15-May-2012

The Carlyle Group LP *(CG)*

Q1 2012 Earnings Call

CORPORATE PARTICIPANTS

Daniel Harris
Head of Investor Relations, The Carlyle Group

David M. Rubenstein
Co-Chief Executive Officer & Director, The Carlyle Group LP

William E. Conway
Co-Chief Executive Officer & Director, The Carlyle Group LP

Adena T. Friedman
Chief Financial Officer, The Carlyle Group LP

MANAGEMENT DISCUSSION SECTION

Operator: Good day ladies and gentlemen and welcome to The Carlyle Group First Quarter 2012 Conference Call. At this time all participants are on a listen-only mode. [Operator Instructions] As a reminder this conference call is being recorded.

I would now like to turn the conference over to host, Mr. Daniel Harris, Head of Investor Relations. You may begin.

Daniel Harris

Head of Investor Relations, The Carlyle Group

Thank you and good morning. Welcome to Carlyle's First Quarter 2012 Earnings Call. My name is Dan Harrison, I'm the Head of Public Market Investor Relations at Carlyle and with me on the call today our Co-Chief Executive Officers Bill Conway and David Rubenstein, and our Chief Financial Officer, Adena Friedman.

If you have not received or seen the earnings release which we published this morning detailing our first quarter results, it is available on the Investor Relations portion of our website at ir.carlyle.com or on Form 8-K filed with the Securities and Exchange Commission. This call is being webcast and a replay will be available on our website immediately following the conclusion of today's call.

While this is our first earnings call as a public entity, we were still a private company in the first quarter, thus included in our results are both GAAP as well as pro forma results which assume we have been a public entity during the first quarter. Some housekeeping items before I hand it over to David.

We will refer to certain non-GAAP financial measures in today's remarks including distributable earnings, economic net income and fee-related earnings. These measures should not be considered in isolation from or as a substitute for measures prepared in accordance with generally accepted accounting principles. Reconciliation of these non-GAAP financial measures to the most comparable measures calculated and presented in accordance with GAAP are included in our earnings release which is available on the Investor Relations portion of our website.

Additionally, we will report our pro forma results for the quarter, which reflect changes related to our IPO as if they had occurred prior in the period. We would like to remind everyone that any forward-looking statements provided today do not guarantee future performance and undue reliance should not be placed on them. These statements are based on current management expectations and involve inherent risks and uncertainties that could cause actual results to differ materially from those indicated including those identified in the risk factor session of our registration statement on Form-S1 filed with the SEC and available on our website as such factors may be updated from time to time in our SEC filings. Carlyle assumes no obligation to update any forward-looking statements. Finally, given the proximity to the IPO and various quiet period restrictions, we will not be conducting a question-and-answer period today.

With that let me turn it over to David Rubenstein.

David M. Rubenstein

Co-Chief Executive Officer & Director, The Carlyle Group LP

Good morning and thank you for joining the Carlyle Group's first public earnings call as we present the results of 2012's first quarter which ended on March 31. We are pleased to provide you with the report on what was a very solid quarter for the firm and which is importantly consistent with our full year performance objectives. We appreciate the support of many institutional and individual investors who subscribed for our units in the recent IPO and we value as well the confidence expressed in us by those who have purchased the units since the IPO.

We want all unitholders to know that we take our responsibilities as fiduciaries on behalf of unitholders very seriously, and consequently we will in this and in all subsequent earnings calls, do our best to provide as much transparency about our activities as competitive factors will permit. We also want our unitholders to know that we firmly believe Carlyle's status as a public company will strengthen our capabilities and the results of that strengthening will in due course be increasingly apparent to our unitholders as well as to our many fund investors, employees and professional relationships throughout the world.

We did not take the decision to go public lightly nor do we take lightly the obligations we have assumed as the leaders of a public company. We trust that this will be apparent to all as we proceed to operate Carlyle as a public company. No doubt as a public company there will be times when we face challenges just as there will be times when we see considerable opportunities. As we initiate today our long-term earnings call relationship with our unit holders and also with the analysts who cover us. We are pleased that the information we will be providing today is in line with the expectations we had prior to going public and also in line with what we generally covey during our recent IPO Roadshow. Carlyle continued its strong performance in the first quarter reflecting the diversity and global reach of our business as well as our unrelenting focus on doing well for our limited partners.

In particular, we realized $3.8 billion in proceeds for our fund investors from 113 investments across 31 funds. We produced $189 million in pro forma distributable earnings equating to a very strong $0.57 per unit quarterly after tax pro forma distributable earnings and we grew total AUM by 8% to $159 billion. We made solid progress in our fundraising efforts with $2 billion raised compared to an average of $1.7 billion per quarter in 2011. Progress which we expect to accelerate as we move into the summer and fall with first closings for our latest vintage U.S. buyout and Asia buyout funds among other funds. We invested $1.5 billion from our carry funds, which represented 67 new or follow on investments across 18 funds.

We are very pleased with our good start to year and we have confidence in our ability to continue to raise new commitments, invest our capital wisely and to find profitable exit and other distribution opportunities across our funds throughout this year.

Before diving into the details of our financials since this is our first earnings call as a public company we would like to begin our call with a brief review of the key attributes that we believe define our business. First, we are global diversified business operating 94 funds and 63 fund-to-fund vehicles across four segments. We are active on six continents, identifying and executing investments that we believe will generate substantial value to our fund investors and ultimately to our unitholders. Second, we operate with a collaborative cross fund and cross segment approach which we call One Carlyle. We believe that our collaborative culture is a major asset of the firm.

This culture and our structure provides us with what we call the Carlyle edge, our value creation model. This model combines global reach with deep industry specialization. It also includes the value added expertise of our senior executive operations group.

In the Carlyle Edge model very importantly also utilizes economic insights from data we track across our portfolio of more than 200 corporate investments and 270 real estate investments. Third, we work for our limited partners that philosophy is at our core. It defines us. Without the trust and confidence of our limited partners, our business would suffer whereas by partnering with them and by aligning our interest with theirs we can achieve success, growth and expansion of our platform.

We believe our operating philosophy drives strong results for our LPs which ultimately will drive strong results for our unitholders. Fourth, we are long-term investors believing that long-term investments can best maximize returns and distributions for those who invest with us. We frequently hold investments for four, five or six years. Thus we would encourage those who hold or follow our units not to focus disproportionately on quarter-to-quarter results. Instead we encourage our unitholders and other who choose to follow us to take a longer term perspective just as we have and will as owners and partners of Carlyle.

Finally, there are a number of different ways to measure our performance including GAAP income, AUM, economic net income, fee-related earnings and distributable earnings. We will, of course, report on these and other metrics in earnings calls or regulatory filing though we actually believe that distributable earnings is the most relevant metric for unitholders. For 25 years, as owners of Carlyle, we have focused on creating gains and making distributions and we still focus on distributions.

Given our global multi-fund structure, we believe we can continue to produce healthy distributions for we have many economic engines, a 157 fund vehicles at the end of the first quarter of 2012. These engines, these 157 fund vehicles drive our results. Therefore, we feel comfortable and confident in measuring ourselves on overall cash creation for our fund investors and for our firm and we fully believe that for our investors and our firm cash creation will ultimately drive results as well for our unitholders.

During the IPO road show, we spoke with investors about what we call the Carlyle engine, the virtuous cycle that drives our business. There are four components of that engine, first investing wisely, second working to create value or appreciation in those investments, third harvesting or exiting those investments profitably and fourth fundraising or attracting new capital commitments for Carlyle funds. I am going to discuss the fund

raising component of The Carlyle engine and Bill will then discuss the other three components.

Fundraising can be challenging at times and for certain funds, but the overall fundraising environment while not back to the 2007 peak is clearly improving. We have always thought and continue to think that we have a competitive advantage in fundraising by having a large in-house global team who size now reaches 62 professionals on the ground in key fundraising markets around the world. More specifically, we believe our LPs are increasing allocations to alternative asset managers for a number of reasons. First, the impact of the so called denominator of that has been tempered. Second, distributions from a number of firms like Carlyle have lately been very strong and LPs are now recycling those proceeds. Third, given the low rates of return the LPs can generate through traditional investments, allocations to alternatives continue to increase. Finally, we are seeing much more interest in alternative investments than we have in the past from high net worth individuals around the world.

With all of this as a backdrop, this year we have or expect to have 11 carried funds in the market, including several of our largest buyout funds in the United States, Asia and Europe. We also have, or will have in the market, our open-ended hedge funds, other credit products and new fund of funds vehicles. The largest fund we have recently launched is our largest – is our latest vintage U.S. buyout fund. All the previous U.S. buyouts funds have performed very well with all of the active funds over their hurdles are now generating performance fees. We are pleased with the strong investor interest in our latest vintage U.S. buyout fund. We anticipate a first close for this fund to occur sometime in the second quarter of this year with further momentum building in the second half of the year. Starting this month, we have also initiated our fundraising efforts for our latest Asia buyout fund and expect to first close in the second half of this year. With these two funds and others, we anticipate strong momentum in our fundraising for the second half of the year.

Turning to the first quarter's fundraising performance, we raised $2 billion across our carry funds, hedge funds, CLOs, and fund to funds during the period. We have fund closings in five carried funds and just to remind you we frequently have multiple closings in a particular fund during the fundraising process. Additionally in April [ph] when our (11:40) first closed in our new first generation Sub-Saharan African Investment Fund.

We're also pleased to have raised a $510 million new issued CLO during the quarter. Our hedge funds continue to attract capital with net inflows of $710 million in the quarter. Our fundraising performance of $2 billion excludes acquisition related AUM growth which in the first quarter included $2.9 billion of Highland CLO collateral as well as $3 billion in new commitments from the original AlpInvest investors.

In summary, the fundraising environment appears to be gaining momentum and we will have the opportunity to take advantage of this improved environment with our diverse set of products including our most mature corporate private equity successor funds which are or will be in the market this year.

Let me now turn it over to Bill Conway. Bill?

William E. Conway

Co-Chief Executive Officer & Director, The Carlyle Group LP

Thank you, David and good morning. I'd like to focus on our investments, value creation and distribution activities across the firm. Before doing so, let me spend a few minutes on one of the tools we regularly use to inform our investment decisions. More specifically Carlyle has more than 200 portfolio companies and more than 270 active real estate investments around the world more than any other alternative investment firm. We track data from these companies on a monthly basis and have selected approximately two dozen data series that are well synchronized with the business cycle or otherwise highly correlated with official government statistics. Importantly, we collect and analyze these data in real-time which gives us an edge in both our investment decisions and how we manage our portfolio. We call this data Carlyle economic indicators.

Let me provide a good example of the value of the proprietary economic indicators that we track. Last summer, when Congress was debating an increase in the debt ceiling, the markets, press and a number of commentators started talking about a double dip recession. We looked at key data from our portfolio companies, sales volumes, capital expenditures, order books among others and due to contraction its highly improbable in the near-term. We concluded that the U.S. economy would continue to grow, albeit slower than we would like. As a result, we not only made important investments within our funds, we also encouraged our portfolio companies to continue to focus on growth as opposed to hunkering down.

Now with respect to Carlyle's investment performance let me turn to the Carlyle engine to which David referred. As you know we had a drift year in 2011. We invested $11.3 billion in our carry funds and our carry funds appreciated by 16% and we distributed $18.8 billion to our fund level investors. Critical to our performance was the diversity of our investment and exit activity.

Last year we made 191 new and follow on investments from 31 carry funds in 19 countries. We made 391, I repeat that 391 distributions averaging more than one each day from more than 230 investments in 45 separate funds and 22 countries. We continued the strong and diversified performance in the first quarter. In total, we invested approximately $1.5 billion through our carry funds and 67 new and follow on investments across 18 funds.

Our investment activity was highly diversified across our platform and around the world in the first quarter. Interestingly, more than 50% of our equity invested was outside the United States. Our investment pace overall was slower this quarter then it was last year during the first quarter, however, we are not as focused on quarter-to-quarter activity, but rather on identifying and evaluating attractive deals.

For example, we may invest quite a bit one quarter and much less the next. We may invest heavily in the U.S. one quarter and heavily outside the U.S. during the next. We may investment heavily in real estate one quarter and heavily in private equity the next. Our limited partners are not focused on whether we make a particular investment on March 31 or April 1 but rather whether we make high quality investments during the investment period of a particular fund.

Our global platform and diversified group of funds allows us to deploy capital wherever the best opportunities might be in a given period and we have significant capacity in dry powder to deploy capital across sectors up and down the capital structure and around the world.

My general view, and one which I have shared with all of the investment professionals is that this is a fantastic time to make investments. It is precisely at times like this when economic data and markets are sending confusing signals that the best investments can be made.

Among our notable investments in the first quarter were, in corporate private equity, an investment in Ri Happy, Brazil's largest toy retailer through our South American fund. A healthcare company in Germany from our Europe buyout fund and a new investment from our Asia buyout fund in the financial sector.

We also made a number of investments across our real estate platform including a large commercial real estate investment in Sweden in our Europe real estate fund, a property development in China, and investments in the multifamily rental sector in the United States, which we believe is experiencing secular growth, and we also made a mezzanine investment in the Plainfield Connecticut biomass power project through our energy mezzanine fund. We're also working to create value in our portfolio. As we reported previously in our prospectus our carry fund portfolio appreciated 9% in the first quarter of 2012. This appreciation occurred across our global carry fund platform including strong appreciation of our publicly traded holdings. Finally, we continue to work to achieve attractive exits across our portfolio. Specifically, we realized proceeds of $3.8 billion which reflected the diversified nature of our business coming from 113 investments across 31 carry funds.

Among the notable realizations were, sales of stakes in a number of publicly traded corporate private equity and real assets companies in the United States, Asia, and Europe. We made secondary sales in Dunkin brands, Nelson, and Triumph Corporation in our U.S. buyout funds. We sold the portion of our stake in HDFC, a larger Indian financial institution and Carlyle Asia partners too and we sold our stake in AZ Electronics in Carlyle Europe partners too. These sales show the benefits of the publicly traded portion of our portfolio enabling us to sell at opportune times.

During the quarter, we also completed the initial public offering of Allison transmission in Carlyle Partners 4 and we completed the sales of InSite, a U.S. cable operator held in Carlyle Partners 3 and Carlyle Partners 4. From our third U.S. growth fund, we sold RMI, a railroad management software company to General Electric. In addition, we realized proceeds from both the sale and operating income or dividends from approximately three dozen real estate investments around the world as well as three debt and/or equity investments in our second distress fund. As you know, distributions to Limited Partners enable us to generate realized performance fees for Carlyle and for our unitholders.

Going forward, we expect to continue to focus on the four elements of the Carlyle engine, making attractive investments, creating value, exiting and distributing money to our fund limited partners and attracting new capital commitments. We have a fair value of $66 billion of capital at work in our carry funds of which about $19 billion is held in publicly traded equities and $38 billion is in investments that we originally acquired more than four years ago. Therefore we have a diverse, mature set of investments with the large liquid portfolio. These facts give us confidence in our ability to continue to achieve attractive distributions.

Let me close by saying that we are pleased with the continued growth of our Global Market Strategies business which is our fastest growing segment. During the quarter, GMS experienced a 15% sequential growth in AUM from $24.5 billion to $28.3 billion due to asset appreciation and organic and acquired growth in our structured credit portfolio.

We also continue to make progress in our fund of funds business with AlpInvest closing on a $300 million commitment from a new investor and receiving authorization to invest another $3 billion from its long-time limited partners. All in all it was a good quarter. I'll now turn it over to Adena Friedman, our Chief Financial Officer for a discussion of our financial results.

Adena T. Friedman

Chief Financial Officer, The Carlyle Group LP

Thank you, Bill. Good morning everyone and let me again welcome you to our first quarterly conference call as a public entity. We intend to follow a similar format each quarter with an update on the environment from our Co-CEOs and then I will walk you through the financial results for the quarter. As many of you know, we have four main segments and I will focus on each during my remarks. For the quarter on a pro forma basis taking into consideration changes related to our IPO Carlyle generated $189 million in distributable earnings or $0.57 per units and after tax distributable earnings, an economic net income of $401 million or $1.10 per units after tax. The primary differences between the pro forma and actual results for the quarter are first the spilt – the change in the spilt of the performance [indiscernible] (22:05) investment team from approximately 55% prior to the IPO to 45% after our internal reorganization and connection with the IPO.

Second, the repayment of the debt with the IPO proceeds, and third for our GAAP results only the change in treatment of partner compensation as an expense as opposed to equity distributions as well as the inclusion of one quarter of IPO related equity compensation charges. Because Carlyle was not a public company during first quarter of 2012, we will not have distributions to common unitholders for the period.

In connection with our second quarter earnings announcement and consistent with our distribution policy we will commence distribution to common unitholders on a pro rata basis to reflect a partial quarter as a public company based on our May second pricing date. On an actual basis and not pro forma for the IPO the Carlyle Group posted pre-tax distributable earnings of $179 dollars, which compares to $284 million in last year's first quarter and $247 million in the fourth quarter of 2011.

Carlyle's first quarter actual economic net income of $392 million was up 54% sequentially due to strong portfolio growth driving our unrealized performance fees. In evaluating Carlyle's results we believe a rolling 12 month view is more consistent with our business model than looking at the firm on a one quarter bases, as we make long-term investments within our funds and investment and distribution timing can play a meaningful part in any single period. Therefore for the last 12 months from Q2 2011 through Q1 2012, distributable earnings were $759 million compared to $560 million in the prior year 12-month period of Q2 2010 through Q1 2011. These results equate to a 35% increase in distributable earnings over the period.

As of quarter end, 70% of our $66 billion in carry fund assets under management, excluding dry-powder, were in funds that are eligible to generate performance fees. We call the metric our AUM and carry ratio and we expect to communicate the metric on a regular basis to assist your understanding of the potential of our portfolio to generate near-term performance fees.

As Bill said, we realized currencies of $3.8 billion, of which $2.3 billion was distributed in the first quarter along with $115 million of distributions realized in prior periods. The remaining $1.5 billion of these proceeds were yet to be distributed as of the quarter end due to the realization occurring late in the quarter.

We raised $2 billion in the first quarter and we believe our largest fundraising opportunities are ahead of us as we begin fundraising and closing on our buyout funds in the U.S. and Asia. I'll now review each of the four seg – the firm's four segments. As I discuss the segment level information, please note that this data is actual and not pro forma adjusted for IPO.

Our largest segment is our Corporate Private Equity segment or CPE, which produced $244 million in economic net income, up from a $162 million in the fourth quarter due to substantial portfolio appreciation. The segment produced a $120 million in distributable earnings, which accounted for 67% of the firm wide results.

Our first quarter distributable earnings were down $14 million from the fourth quarter with half of that decline due to lower realized investment income and the rest due to a combination of lower realized performance fees and modestly lower transaction fee revenues in the segment. Total revenue of $614 million was up 34% versus last quarter and down 22% relative to the first quarter sales in the 2011. Our strong sequential results were driven by an 8% gain in the CPE carry fund.

Total assets under management and CPE rose 4% sequentially to $53.3 billion while fee earning AUM of $37.8 billion was flat on a sequential basis. As David mentioned we expect our fundraising and CPE in particular the pickup in the second half of the year.

Our fastest growing segment Global Market Strategies or GMS ended the first quarter with $26.8 billion in fee earning AUM up 40% year-over-year and $28.3 billion in total AUM.

Distributable earnings were $31 million and accounted for 18% of Carlyle's total distributable earnings. GMS has a seasonal year end realization event in the hedge fund. So a rolling 12-months view of distributable earnings is an appropriate measure of financial performance. On the last 12 month basis distributable earnings were $197 million compared to prior year 12 months of $46 million. Through a combination of organic growth, strategic partnership and acquisition we believe that we are building a diversified global platform which serves the needs, the investment needs of the LPs.

We look at our GMS business in three areas structured credit, carry funds, and hedge fund. First structured credit invests in leverage funds and structured products with CLOs and managed accounts. We are the second largest CLO manager globally and have actively participated in the consolidation of CLO management contracts having acquired $10.4 billion to the AUM over the last two years including the acquisition of several Highland European CLOs in the first quarter of this year. Additionally we raised a $510 million new issue CLO in the first quarter continuing our organic growth average to leverage our expertise and scale in this sector.

Second the carry funds include our closed end energy mezzanine opportunity fund, distressed funds and our corporate mezzanine funds. These funds appreciated 12% in the quarter and their exit activities generated $14 million in net realized performance fees.

The third area are the hedge funds, comprised today of our 55% stake in Claren Road, a long short credit fund manager, and 55% stake in Emerging Sovereign Group, which focuses on emerging markets equities and macroeconomic strategy. Within the quarter our hedge fund group experienced net inflows of $710 million and ended the quarter with $8.8 billion in total assets under management. We will continue to grow this segment through a combination of acquisitions and organic growth. Our acquisition targets will either leverage our existing platforms to provide competitive scale or provide our LTEs access to new strategies, which offer attractive risk adjusted returns.

Moving onto real assets, distributable earnings for the quarter was $21 million, 12% of the firm's total and up 49%, compared to last quarter. The increase is primarily due to higher net realized performance fees. Within the energy business through our joint venture with Riverstone, we continue to have $18.4 billion in assets under management in our energy area and we'll benefit from any appreciation and realization in that portfolio over the next several years. That said we remain focused on building out our proprietary capabilities, and are actively seeking opportunities in the energy area.

Our last segment is the fund to fund solutions, which currently encompasses our 60% ownership stake in AlpInvest, which we acquired on July 1, 2011. This is our smallest segment in terms of distributable earnings accounting for 3% of the firm-wide distributable earnings, but it provides a strong base for us to build and deepen our relations with our limited partners.

We've already seen the benefits of that relationship in our fundraising efforts including a significant commitment from a U.S. pension fund that split its allocation between AlpInvest and Carlyle funds. We also belief fund to- und solutions will continue to play an increasing role in the private equity environment as investors look for comprehensive diversified and bundled solutions that AlpInvest offers.

Total assets under management rose to $45.4 billion at the end of the quarter up from $40.7 billion last quarter, while fee-earning AUM grew 7% sequentially to $29.5 billion. The growth in AUM during the quarter benefited from approximately $3 billion of mandates from AlpInvest's existing investors that became active during the quarter as well as appreciation underlying funds.

Moving to expenses across the segment, Carlyle incurred a $195 million of operating costs, $10 million in interest expense and $297 million in performance fee related compensation expense, for total expenses of $502 million. That compares to $411 million in Q4 of 2011 and $618 million in Q1 of 2011. Excluding performance fee related compensation, our operating and interest expenses declined $18 million from Q4 of 2011 and increased $8 million from Q1 of 2011. Our operating expenses for the first quarter reflect our overall pace of activity in the quarter. However, we would like to note that our operating expenses will be impacted as we accelerate our pace of fundraising since fundraising incentives and related costs are recognized in the period in which the fund closings occur whereas the related revenues will benefit the firm over many future periods.

Additionally, as we support our public company activities as well as our growth related initiatives that provide future revenue potential, we will continue to make modest investments in fund teams and our infrastructure.

Lastly, our non-GAAP expenses in future quarters will include equity compensations related to future regular course, employee equity grants.

Moving to the initial public offering and the balance sheet, we completed our IPO which priced on May 2 and sold 30.5 million common units and received $639 million in proceeds after the underwriters discount. We have used that cash to optimize our balance sheet and on a pro forma basis for March 31, 2012 adjusting only for the IPO proceeds, we have $507 million in cash and equivalents, a $500 million unsecured term loan, and a $750 million undrawn but committed revolver. Due to strong portfolio performance in the quarter, our U.S. GAAP accrued carry balance increased to $2.4 billion, net of Giveback Obligations, up from $2.1 billion at year-end 2011.

We look forward to developing our relationship with our untiholders in the months and years to come. While we look forward to taking your questions on future earnings calls, as we noted earlier given the proximity to our IPO and the various quiet period restrictions, we will not conduct a Q&A session as part of this earnings call.

Now, let me turn it back over to David for a few last comments.

David M. Rubenstein

Co-Chief Executive Officer & Director, The Carlyle Group LP

Thank you Adena and thank you all for participating in our first quarter earnings call. As we now prepared to conclude this call, we want to leave you with three key takeaways from this quarter. First, we generated $0.57 in distributable earnings per unit, a great start to the year and importantly consistent with our full-year performance objectives. Second, the pace of our realizations that Carlyle fund investors remain healthy as we have $3.8 billion in realized proceeds during the first quarter. And lastly, our investment performance continues to be very solid with our carry funds appreciating 9% during the quarter. We have been and remain optimistic about our firm and the prospects that lie in front of us. We look forward to speaking with you again next quarter, and again thank you very much for listening to this call. Good day.

Operator: Thank you. Ladies and gentlemen, this concludes the conference for today. You may all disconnect and have a wonderful day.