go. So I start at the top of the ecosystem, the U.S. economy needs credit, consumers, and businesses as a result of GDP and GDP growth. How that credit is provided has been in a secular change, particularly since Dodd-Frank, with more of that credit coming from investors who are the new banks versus from the banking system, government guarantee, government-backed deposit insured banks. So as a general matter, investors are supplying more credit relative to the banking system.

Then we have this growth of something we call private credit, but those are two words that don't really mean anything. They just sound like they mean something because private credit can be AA or private credit can be highly risky CCC. For the most part, popular press has taken private credit to mean levered lending, which is below investment grade, which is a relatively small part of the private credit ecosystem. Yet, when investors talk about private credit and their allocation to private credit, and they sometimes use the term direct lending, almost all of that is focused on the below investment grade levered lending or direct lending. And people also think about lending in corporate format because that is the most familiar, the most common way people think about it.

For our ecosystem, we love the direct lending, below investment-grade levered lending business sometimes. Right now, we happen to love it. There's not a lot of providers. Funds are still needed. We can make commitments underwriting in a negative mindset, we can earn wide spreads, and there's a shortage of capital so we have good deal selection. Now is a good entry point to below investment grade, levered lending, private credit direct lending, however you define it.

The point I was making is when you look at the macro of how the country is now banking in the investor marketplace, it doesn't bank primarily by selling loans in direct form to investors. It banks indirectly through securitization. When you look at the growth in ABS, when you look at the growth in other forms of structured product, that is now how America banks. And if you go to our website and you actually look at performance, not just put out by us, but put out by others, you would see that a fair read of all of the information available is that if you look at an investment-grade corporate bond today versus an investment-grade securitized product, you would conclude that the same ratings point, the investment-grade securitized product is a better credit, which just makes sense. Because what we've seen in the economy taking place is a significant pickup in the pace of technological change, consumer change, societal change, cultural change. And therefore, we've had more single points of failure in single investment-grade corporate issues, think SVB, think Credit Suisse, versus what securitization gives you, which is the benefit of diversification, which now has more value than ever. And it's not just Apollo saying this. This is almost everyone who has looked at the topic in an academic sense.

So investors are, for the most part, exposed to private credit and direct lending and corporate format in below investment grade. They are at the early stages of fixed income replacement, of taking their IG portfolio and rotating it into something that offers them at the same ratings point, 200 to 300 basis points more. Insurance companies, others have been doing this for a really long time. And I believe that investors will also enter this market in a big way. And therefore, I think there's a lot of running room in the securitized marketplace. But once again, make a distinction between investment grade, which is a vast large market and below investment grade, which is an opportunistic, still really interesting market, sometimes.

Scott Kleinman
Yeah. I would just add, as you look back and think about the evolution of the direct lending or private credit market over the last decade, that's really been a single name issuer level, mostly at the sub-investment grade, as we've certainly been doing over the last several years at the IG replacement level. We look at the asset-backed opportunity and see similar type of evolution over the next five to ten years. It's certainly what we've been doing with our own balance sheet for the last many years. That's been a key driver of the excess spread that we've been able to deliver.

But ultimately, we think the rest of the market is waking up to this and will be just a huge, massive market opportunity. The difference being, you really do need the specialized origination, the specialized underwriting to really be able to be in that market, and that's just a huge benefit that we have that we've worked so hard to build over the last five, seven, ten years.

Operator
Thank you. The next question is coming from Finian O'Shea of Wells Fargo. Please go ahead.

Finian O'Shea
Hi, everyone. Good morning. Higher-level question on private investment grade. As you produce alpha there and now share that benefit between the asset manager, the annuity policyholder, and outside

owners of origination, for example, in AAA, do you see attention on claims to that excess return? And is there enough to go around in a more normal market environment? Thank you.

Marc Rowan
So it's Marc. The short answer is no. But I have said previously the capacity to produce excess spread or more broadly, excess return per unit of risk, is the limiter of growth in our business. In alternatives, if we are true to what we're doing, we only exist to provide this excess return per unit of risk. Otherwise, investors should be public and shouldn't live with any liquidity restrictions. So it is our job to grow it and not try to grow our AUM any faster than we have excess spread per unit of risk. So far, we have been good at balancing that. But we look at this all the time. This is ultimately the cap, if you will, on an intelligent way to grow a long-term alternatives franchise that meets investors' needs.

Scott Kleinman
To address though the three categories you highlighted, right, the underlying annuity holder gets the underlying rate plus some amount of excess that allows Athene's products to be attractive. Athene captures the excess spread inherent in our origination machine to be able to do that and AAA captures the return on the platform for being a creator of this attractive product. So it's actually quite a pretty logical split as to how that waterfall works.

Operator
Thank you. The next question is coming from Ben Budish of Barclays. Please go ahead.

Ben Budish
Hi, there. Thanks so much for taking the question. I wanted to ask about the private equity franchise. I know you indicated that you expect to close Fund X this summer. And looking at the last several funds, you probably won't be back in the market for some time. But just a high-level question on how you think about scaling in that business. What are the sort of natural limits to a private equity drawdown fund? And then again, understanding that the scaling in your business is tending a couple of other places, but just curious about how we should think about the kind of forward trajectory in terms of the next several funds in that business.

Scott Kleinman
Yes, sure. So in our core private equity business, we think we're operating at the right size. A $20 billion to $25 billion footprint gives us all the capacity we need to execute on the type of transactions that we think are most attractive. A, it puts us among the largest pools of capital out there in the private equity business. And certainly, the types of opportunistic public to privates, the scale, stressed or distressed opportunities should they arise, that's the right size of capital, meaningfully larger and perhaps it's

possible. But right now, our capacity is sized, our execution capacity is sized to that level. And certainly, the corporate environment, that really does feel like the right size.

As we think about scaling, right, it obviously will come from other ancillary and related businesses. So whether it's our S3 business, our infrastructure business, our hybrid value business, just to name a few, these are platforms that are still in the maturing phases of their scale and footprint. And we do ultimately see those reaching the next stages in the coming years. But for core private equity, we think we're sitting at that sweet spot in the $20 billion size platform.

Operator
Thank you. The next question is coming from Adam Beatty of UBS. Please go ahead.

Adam Beatty
Thank you, and good morning. Wanted to ask about the pension group annuities channel for Athene. It sounds like you've got a healthy pipeline coming up there. Just wanted to get your thoughts on the impact of higher rates and maybe economic uncertainty on the level of demand and activity there? And then just how you view the attractiveness of that channel relative to other opportunities? Thank you.

Marc Rowan
So it's Marc. So with higher rates for the most part, corporates who are the primary people who execute pension group annuity transactions, find this more attractive because they simply have to contribute less to close a gap if there is a gap in the underlying. Now I wish the equation were just that simple. But of course, it depends how they were positioned. Because if they were positioned in long-duration bonds and rates go up, their gap gets wider. If they were positioned in equities and equities sell off, their gap gets wider.

But for the most part, corporations considering pension group annuities, have been guiding towards a strategy that gets them to a more market neutral place, think shorter duration fixed income, less esoteric in the equity business. And so the benefit of higher rates is for this business overall a net positive.

This is a trust business that comes from having lots of capital, by having an institutional capability to pass independent fiduciaries, and by having the know-how to do and onboard 100,000 clients at a time. There is a handful of companies in our industry who have met all those requirements. It is a competitive, but less competitive market than the origination business, which itself is significantly less competitive than the inorganic buying of blocks business, which I've already given you my comments on, which I think is in its final throes.

So I for one, I'm excited about pension group annuities. I think the team at Athene is second to none and the pipeline is as it should be.

Operator

Thank you. That concludes the Q&A portion of today's call. I will now return the floor to Noah Gunn for any additional or closing comments.

Noah Gunn

Great. Thanks for your help this morning, Donna, and thanks to everyone for joining our call. If you have any questions or feedback on our call today, feel free to reach out to us directly, and we look forward to speaking with you all again next quarter.

Operator

Ladies and gentlemen, thank you for your participation. This concludes today's event. You may disconnect your lines at this time or log off the webcast and enjoy rest of your day.