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Virtus Investment Partners, Inc. (VRTS)

Q2 2026 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Jacinda, and I will be your conference operator today. I would like to welcome everyone to the Virtus Investment Partners Quarterly Conference Call. The slide presentation for this call is available on the Investor Relations section of the Virtus website at www.virtus.com. This call is being recorded and will be available for replay on the Virtus website. At this time, all participants are in a listen-only mode. After the speakers' remarks, there will be a question-and-answer period, and instructions will follow at that time.

I will now turn the conference to your host, Sean Rourke.

Sean P. Rourke

Vice President-Investor Relations, Virtus Investment Partners, Inc.

Thanks, Jacinda, and good morning, everyone. Welcome to Virtus Investment Partners discussion of our second quarter 2016 financial and operating results. Joining me today are George Aylward, our President and CEO; and Mike Angerthal, our Chief Financial Officer. After their prepared remarks, we will open the call for questions. Before we begin, I'll refer you to the disclosures on slide 2. Today's comments may include forward-looking statements, which involve risks and uncertainties described in our news release and SEC filings. Actual results may differ materially. We will also reference certain non-GAAP financial measures. Reconciliations to the most directly comparable GAAP measures are available in today's news release and financial supplement on our website.

Now, I'd like to turn the call over to George. George?

George Robert Aylward

President, Chief Executive Officer & Director, Virtus Investment Partners, Inc.

Thank you, Sean. And good morning, everyone. I will start with an overview of the results we reported this morning, and then Mike will provide more detail. While our results continue to reflect the challenging environment for quality-oriented equity strategies, there were several positive underlying trends during the quarter, which included; a meaningful improvement in total net flows, over $1 billion of positive net flows, excluding the quality equity strategies; our strongest quarter of institutional sales in net flows in nearly three years; positive net flows in alternatives, fixed income and multi-asset strategies; higher sales across multiple products,including institutional, wealth management and ETFs; and continued return of capital to shareholders while reducing debt.

We also continued to broaden our product offerings in areas where we see attractive growth opportunities. During the quarter, we introduced new, actively managed ETFs from Duff & Phelps and Silvant, further expanding our ETF platform, and providing clients with differentiated investment solutions. ETFs have continued to generate positive net flows, and for perspective, our ETF business has grown significantly from just $1 billion five years ago, and generated $2 billion of net flows in the past year alone. We remain focused on expanding our capabilities and product offerings in ETFs and other areas where we see growing client demand and attractive opportunities for long term growth.

Turning to investment performance, outside of quality equity, our performance remains strong across periods. Fixed income and alternative strategies have had consistently strong performance with 80% and 67%, respectively, beating benchmarks for the three-year period, over the longer 10-year period, 73% of our fixed income and 67% of alternative strategies beat their benchmarks. Our equity investment performance reflects our overweight to quality-oriented equity strategies. These strategies have had the opportunity to demonstrate strong performance in more constructive markets, which have been absent for the past two years. However, we have seen indications of the impact of such opportunities, for example, in the most recent period since late June. While it's still early in the quarter, in a very short timeframe, nearly every quality strategy has been outperforming its benchmarks quarter-to-date and some meaningfully so.

The improvement has coincided with a broadening market environment that is more supportive of fundamentally-driven active security selection and is consistent with the type of market in which these strategies have historically performed well. Again, with such a short period, it is difficult to draw a conclusion on the cycle, but it does demonstrate the opportunity when it does change. Looking at our second quarter results, assets under management were $152 billion at June 30, up from $149 billion, primarily due to market performance. Total sales increased 5% to $6.1 billion, with higher sales of institutional, wealth management and ETFs. For institutional and wealth management, it was our highest level of sales in several years. Total net outflows improved to $5.6 billion from $8.4 billion due to both higher sales and lower redemptions. By product, net flows improved sequentially for institutional, intermediary sold retail separate accounts, ETFs and wealth management.

Looking at flows across asset classes and consistent with prior quarters, the net outflows reflected the continued style headwind for quality-oriented strategies. Outside of those strategies, positive net flows were broad-based across managers spanning fixed income, alternatives, multi-asset and equity strategies that do not have the quality orientation. In terms of what we've seen in July, US retail fund sales and net flows are tracking more favorably than in each month of the second quarter, and ETF net flows continue at a similar pace. On the institutional side, while known redemptions do exceed known wins, the sales pipeline is stronger than it has been in a year and is diversified across five managers and six strategies. In addition, we anticipate issuing a new CLO later this year.

Turning now to our financial results, earnings per share and the operating margin each increased sequentially due to the impact of prior quarter seasonal expenses, offset partially by a discrete non-cash expense item related to previously issued investment professional stock awards. The operating margin was 26.1%, up from 24%, and excluding the discrete item, was 28.2%. Earnings per share as suggested of $5.54 increased from $5.38, and were $5.97 excluding the discrete item. In terms of our balance sheet and capital, we ended the quarter with cash and equivalents of $176 million, seed, CLO and other investments of $273 million and $220 million of undrawn capacity on our revolving credit facility. During the quarter, we repurchased approximately 70,000 shares for $10 million and paid our quarterly dividend. We continue to have financial flexibility to balance our capital priorities of investing in the business, returning capital to shareholders and maintaining appropriate leverage.

With that, I'll turn the call over to Mike to provide more detail on the results. Mike?

Michael A. Angerthal

Executive Vice President & Chief Financial Officer, Virtus Investment Partners, Inc.

Thank you, George. Good to be with you all this morning. Starting with our results on slide 7, assets under management. Our total assets under management at June 30 were $152.2 billion, up 2%, primarily due to market performance, and average assets were $153.3 billion, down 3% sequentially. Our AUM is well diversified across products and asset classes. By product, institutional accounts were 33% of AUM, US retail funds represented 27%, and retail separate accounts, including wealth management, represented 24%. The remaining 16% consisted of closed end and tender offer funds, ETFs and global funds.

Within open-end funds, ETF AUM increased to $5.8 billion, up $0.4 billion sequentially, reflecting continued positive net flows, and up 58% year-over-year. By asset class, fixed income represented nearly 27% of AUM, with offerings diversified across duration, credit quality and geography. Alternatives and multi-asset together represented over 28% of AUM, up from 21% a year ago, and included positive net flows in alternatives and the addition of Keystone in the first quarter. We also have broad representation across domestic and international equities, including mid, small and large-cap strategies.

Turning to slide 8, asset flows. Total sales increased 5% to $6.1 billion, up from $5.8 billion in the first quarter, with higher sales in institutional, wealth management and ETFs. Reviewing by product, institutional sales increased to $2.2 billion from $1.2 billion, with higher sales in alternatives, equities and fixed income, and included a large global-listed real estate inflow. This was the highest level of institutional sales in three years. Retail separate account sales of $1.2 billion declined from $1.4 billion in the first quarter, as higher wealth management sales were more than offset by lower intermediary sold.

Wealth management sales were at their highest level since the fourth quarter of 2023. Open-end fund sales declined 14% to $2.6 billion, as higher ETF sales were more than offset by lower US retail and global funds. Total net outflows improved to $5.6 billion from $8.4 billion last quarter. By product, institutional net outflows of $0.7 billion improved meaningfully from $3.2 billion last quarter, driven by both higher sales and lower redemptions, and represented our best quarter of institutional flows in nearly three years. The majority of the redemptions continued to be concentrated in quality-oriented equity strategies.

Retail separate account net outflows of $3.1 billion improved from $3.9 billion last quarter, with the outflows driven by intermediary sold quality-oriented equities. Wealth management net flows were positive. Open-end net outflows of $1.8 billion compared with $1.3 billion last quarter, and included positive net flows in fixed income. Within open-end funds, ETFs continued to grow, generating $0.3 billion of positive net flows and sustaining a strong double-digit organic growth rate. For closed-end funds and tender offer funds, we reported essentially breakeven net flows.

Turning to slide 9, investment management fees as adjusted were $164.8 million, up 1% as a higher average fee rate was partially offset by lower average assets. The average fee rate of 43.1 basis points, up from 41.9 basis points last quarter and included approximately 1.2 basis points of incentive fees. For modeling purposes, the second quarter fee rate is reasonable. And as always, the fee rate will vary with market levels and asset mix.

Slide 10 shows the five quarter trend in employment expenses. Total employment expenses as adjusted of $102.1 million declined 4% sequentially, reflecting the impact of prior quarter seasonal items, partially offset by a full quarter of expenses of a new manager and a $3.8 million discrete expense item. This non-recurring item consisted of a non-cash expense related to multiple annual investment professional stock-based awards that were fully expensed primarily due to required acceleration upon achievement of employee retirement eligibility in the quarter.

These multi-year performance-based awards will fluctuate over the measurement periods, and are currently marked at the maximum level of the awards performance range. As a percentage of revenue, employment expenses were 55.6% or 53.5%, excluding the discrete item, essentially in line with our outlook. For modeling purposes, 54% is a reasonable level for the third quarter. As always, results will vary with flows and market performance.

Turning to slide 11, other operating expenses as adjusted were $31.9 million, and included the annual equity grant to the board of directors of $0.7 million. Excluding the grant, the modest increase in other operating expenses reflected the full quarter impact of a new manager. I would note that even with that addition, other operating expenses declined modestly compared with the prior year period. For modeling purposes, a quarterly range of $30 million to $32 million is reasonable going forward.

Slide 12 illustrates the trend in earnings. Operating income as adjusted of $47.9 million increased from $43.8 million due to prior quarter seasonality and higher investment management fees, partially offset by the discrete item. The operating margin as adjusted was 26.1%, or 28.2% excluding the discrete item. With respect to non-operating items, interest expense increased by $0.4 million due to higher average gross debt. With the repayment of a portion of the credit facility during the quarter, we would anticipate a modest decline in interest expense in the third quarter.

Turning to income taxes, our effective tax rate for the second quarter was 13.3%, essentially unchanged from the prior quarter level. As a reminder, our effective tax rate includes the economic benefit of our intangible tax assets. Looking ahead, an effective tax rate in the range of 13% to 14% would be reasonable to expect. Net income as adjusted of $5.54 per diluted share included the $0.43 discrete expense item. The increase from $5.38 in the prior quarter reflected first quarter's seasonality and higher revenues.

Slide 13 shows the trend of our capital, liquidity and select balance sheet items. Cash and equivalents at June 30 were $176 million, up from the prior quarter due to cash earnings in excess of return of capital and repayment of debt. In addition, we had $273 million of other investments, including seed capital, to support future growth opportunities. Return of capital to shareholders in the second quarter included the repurchase of 70,097 shares of common stock for $10 million. We also repaid $20 million of the outstanding amount on our revolving credit facility, and anticipate repaying the remaining $30 million in the short term. Gross debt at the end of the quarter was $427 million, down from $448 million at March 31. Net debt was $251 million or 0.9 times EBITDA.

And with that, let me turn the call back over to George. George?

George Robert Aylward

President, Chief Executive Officer & Director, Virtus Investment Partners, Inc.

Thank you, Mike. We will now take your questions. Jacinda, would you open up the lines, please?

QUESTION AND ANSWER SECTION

Operator: Thank you. At this time, we will conduct the question-answer session. [Operator Instructions] Our first question comes from Bill Katz at TD Cowen.

Bradley Hays
Analyst, TD Securities (USA) LLC

Q

Hi. It's Bradley Hays on for Bill Katz. George, maybe one for you to start. While quality equities broadly lagged, you've gotten strong performance in fixed income and also continued to trend favorably. What's driving some of the strength in those two buckets and maybe some color on upturn potential within equities?

George Robert Aylward
President, Chief Executive Officer & Director, Virtus Investment Partners, Inc.

A

Sure. So as you know, the overweight we have to quality equities really overshadowed quite a bit, because as you referenced, we've had positive flows in fixed income, alternatives, multi-asset, et cetera. So in our fixed income, we have several capabilities, from the multi-sector to emerging market debt, leveraged loans and investment grade. And generally, all of them have performed well, and we've seen assets increase in several of the various product structures. On the alternative side, and again for alternatives, we do include listed securities like REITs and global REIT. And as we called out in the quarter, we had a – I'm very pleased to have a large inflow into a global listed REIT capability.

And then in our other equity strategies that are not quality-oriented, we have seen growth in those for several quarters just given their relative size. It has not yet been as noticeable. We're optimistic that that can change going forward. So I think, all of those areas on their own are actually in a very competitive opportunity, and we would ultimately expect them hopefully to continue to grow. But again, the overshadowing of the quality is obviously there. We were pleased to see a reduction in the level of outflows, just given that the outflows have come down a bit. But sales have also gone up.

And as we're very clear in saying, while it's only really a short period of time, it was very nice to see a full month so far of significant outperformance in some of the select quality-oriented strategies. Again, that is the statement that those types of strategies want to make, that when they're in favor, they can have significant performance, and some of those strategies that we indicated were meaningfully strong. Again, short period of time, too early to know whether the tide is turning. But again, from our perspective, it shows why investors should be diversified into different types of strategies so that you can balance out the cycles of different equity strategies.

Bradley Hays
Analyst, TD Securities (USA) LLC

Q

Makes sense. So then maybe a bit more of a narrow question on the lumpy comp expense, anything to be aware of in the coming quarters or in 2027? And related to that, how much of the 3Q comp guide is driven by future discrete items?

Michael A. Angerthal
Executive Vice President & Chief Financial Officer, Virtus Investment Partners, Inc.

A

Yeah. I think, the going forward guide at 54% just takes into account the current state of the business. I think, the discrete item was just that. It was stock-based and an acceleration of multi-years of performance-based investments, professional awards. So the good news is, there were strong investment performance, as George alluded to, across strategies that, given the retirement eligibility was all recognized in one quarter. But going forward, I would expect 54% to be the right level for modeling.

George Robert Aylward
President, Chief Executive Officer & Director, Virtus Investment Partners, Inc.

A

Depending on revenue, because revenue actually in some ways impacts that margin almost more in some quarters than the [indiscernible] (00:21:11) expense.

Bradley Hays
Analyst, TD Securities (USA) LLC

Q

Makes sense. And then you mentioned expecting to issue a CLO later this year. Any color on size, timing or perhaps capital to be invested on your end?

George Robert Aylward
President, Chief Executive Officer & Director, Virtus Investment Partners, Inc.

A

Well, historically, the last few that we've done, we've sized in the $300 million to $400 million range. And generally, I think, they've been in the mid-$20s million to low $30 million range in terms of capital. Again, too early to give the specifics on that, but that's generally the range that we have previously targeted, and is reasonable for going forward.

Bradley Hays
Analyst, TD Securities (USA) LLC

Q

Thank you.

George Robert Aylward
President, Chief Executive Officer & Director, Virtus Investment Partners, Inc.

A

Thank you.

Operator: Our next question comes from indiscernible] (00:21:57) at Piper Sandler.

Q

Hi. Good morning. Thanks so much for taking my questions. I'm looking just for an update on Keystone, particularly first brands exposures. Keystone funds have exposures to a good size of loans that Keystone has self-identified as being in default or tied to a bankruptcy based on its portfolio of investments reports. But they're marked at par around par. So just wondering if you could give an update there, just why does it make sense for those to be marked that way and then carry at par near par? Thank you.

George Robert Aylward
President, Chief Executive Officer & Director, Virtus Investment Partners, Inc.

A

Yeah. Again, we've previously commented on that the Keystone fund had exposure to first brands and there is exposure out there. And again, the way that it is structured, it has not had implications, and is not at the level that you may be thinking about. So currently there is no update in terms of any kind of impact, but the expectation is that there should not be any further impact. I missed your – I don't understand your specific question. I'm not sure what you were asking. Are you talking about something in a filing?

Q

Sorry?

George Robert Aylward
President, Chief Executive Officer & Director, Virtus Investment Partners, Inc.

A

Can you repeat that? I could not get the specific nature of your question.

Q

Okay. Of course. Yeah. So just wondering if for loans that Keystone has self-identified as being in default or tied to a bankruptcy, they're marked at par or around par. So I'm just wondering kind of what the rationale there is, or if it makes sense to be marked that way or carries at par or near par?

George Robert Aylward
President, Chief Executive Officer & Director, Virtus Investment Partners, Inc.

A

When you say – I'm sorry, I don't know which loan – again, they do financing and there are exposures and they use standard methodologies for mark-to-mark. So yeah, I'm sorry, I'm not clear on specifically what you're referring to marked at what.

Q

No. To be honest, that kind of gave me the color I was looking for there. So I appreciate. I can move on. I just had another question as well just on flows, more specifically on how they remain concentrated in your quality-oriented equity strategies. I'm just wondering also if you see this primarily as a style or performance cycle issue that would reverse with perhaps a rotation back to quality, or if it's more of a structural or distribution-related redemptions embedded that persist regardless of performance there.

George Robert Aylward
President, Chief Executive Officer & Director, Virtus Investment Partners, Inc.

A

Yeah. No, I mean, our view is that, this really is a cyclical matter where our quality-oriented strategies, when they have been in favor and have generated strong performance have been our biggest asset gatherers. And in this very, from our perspective, painful period over the last few years, where the factors that are included in quality have significantly underperformed momentum, they have driven those outflows. We do not think that the strategies themselves are doing anything other than sticking to their knitting. But again, their stock selection will be based upon factors that the market has not been rewarding as much as more momentum names. Again, so we're hopeful that as the cycle changes, and again, we've seen a very short period of time, but it does show the impact of going from things that are in the bottom percent, all the way up to the top percent in a very short period of time, depending upon the cycle changes. So we do look at that as more of a market cycle in and out of favor as opposed to anything else.

Q

Awesome. And I really appreciate the color there. I'll step back, but thanks so much for taking my questions.

George Robert Aylward
President, Chief Executive Officer & Director, Virtus Investment Partners, Inc.

A

Great. Thank you very much.

Operator: This concludes our question-and-answer session. I would like to turn the conference back over to Mr. Aylward.

George Robert Aylward
President, Chief Executive Officer & Director, Virtus Investment Partners, Inc.

I want to thank everyone for joining us today, and certainly encourage you to reach out if you have any other further questions. Thank you.

Operator: That concludes today's call. Thank you for participating. You may now disconnect.