

Apollo Global Management

A rise in both annuity surrenders & OTTIs could weigh on future EPS revisions

Maintain Rating: NEUTRAL | PO: 72.00 USD | Price: 62.69 USD

Expect annuity surrenders to increase in 2Q23 (not 1Q23)

While recent commentary from Apollo Global Management's (APO) leadership team and LIMRA data lead us to believe that annuity surrenders didn't pick up in 1Q23, we believe the backdrop has changed significantly since early March and we now expect surrenders to rise in 2Q23 and 3Q23. We believe the macro setup is a near perfect storm for annuity surrenders, as interest rates rose significantly over the last year (widening the spread between new annuities and older vintages) and now the markets are looking for an interest rate plateau followed by declines in 2H23-2024 (driving a desire to "lock-in high rates"). Accordingly, we think it's an ideal moment for investors to "sort" their annuities via a tax free 1030 exchange and pick up 2-3% of annual yield while their brokers can pocket a 5% commission.

Rise in surrenders increases Athene's liability costs

We believe a pick-up in surrenders would essentially shrink the duration of Athene's liability base relative to its assets, which would likely cause Athene to increase its originations (rather than shrink the balance sheet). New annuities could come in with a cost of 5%, which is about 2-3% higher than Athene's existing liabilities. This would then weigh on APO's SRE trajectory and retirement services spread. On page 24 of its earnings release, APO disclosed that surrenders were stable in 4Q22 at 10% which was in-line with 2022. We will be focused on this data point over the next few quarters.

Estimate downside to SRE expectations

Unlike most Alt managers which are experiencing negative earnings growth in 2023 due to lower performance fees, transaction fees and investment income in addition to softer fundraising, APO's profits are exhibiting defensive qualities through its stable organic growth from its insurance channel while it has benefited from net asset sensitivity from higher rates. However, if annuity surrenders pick up, this could lead to lower interest rate sensitivity going forward because liability costs rise at a faster pace than asset yields. We note that SRE garners a lower valuation from the markets due to its capital intensity with a majority of this earnings stream remaining inside of Athene's regulated insurance entities to support future growth. Despite our view that there could be downside to EPS estimates due to an increase in surrenders and OTTIs, our price objective implies a 15% 12-month return, which supports our Neutral rating on the stock within our bullish long-term stance for the alternative asset manager industry.

Estimates (Dec) (US\$)	2021A	2022A	2023E	2024E	2025E
EPS	4.55	5.22	5.87	6.94	7.93
EPS Change (YoY)	125.2%	14.7%	12.5%	18.2%	14.3%
DPS	1.90	1.60	1.72	1.72	1.72
Valuation (Dec)					
P/E	13.8x	12.0x	10.7x	9.0x	7.9x
GAAP P/E	13.8x	12.0x	10.7x	9.0x	7.9x
Dividend Yield	3.0%	2.6%	2.7%	2.7%	2.7%

28 April 2023

Equity

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Stock Data

Price	62.69 USD
Price Objective	72.00 USD
Date Established	4-Apr-2023
Investment Opinion	B-2-8
52-Week Range	45.62 USD -74.63 USD
Mkt Val / Shares Out (mn)	37,637 USD / 600.4
Average Daily Value	159.36 USD
BofA Ticker / Exchange	APO / NYS
Bloomberg / Reuters	APO US / APO.N
ROE (2023E)	60.0%
ESGMeter™	Medium

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Glossary

SRE: Spread related earnings
MVA: Market value adjustment
OTTIs: Other than temporary impairments
RBC: Risk-based capital

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Refer to important disclosures on page 7 to 9. Analyst Certification on page 5. Price Objective Basis/Risk on page 5.

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Timestamp: 28 April 2023 07:46AM EDT

iQprofileSM Apollo Global Management

Economic Income (Dec)	2021A	2022A	2023E	2024E	2025E
(US\$ Millions)					
Management fees	1,878	2,135	2,566	3,001	3,312
Other fees	355	485	494	583	600
Total fee-related revenue	2,233	2,620	3,060	3,584	3,912
Performance fees	1,589	595	812	1,524	2,041
Total revenue	4,260	3,545	3,954	5,197	6,048
Base compensation expense	(653)	(754)	(829)	(895)	(967)
Non-compensation expense	(242)	(456)	(563)	(600)	(666)
Total fee-related expenses	(896)	(1,210)	(1,392)	(1,495)	(1,633)
Performance fee compensation	(876)	(585)	(563)	(1,032)	(1,388)
Total expenses	(1,984)	(6,610)	(7,854)	(9,326)	(11,034)
Total fee-related earnings	1,267	1,410	1,668	2,089	2,280
Distributable earnings	2,374	4,021	4,393	5,184	5,922
Taxes	(173)	(764)	(791)	(933)	(1,066)
After tax distributable earnings	2,032	3,135	3,517	4,156	4,750
Distributable earnings per share	4.55	5.22	5.87	6.94	7.93
Distribution per share	1.90	1.60	1.72	1.72	1.72

Assets Under Management

Assets under Management - EOP	497,552	547,647	655,233	752,291	845,579
Fee Paying AUM	369,101	412,087	499,150	552,990	602,797

Company Sector

Asset Management

Company Description

Apollo is one of the largest alternative asset managers in the world and offers investment solutions for institutions and individual investors across the risk-return spectrum in yield, hybrid and equity. Apollo has offices worldwide and is headquartered in New York. Apollo was founded in 1990 and publicly listed on the NYSE in 2011.

Investment Rationale

While we estimate significant earnings growth potential for APO, we believe that its valuation will be weighed down by its high mix of insurance earnings (approximately 60% after including the ATH investment management agreement) even after applying a premium relative to the public life insurance comps. While we forecast a positive return for APO shareholders, we assign a Neutral rating given other higher-growth Alt peers.

Quarterly Earnings Estimates

	2022	2023
Q1	1.52A	1.46E
Q2	0.94A	1.47E
Q3	1.33A	1.46E
Q4	1.42A	1.48E

Additional Details

Exhibit 1: Investment-grade bond yield curve

It's a perfect time for annuity holders to surrender given the impending interest rate declines



Source: Bloomberg

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Risk 2: OTTI could increase in parallel with surrenders

Investors could monitor a deterioration to both the asset and liability side of Athene's balance sheet in parallel over the next year. While 95% of Athene's portfolio is rated investment grade, Athene is overweight structured credit, real estate debt and private corporate loans. Its portfolio also has not been stress tested before in a real economic recession (2020 was too short). Additionally, Athene now owns a stake in AAA in its Alts bucket, which owns the equity (first loss tranche) of its credit origination vehicles including Wheels Donlen, Redding Ridge, NNN Lease, MidCap, Foundation Home Loans, PK AirFinance and Acqua Finance. We believe an OTTI curve will form with realized losses rising q/q over the next year, which should rise in parallel with the US banking industry net charge-offs and the OTTI of the life insurance industry. While Athene has more than \$2B of excess capital above its RBC thresholds, we believe it needs to hold this excess to support its ratings given its unique portfolio allocations (private/structured credit overweights).

Sizing the surrender risk inside of Athene

Athene has \$29B of annuities with no surrender charges and no MVA. We estimate about 1/3rd of the \$29B are fixed annuities with an average yield around 2.5%, which is 2-3% below the new money yields offered by annuities today. We estimate 2/3rds of Athene's annuity book are fixed index annuities (FIAs), which also have lower yields than the new products offered today (while owners also rely on equity market appreciation for their total returns). Here are three new takeaways from recent channel checks with insurance brokers, insurance product gatekeepers at wirehouses and insurance actuaries.

- We don't think annuities with only a surrender charge or a surrender charge plus a MVAs (essentially a double surrender charge) will see a large increase in lapses even in the cases where its financially attractive to surrender. This is due to: (a) psychological issue with paying surrenders; (b) restrictive broker compliance departments which make churning and surrender charge lapses



more complicated (especially post the 2016 Department of Labor Fiduciary Rule).

- FIAs may exhibit lower increases in surrenders (vs. FAs) as the annuity holder of the FIA is more focused on total appreciation, which can be driven by the FIAs upside participation in equity markets vs. fixed annuities singular focus on its guaranteed yield.
- We believe some of the \$29B of annuities are detached from their broker so there might not be any external motivation to encourage a “lost” retail investor to surrender and seek a higher yield.

Fixed annuity sales have increased significantly in 2023 so we know the industry is focused on the higher yields. However, surrenders have not started to increase yet as interest rates were not expected to plateau until early March when 3 banks collapsed driving future interest rate expectations lower. Specifically, 6+ months ago the markets were expecting significant interest rate increases, which we think kept surrenders muted. More recently, expectations for rate increases collapsed with the US regional bank failures. We think now is an ideal time for annuity holders to surrender given the expectation for Fed rate cuts in 2H23-2024.

Exhibit 2: Details on Athene’s surrender charges from the 4Q22 statistical supplement

\$29B of annuities have no surrender charges or MVAs

Surrender Charges of deferred annuities net account value	Surrender Charges (gross \$M)	Percent of total
No Surrender Charges	28,643	23.8%
0.0% < 2.0%	1,765	1.5%
2.0% < 4.0%	5,906	4.9%
4.0% < 6.0%	12,483	10.4%
6.0% or greater	71,696	59.5%
	120,493	100.0%

Source: Company data, BofA Global Research

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Price objective basis & risk

Apollo Global Management (APO)

Our \$72 price objective for Apollo is derived from a 10x multiple on APO's adjusted 25E cash earnings. We estimate APO will continue to trade below the industry mean (7-25x) given its high mix of insurance earnings.

Upside risks are S&P 500 index addition (estimate 2023), inorganic growth announcements for Athene, rate sensitivity of Athene's variable rate assets, and defensive organic growth.

Downside risks are credit risk at Athene and a pick-up in annuity surrenders with higher long-term interest rates.

Analyst Certification

I, Craig Siegenthaler, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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BUY				
	Ameriprise Financial	AMP	AMP US	Craig Siegenthaler, CFA
	Ares Management Corp	ARES	ARES US	Craig Siegenthaler, CFA
	BlackRock, Inc.	BLK	BLK US	Craig Siegenthaler, CFA
	Blackstone	BX	BX US	Craig Siegenthaler, CFA
	Blue Owl Capital	OWL	OWL US	Craig Siegenthaler, CFA
	Interactive Brokers	IBKR	IBKR US	Craig Siegenthaler, CFA
	Intercontinental Exchange	ICE	ICE US	Craig Siegenthaler, CFA
	KKR & Co. Inc.	KKR	KKR US	Craig Siegenthaler, CFA
	TPG Inc	TPG	TPG US	Craig Siegenthaler, CFA
	Tradeweb Markets Inc.	TW	TW US	Craig Siegenthaler, CFA
	Victory Capital Holdings, Inc.	VCTR	VCTR US	Craig Siegenthaler, CFA



US - Brokers, Asset Managers, & Exchanges Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
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	AllianceBernstein	AB	AB US	Craig Siegenthaler, CFA
	Apollo Global Management	APO	APO US	Craig Siegenthaler, CFA
	Invesco	IVZ	IVZ US	Craig Siegenthaler, CFA
	Janus Henderson Group	JHG	JHG US	Craig Siegenthaler, CFA
	Janus Henderson Group	JUHDY	JHG AU	Craig Siegenthaler, CFA
	LPL Financial Holdings	LPLA	LPLA US	Craig Siegenthaler, CFA
	Patria	PAX	PAX US	Craig Siegenthaler, CFA
UNDERPERFORM	Charles Schwab Corp.	SCHW	SCHW US	Craig Siegenthaler, CFA
	CME Group Inc	CME	CME US	Craig Siegenthaler, CFA
	Franklin Resources	BEN	BEN US	Craig Siegenthaler, CFA
	Nasdaq	NDAQ	NDAQ US	Craig Siegenthaler, CFA
	Robinhood Markets	HOOD	HOOD US	Craig Siegenthaler, CFA
	T. Rowe Price	TROW	TROW US	Craig Siegenthaler, CFA
	The Carlyle Group	CG	CG US	Craig Siegenthaler, CFA
RSTR	Focus Financial Partners	FOCS	FOCS US	Craig Siegenthaler, CFA

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Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Return On Equity	Net Income	Amortization
Operating Margin	Operating Profit	Shareholders' Equity
Earnings Growth	Expected 5 Year CAGR From Latest Actual	Sales
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
		N/A
Quality of Earnings	Numerator	Denominator
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt – Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit	Numerator	Denominator
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap = Current Share Price × Current Basic Shares
Enterprise Value / Sales	EV = Current Share Price × Current Shares + Minority Equity + Net Debt + Other LT Liabilities	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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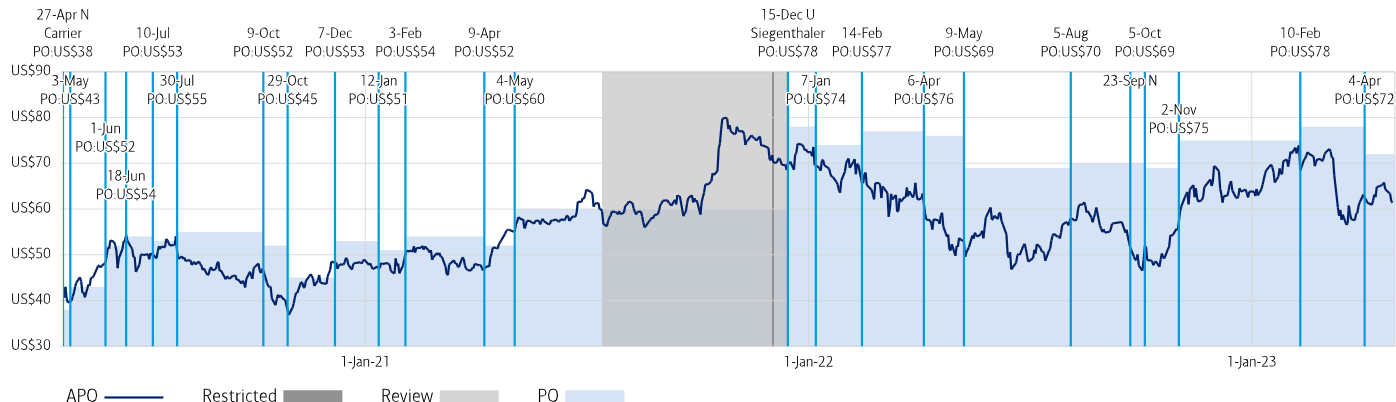
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Apollo (APO) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

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Equity Investment Rating Distribution: Financial Services Group (as of 31 Mar 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	152	52.41%	Buy	92	60.53%
Hold	73	25.17%	Hold	44	60.27%
Sell	65	22.41%	Sell	41	63.08%

Equity Investment Rating Distribution: Global Group (as of 31 Mar 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1869	53.01%	Buy	1030	55.11%
Hold	827	23.45%	Hold	476	57.56%
Sell	830	23.54%	Sell	389	46.87%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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