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The Carlyle Group LP (CG)

Q2 2017 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to The Carlyle Group's Second Quarter 2017 Earnings Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will be given at that time. [Operator Instructions]

I would now like to introduce your host for today's conference, Head of Investor Relations, Mr. Daniel Harris. Sir, you may begin.

Daniel F. Harris

Managing Director & Head-Public Investor Relations, The Carlyle Group LP

Thank you, James.

Good morning and welcome to Carlyle's second quarter 2017 earnings call. With me on the call today are our Co-Chief Executive Officers, David Rubenstein, Bill Conway; and our Chief Financial Officer, Curt Buser.

Earlier this morning, we issued a press release and detailed earnings presentation with our second quarter results, a copy of which is available on our Investor Relations website. Following our remarks, we will hold a question-and-answer session for analysts and institutional investors. To ensure participation by all those on the call, please limit yourself to one question and return to the queue for any follow-ups. This call is being webcast and a replay will be available on our website.

We will refer to certain non-GAAP financial measures during today's call. These measures should not be considered in isolation from or as a substitute for measures prepared in accordance with generally accepted accounting principles. We have provided reconciliations of these measures to GAAP in our earnings release.

Any forward-looking statements made 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, including those identified in the Risk Factor section of our Annual Report on Form 10-K that could cause actual results to differ materially from those indicated. Carlyle assumes no obligation to update any forward-looking statements at any time.

With that, let me turn it over to David for his remarks.

David M. Rubenstein

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

Thank you, Dan.

We're pleased to discuss our strong second quarter results, which we believe demonstrate the continued positive momentum in our business. Last quarter, Bill highlighted our firm's four goals for this year and beyond: continuing to invest wisely, raising \$100 billion, building our global credit business and resolving some of the legacy issues that have negatively impacted some parts of our firm. In the second quarter, we made great progress against each of these goals.

First, our investments created substantial value once again this quarter. We generated nearly \$300 million in performance fees, driven by 5% appreciation across our carry funds, and our net accrued carry balance increased 9% to \$1.6 billion.

Second, we had an exceptional fundraising quarter with \$8.4 billion raised in the second quarter, and we have substantial fundraising momentum heading into the second half of this year when some of our large buyout funds, for which it is already clear there is robust interest, will be in the market.

Third, in our global credit business, we made several key hires and raised funds, which will be quite helpful as we further develop and expand that business.

And fourth, we have resolved our legacy commodities issues.

Drilling down on each of these key themes. Similar to our results in the first quarter, the main story of this quarter was the continued impressive performance of our portfolio. Broad-based fund appreciation drove \$300 million in second quarter Economic Net Income. ENI was \$0.81 per unit after-tax.

In the first six months of this year, we generated \$700 million in ENI, about the amount we created in all of 2015 and 2016 combined. Our net accrued carry balance grew by \$131 million in the second quarter, notwithstanding \$182 million in net performance fees realized during the quarter. In the last six months, our net accrued carry balance has grown by 46%.

Unitholders should benefit from robust future distributions derived from our strong current fund performance, and we expect to continue to create value in our current funds as the underlying portfolios further strengthen.

Consistent with some of our strongest quarters for DE in previous years, we generated \$199 million in Distributable Earnings this quarter, or \$0.56 per unit and declared a \$0.42 per unit distribution. Last quarter, I spoke at length about the favorable fundraising environment and the growing allocation by investors from around the world to alternatives.

This quarter's results provide further evidence of both the industry tailwinds in general, as well as the attractiveness of Carlyle's funds in particular. We raised more in the second quarter than we have in any quarter since 2007/2008 period, and we did so without any of the three large buyout funds yet being in the market.

We are targeting first closes for the Asia and U.S. Buyout funds in the second half of this year and Europe in the first half of next year. We are seeing strong investor interest in virtually all of our funds. In fact, we're signaling to our fund investors that they should commit early to each of these funds as we expect demand to far outpace capacity in many of them.

To summarize, our fundraising activities in the second quarter, we raised \$3.3 billion in our eighth U.S. realty fund and we expect to finish out this fundraise this year. We raised three new issue CLOs in the U.S. and Europe totaling \$1.7 billion of new capital later this year. I'm sorry, we raised approximately \$1.1 billion for Alpinvest's latest vintage co-investment program, for which we expect to be at the hard cap for the program by year end.

We also had a strong first close for Metropolitan Secondaries Fund II. We had a first close in our new credit opportunities fund of more than \$500 million. And finally, we raised almost \$0.5 billion for new secondaries structured credit fund and expect the final close for the fund in the third quarter. And of course, we had a first close in our third financial service fund and expect another substantial close by the end of the third quarter.

Looking forward, we expect the pace of fundraising to accelerate further in the second half of 2017, as we complete fundraising for our latest Carlyle Realty Partners Fund, as we hold the first close in the latest NGP fund and as we launch our large buyout funds for U.S., Asia and Europe.

Our ability to raise new funds is only possible because of the strong investment performance across our platform. Our track record, global reach and capacity to deliver future returns should help us scale many of our fund platforms beyond their current size, as well as launch new first-generation funds. With new and larger funds, we will grow Fee-Earning AUM and Fee-Related Earnings, and most importantly, create the potential for higher performance fees in the future.

Before I turn it over to Bill, as noted earlier, we resolved the previously disclosed liabilities within our Global Market Strategies business by reaching a settlement with investors in two commodities investment vehicles. We incurred a net charge of \$6 million this quarter, significantly less than we originally anticipated, due to higher insurance offsets.

That said, we're disappointed with the charges we have incurred in our GMS segment over the past several quarters. But as we noted earlier this year, we have moved aggressively to put legacy issues behind us and to focus on the enormous opportunities in global credit.

This segment is now led by highly talented and very experienced professionals who are working closely together to draw upon the knowledge and capabilities of their colleagues across Carlyle to build a world-class private credit business. It's very clear to us that we now have the ability to build over time a world-class private credit business and we have already begun to do so.

In sum, our business across the board continues to gain momentum. Bill?

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William E. Conway, Jr.

Co-Founder, Co-Chief Executive Officer and Managing Director & Chief Investment Officer, The Carlyle Group LP

Thank you, David.

Last quarter, we reported our results shortly after a week official U.S. GDP first quarter growth estimate of 0.7%. We noted that our proprietary portfolio data suggested a more robust growth than that reported by the Commerce Department. Subsequently, the official U.S. GDP first quarter report was revised upwards to a 1.4%, and the initial estimate of second quarter growth of 2.6% was recently announced.

Today, we continue to see synchronized global growth led by industrial orders and manufacturing trade volumes. Globally, industrial orders appear to be growing at the fastest rate in six years, with particular strength evident in the Eurozone and emerging Asia.

The improved economic backdrop has been reflected in the performance of our more than 200 portfolio companies. Trend growth for both sales and earnings has averaged roughly 10% across our global portfolio. This in turn has led to rapid appreciation of our \$64 billion portfolio at the existing Corporate Private Equity, Real Asset and GMS carry fund investments.

Our overall carry fund portfolio appreciated by 5% in the second quarter and has appreciated 11% in the first six months and 19% in the last 12 months. Our Corporate Private Equity segment appreciated even more, 8% in the

quarter, 18% for the first six months, and 23% over the past 12 months. We saw particular strength in our industrial, healthcare and technology investments.

We also produced significant appreciation in real estate and natural resources, both of which appreciated 6% in the quarter. Importantly, we realized the strongest appreciation in those funds that are already in carry. These include Carlyle Partners VI, Carlyle Asia Partners IV, Carlyle Realty Partners VII and NGP XI.

In terms of new investments, we invested \$3.4 billion for the quarter and have more than \$6 billion in investments that we have signed but not yet closed. We have deployed nearly \$17 billion of capital over the past 12 months across our global platform. Thanks to our global platform and more than 600 investment professionals, we continue to find suitable investments for our fund investors.

Interest rates remain very low and prices across most asset classes are relatively high. Although we know this situation will not continue forever, we do not see today a likely near-term catalyst that will cause the state of the investment environment to change.

However, we remain vigilant given that today's relatively high valuations are anchored on very low nominal interest rates. We do expect that nominal rates of return in a world of low or even negative real interest rates are likely to be lower on new investments compared to most investments of the past decade. Our job remains to find investments that, on a risk adjusted basis, meet the needs of our fund investors while generating attractive profits for our unitholders. We continue to believe that we can find such investments.

We realized proceeds of \$6 billion for the quarter. Investment Solutions realized approximately \$2.3 billion and CPE realized about \$2.7 billion. Notable CPE exits were the first phase of PPD by U.S. Buyout, the sale of Multi Packaging Solutions by our Europe Buyout fund, the sale of Crystal Orange Hotels in China by our Asia Buyout fund, and the sale of Solasto Corporation by our Japan Buyout fund.

In general, our CPE business is performing well across the board, with most geographies and fund groups performing well in terms of appreciating assets, their investment pace, realizations and fundraising. In Real Assets, our U.S. real estate business remains extremely successful. U.S. real estate funds III through VII have invested \$9.7 billion, with a total value today of \$16.5 billion. And David has spoken about our progress on the fundraising of our newest Fund VIII.

Our European real estate team has taken impressive steps to rebuild its business. And our Natural Resources platform with AUM of about \$16 billion is among the largest in our industry and has an enviable track record. As David mentioned, enhancing our credit business remains a top priority.

Our Distressed Credit team recently negotiated the successful sale of Brintons Carpets and investment in our second and third distressed funds. Our Structured Credit business is active and growing, and we're raising capital for several new BDCs and other credit vehicles. We also took our first BDC, Business Development Company, public. Finally, we see early success in building our new opportunistic credit fund.

While it remains early, the diversity, scale and leadership of our credit business is in good and improving shape. The entire firm is energized and making great progress on each of our four goals.

And with that, let me turn it over to Curt Buser. Curt?

Curtis L. Buser

Chief Financial Officer & Director, The Carlyle Group LP

Thank you, Bill. Our performance across the firm was solid once again and we are well-positioned for the future. For the first six months of this year, we generated economic net income of \$700 million or \$1.90 per unit after tax, over three times the per unit amount we earned in the first half of 2016.

Economic net income this quarter was up 90% from Q2 last year, with nearly \$300 million generated in net performance fees, up 159% from the second quarter of last year. Year-to-date, 65% of our net performance fees were generated by funds that are still in their investment phase. In other words, these are relatively young funds and are the funds that will produce a substantial amount of our realized carry over the coming years.

I would be remiss as the CFO if I did not remind everyone that ENI is inherently unpredictable due to the nature of mark-to-market accounting. Fee-related earnings were \$6 million for the quarter after fundraising costs and the commodities charge. Fundraising costs were \$15 million more than the first quarter of 2017 and the second quarter of 2016, due to the significant fundraising activity in the quarter. We expect elevated fundraising levels in the near term; and accordingly, expect to see continued high levels of fundraising costs.

Raising large amounts of new capital will produce benefits for years to come, but we incur the costs immediately. This quarter's fundraising was primarily accomplished through our internal team, our most economical way to raise capital. Future quarters maybe relatively more expensive as we augment our internal team with external fundraising efforts.

Expenses this quarter were largely flat compared to the first quarter of 2017 and the second quarter of 2016, with the exception of fundraising costs and the commodities charge. Fundraising costs appear in the elevated indirect compensation expense and to a lesser extent in G&A.

Excluding the increase in fundraising costs, direct and indirect compensation would have been about the same this quarter as previous quarters. Equity-based compensation increased to \$37 million from \$31 million a year ago, reflecting new grants though the near-term run rate should be modestly lower than this level.

Fee-Earning Assets Under Management remained relatively flat at \$116 billion. But pending Fee-Earning Assets Under Management increased to \$9 billion from \$4 billion as of March 31. Pending Fee-Earning AUM reflects capital raise which we have not yet activated fees. And it will be an important metric to monitor as we activate new funds over the next several quarters of elevated fundraising. All fundraising does go into total assets under management which increased to \$170 billion, reflecting the new capital raise and the appreciation across the portfolio.

Now, let's turn to review of our business segments. The Corporate Private Equity portfolio continue to perform exceptionally well with strong appreciation. Economic net income of \$242 million, substantially exceeded the \$58 million earned a year ago, reflecting the 8% Corporate Private Equity appreciation in the current quarter. A larger number of our current generation of funds are accruing carry compared to a year ago, and the appreciation in the quarter was double the 4% from the second quarter of 2016.

Corporate Private Equity produced robust distributable earnings of \$173 million, though lower than the \$235 million in the second quarter of 2016, largely driven by \$2.7 billion in realized proceeds in CPE this quarter compared to \$4 billion a year ago. Fee-related earnings in Corporate Private Equity were \$13 million this quarter,

lower than compared to a year ago as fee revenue was partially offset – as lower fee revenue was partially offset by lower G&A expenses.

The bulk of the firm's fundraising over the last year has been outside of the CPE segment. And as we raised new CPE funds and turn on fees, we anticipate solid growth in fee-related earnings and management fees.

Moving on to Real Assets. This year is a big fundraising year for Real Assets with a significant focus on our eighth opportunistic real estate fund, NGP's XII fund, and growing the capital base for our Core Plus real estate platform in addition to several other initiatives. As a result, fee-related earnings for the segment reflects the cost of this fundraising without yet having the benefit of the increase in revenue that will occur once we turn on the fees for the newly raised capital.

Net accrued carry in Real Assets has been growing sharply over the past six quarters, as both U.S. real estate and Natural Resources have seen strong fund performance. Real Assets' net accrued to carry stood at \$385 million at June 30, 2017, over four times the \$90 million at year-end 2015, demonstrating our growing earnings power in this segment.

Economic net income in Real Assets was \$51 million for the quarter, a good quarter for appreciation, particularly with energy price pressure albeit lower than the \$79 million generated a year ago. Real Assets produced distributable earnings of \$12 million, with \$22 million in realized net performance fees, offset by negative \$11 million in fee-related earnings.

The negative FRE reflects the fundraising cost in the quarter, primarily associated with our \$3.3 billion fundraise in U.S. real estate, for which we have not yet activated management fees. Continued realizations in the prior generation of funds also contributed to the negative FRE by reducing management fees. We expect to turn on fees for U.S. real estate, Fund VIII and NGP Fund XII during the second half of this year at which time we should see growth in management fees.

Turning to Global Market Strategies. This segment is at an important positive turning point, as we believe we have resolved the issues related to our hedge and commodity funds. While that is good news for future earnings and will enable us to focus exclusively on growing our credit platform, fee-related earnings, economic net income and distributable earnings in GMS, all reflect the \$6 million commodities charge this quarter.

Absent the charge, FRE and GMS would have been \$4 million as compared to \$1 million a year ago. Distributable earnings would have been \$15 million or more than double the prior year amount. And our CLO business, Distressed Debt funds and our BDC combined, to generate realized performance fees of \$9 million in the quarter.

In Investment Solutions, we continue to make steady focused progress on building our fund to funds, secondaries, and co-investment platforms for both private equity and real estate. Fee-related earnings were \$5 million in the quarter compared to \$6 million a year ago. Again, we were very successful in fundraising in the Investment Solutions segment, which is great news for the medium-term, but fundraising costs had a negative impact on FRE in the segment.

Summing up, as we said last quarter, 2017 is an important transition year in which we are building for the future. The results this quarter and for the first half of the year showed good progress towards achieving our goals and position the firm for growth in 2018 and thereafter.

With that, let me turn it back to David for some closing comments.

David M. Rubenstein

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

In brief, we had a strong quarter by the metrics that we believe are important in measuring our success and our progress. And we feel that we are well-positioned to build further on our current base and to grow our global platform and our profitability.

We're now ready to take your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from Craig Siegenthaler with Credit Suisse. Your line is open.

Craig Siegenthaler

Analyst, Credit Suisse Securities (USA) LLC

Good morning.

Q

David M. Rubenstein

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

Good morning.

A

Craig Siegenthaler

Analyst, Credit Suisse Securities (USA) LLC

So I heard your comments, you expect first closes in both U.S. and Asia Buyout in the second half. But just given the really strong fundraising environment that we're seeing and I'm also looking at Apollo's result this quarter which had a very big Fund IX closing there, I'm just wondering do you think we could have final closes in both U.S. and Asia Buyout by December 31?

Q

David M. Rubenstein

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

We don't want to say exactly when the final close will be, we don't know for sure. We have not historically done one-and-done kind of closings on these large buyout funds. But there's no doubt that there's enormous amount of interest in it. And I don't think that the fundraising for either of those funds will be very elongated compared to what we've had in the past.

A

Craig Siegenthaler

Analyst, Credit Suisse Securities (USA) LLC

Thank you.

Q

Operator: Thank you. Our next question comes from Ken Worthington with JPMorgan. Your line is open.

Kenneth B. Worthington

Analyst, JPMorgan Securities LLC

Q

Hi, good morning. As you think about expenses for both comp and G&A as we look forward in assets excluding the fundraising costs, can you help us with an outlook, say, for the next couple of years? The investment teams, I think, are largely in place for your bigger funds that are fundraising. But as we think about costs, Carlyle has been sort of tightening the belt for the last couple of years. Does the big fundraising and the improved outlook for Fee-Earning AUM sort of take some of the pressure off your cost containment? And how should we think about those expenses sort of stepping up or ramping up over the next couple of years?

Curtis L. Buser

Chief Financial Officer & Director, The Carlyle Group LP

A

Hey, Ken, it's Curt. Hey, thanks for your question. Look, we've been very focused on cost control definitely over the last two years. And as you look at the numbers, especially as you exclude kind of one-time type charges, you exclude the fundraising costs, you can really see that the costs over that time period have either trended down or, worst case, kind of flat.

So as we look forward, there's two obvious places where obviously we're going to have expense pressure. One is the fundraising cost as we talked about; and the second, we're going to continue to build out the credit business. And so, as we build out the credit business, you're going to see some costs coming in there, especially as we grow that. We think that that is really going to lay the groundwork for very good future FRE, but it's going to take us some time to get there.

The other thing that I will say is, I do think, as we go through this fundraising process, I'm optimistic for the results of the fundraising. And I do think that you're going to see some elevations and some growth in comp here and there, but it's going to be very controlled and we're going to remain very cost conscious as we go through the next time period. I'm optimistic in terms of the fee-related earnings potential, especially as we get through this \$100 billion fundraise.

Operator: Thank you. Our next question comes from Bill Katz with Citigroup. Your line is open.

William Raymond Katz

Analyst, Citigroup Global Markets, Inc.

Q

Okay. Well, thank you very much for taking my questions and really appreciate your good disclosures. So David, in the past you've talked about taking market share and the industry as a whole and Carlyle as well. Just wondering if you had some statistics at your hand I can talk to, some of the cross-sell that you're enjoying. Sort of curious of how much of these sort of stepped up mandates are coming from existing LP base versus maybe the ability to extend the franchise?

David M. Rubenstein

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

A

Okay. We have such a large investor base that is – it's likely that our new funds are going to see most of those investors in those new funds coming from our existing fundraising base. However, in this quarter alone, we've got about 200 new investors in various funds. So, we're always looking for new investors.

But if you take the sovereign wealth funds, for example, of the 25 largest sovereign wealth funds, of the 23 of them that invest in alternative assets or private equity, I think we've got 22 or 23 of them. So it's hard to get a lot of new investors, I'd say, for example, in that space. The same would be true in most of a large U.S. public pension funds. We have a very, very large share of them.

However, we're always looking for new investors and we're always traveling the world for them. I would say, right now, we have a pretty happy investor base. And we're finding that, what I call, the cross-sell does sort of work and that was the premise of much of what we did when we built the firm which is to say, if you like Carlyle in Fund I, you might – in fund area A, you might like Carlyle in fund area B.

And so we find now, for example, that that 60% of our funds having – investors that are – I think the statistic is that, 60% of our investors are in six or more of our funds, and about 10% of our investors are in 20 or more of our funds. They're very loyal. So, there are a very few investors we have now who are only in one fund.

And so, the most effective way to get an investor into a fund is to get an existing investor; it's a lot less expensive to get an existing investor than new investor, but we are still trying to find new investors. And I'd say, just for the quarter, I think about 230 individual or organization new investors came into our various funds.

Operator: Thank you. Our next question comes from Patrick Davitt with Autonomous Research. Your line is open.

Patrick Davitt
Analyst, Autonomous Research US LP

Q

Good morning. Thanks. So, you've seen a pickup in fairly sizable realization announcements, and obviously I think you have another part of PPD coming through. So could you frame maybe a range or size of expected cash carry from these pretty lumpy deals, most notably, I guess, PPD, Nature's Bounty and EPIC this week?

Curtis L. Buser
Chief Financial Officer & Director, The Carlyle Group LP

A

Patrick, it's Curt. Hey, thanks for your question. What we don't like to do is, obviously give specifics on items that are really hard to predict. We make an assessment of carry at the time of each realization. Generally speaking, we'll be on the frontend of a new fund that's in carry initial realizations.

We'll generally tend to be a little conservative in terms of our carry decisions, because we don't want to be in a situation where we have clawback. We're very focused on managing call back risk. But generally, the game plan is generally to try to be in a place to, on average, take about 20% of the gain in carry.

But again, you're looking at different things and times, you might even be in a more of a catch-up mode where you're actually taking a little bit more than the 20%. The right way I think to kind of think about realization of carry is the following. We've been able to grow accrued carry. We're now at about \$1.6 billion of net accrued carry, that's up 46% from the end of the year.

We have about \$64 billion in remaining fair value in our carry funds, excluding Investment Solutions. Of that \$64 billion, about 27% of it is over four years old. So generally speaking, about ready to be monetized. When I think about path on performance realizations, especially of that accrued carry balance, I generally think on average it takes us about three to four years to realize carry – to realize the net accrued carry number once a fund is fully invested.

So obviously, earlier before that's sold in the investment period, it's been obviously a longer time period. The other key step I'd point you to that we have shared many times is that, over the last five plus years, our realization of net performance fees has generally been ranging from 40% to 55% of our beginning of the year accrued carry balance.

Now, that's not statistically whatever, it's just happened to be that way, but it's over five and a half years of kind of doing that. I would say, that's a pretty good way to think about things with the following exception. Right now, we have a lot of our accrued carry is in funds that are relatively new. 65% in fact, of the carry generated this year from an accrual perspective is in funds that are still in their investment period.

So if you're going to use that last metric of 40% to 60% or 40% to 55%, I'd look at it on the lower end of that range simply because so much of that carry is still relatively new. But that's, I think, a good way to overall frame kind of carry realizations.

David M. Rubenstein

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

A

And I'd clarify something I said earlier to David. I think I didn't quite reflect accurately what the situation was. We had in the quarter probably 30 new institutional investors, probably several hundred overall individual new investors. But when you have a feeder fund, you may get a few hundred individual investors in there and we don't really probably count each of those.

But we did have a lot of feeder funds in the quarter that produce money and they probably each had a few hundred individual investors. But institutional investors that were new for the quarter, we've got 30 of them, they committed total of about \$320 million.

Operator: Thank you. Our next question comes from Michael Carrier with Bank of America. Your line is open.

Michael Carrier

Analyst, Bank of America Merrill Lynch

Q

Thanks, guys. Just given the strong performance this quarter, I mean you gave the update on the portfolio companies. Just wanted to get a sense – I know there's the performance, there's the amount that can generate carry. Was there much in terms of the acceleration of carry? And in Real Assets, it seems like there's been a fairly consistent strain. So any kind of granularity what's been driving that, because it's obviously been building on the accrued carry as well? So, just some detail there.

Curtis L. Buser

Chief Financial Officer & Director, The Carlyle Group LP

A

Mike, it's Curt. Hey, the underlying driver has really been the consistent strong performance across the portfolio. So in the Corporate Private Equity sector, 8% in the quarter; and as Bill said in his prepared remarks, really coming from many of the big funds. So it's been continued appreciation in U.S. Buyout, Asia Buyout for the big funds, et cetera. So, this quarter wasn't so much about new funds coming into carry, but was really more about continued strong appreciation of funds that were in carry.

Now, having said that, there's a lot more funds in carry this quarter than, say, a year ago, and that also helps on the year-over-year comparison. In Real Assets, keep in mind that we have a very diverse portfolio, particularly in real estate. So, well over a 100 individual assets in that portfolio, very focused on appreciation in picking our spots asset-by-asset, geography-by-geography, and we've really just had a very good run or very strong performance across that portfolio.

Rob Stuckey who runs that particular fund, does a great job of kind of looking at piece-by-piece and really kind of very focused on fund construction in terms of how to manage things, looking for key trends, key drivers and both from a specific area, but also asset type.

And then in the energy piece, again, kind of a similar story in terms of being able to look at it from a asset-by-asset place as opposed to kind of across the board. Both in real estate and in energy, we benefited from a number of exits of recent and not only did that show up in the realized number, but it really also helps you from really setting the valuations. So you have very good comparable marks upon which how to value the portfolio. I don't know, if you have anything to add to that.

David M. Rubenstein

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

A

No.

Operator: Thank you. Our next question comes from Chris Kotowski with Oppenheimer. Your line is open.

Chris Kotowski

Analyst, Oppenheimer & Co., Inc.

Q

Good morning. CPE VI is now about five years old and more than 70% invested. And by my calculations, you must have had about like over \$2.5 billion of realizations out of the fund. So, the net IRR kind of must be coming into focus. And I wonder if you can kind of tell us roughly where that is tracking and whether it's in for carry?

David M. Rubenstein

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

A

So on CPE VI, there's a couple of key steps to obviously look at. We have about \$9.7 billion of remaining fair value, you'll see that on page 29 of the press release.

Chris Kotowski

Analyst, Oppenheimer & Co., Inc.

Q

Right.

David M. Rubenstein

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

A

It's a total – multiple of invested capital of about 1.3 times, 72% invested. If you also look on page 24 of the press release, you'll see a gross IRR for CPE VI of 19%, and a net internal rate of return of a 11%, hence why that fund is doing well and isn't in accrued carry.

Chris Kotowski

Analyst, Oppenheimer & Co., Inc.

Q

Okay. Great. Thank you.

Operator: Thank you. Our next question comes from Alex Blostein with Goldman Sachs. Your line is open.

Alexander Blostein

Analyst, Goldman Sachs & Co. LLC

Q

Hey, good morning, everybody. Another one around just the fundraising dynamic. So, obviously, it seems like returns are great and the institutional appetite remains quite robust. How do you guys think about the opportunity to potentially upsize the \$100 billion target? And if so, any areas in particular where you're seeing a lot more incremental demand that could drive that upside?

David M. Rubenstein

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

A

Well, I'd say, if we had a higher number, we probably wouldn't want to disclose it publicly. I'd say that, there's no advantage in having a higher number. \$100 billion is a pretty awesome amount of money to raise. We think we can do it. We're pretty confident we can do it.

There probably will be excess demand in most of our funds that are in the market today. But we've tried over the years not to take more money than we can invest. So we've set the targets at levels that we actually think we can invest prudently and wisely.

So, while it might be possible to raise more than we're targeting in large buyout funds, we don't actually think it's necessarily a great idea to get more AUM just for the sake of having it if we can't invest it wisely. So, we're pretty comfortable with the \$100 billion target and pretty comfortable with the targets we put in each of the funds. And I think we'll probably stay there for the time being unless something unforeseen happens.

William E. Conway, Jr.

Co-Founder, Co-Chief Executive Officer and Managing Director & Chief Investment Officer, The Carlyle Group LP

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Yeah. I think the ability to invest the money, if we were just – a contest to see how much money we could raise, we could raise more than \$100 billion. I don't think that's what it's all about. We tend to size our funds relative to what we see in the strengths of our team, the market opportunities, competitive dynamics, whatever it may be. Over the life of Carlyle for 30 years, I think, there may be two funds in that period of time that really didn't reach at least 80% of that fund invested.

So, we generally are sizing the funds on what we think we can invest. There are times when it's easy to invest the money than it is to raise it, and there are times when it's easy to raise it than it is to invest it. Obviously, the time to raise it is when people want to give you the money. And right now, people, I think, want to entrust firms like Carlyle with their money and we've done a pretty good job.

David M. Rubenstein

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

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The internal targets that we have for our three large buyout funds would take us roughly to about \$25 billion for those three funds; U.S., Europe, Asia, could be slightly more than that – around that range and we divided ours. Some organizations have one big global fund, we have it done differently. But we think that that amount of money is the level that we're comfortable investing over the investment period.

Operator: Thank you. Our next question comes from Gerald O'Hara with Jefferies. Your line is open.

Gerald Edward O'Hara

Analyst, Jefferies LLC

Q

Great. Thanks. Just circling back to Real Assets and maybe just if you wouldn't mind providing a little bit of color on the performance of the energy portfolio in the quarter. It looks like, there's some headwinds just broadly speaking with commodity pricing and your funds look like they've done quite well, including the international

energy fund that was up, it looks like 19% in the quarter. Could you perhaps just talk a little bit about some of the puts and takes or dynamics there that have enabled you to perform so well during the quarter and of late? Thank you.

William E. Conway, Jr.

Co-Founder, Co-Chief Executive Officer and Managing Director & Chief Investment Officer, The Carlyle Group LP

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Sure. This is Bill. I'd say that the – our energy business did perform very well. And we're not, however, immune to the headwinds that are going on in the energy world. As you know, we don't actually invest in funds. We're not an ETF or something like that. We invest on an asset-by-asset basis.

So, the things that affected the second quarter and made it an excellent quarter from energy appreciation were one, in international energy, which as you pointed out, was up double digits. We have there a relatively high percentage of energy infrastructure spending in the international energy funds. And infrastructure assets are more immune to what goes on with regard to the price of the underlying commodity. So that was a relatively big factor in the performance of the international energy business.

In domestic energy business, NGP, which is a fabulous business. As you know, we're raising the XII Fund now. The first nine funds all reached a carry. We expect that will happen to X and XI as well and hopefully, it will continue for the future. And that's been done in markets of good times and bad, good demand, high and low prices, they're not immune. But they tend to be invested in the very best basins in the United States, the Permian and related basins is one of the areas of really strong investments and asset prices in that part of the market have been relatively strong. So that's been another factor.

On the other hand, to give you an example of where maybe we're not immune, our energy mezzanine lending business, which is now carried at 0.9 times our money. So anytime you're lending money against a commodity there whose price has been cut in half, obviously, you can have some effect on valuations in that part of the market.

It's a relatively smaller fund. New investments being done in that fund of course are benefiting from investments at the lower energy prices. But those done before the price fell from \$100 to roughly \$50, they obviously can be affected by what's going on in the market.

Operator: Thank you. Our next question comes from Glenn Schorr with Evercore. Your line is open.

Glenn Schorr

Analyst, Evercore ISI

Q

Hi, thanks very much. Maybe a two-parter. The first part is, I agree with your assessment on the low rates and high valuations impacting nominal returns, it is a question. But I'm assuming LPs are moderating their expectations for forward returns and are eyes wide open to your assessment. I mean, they're giving you tons of money anyway, but I'm just curious if they're fully aware if it's part of the conversation?

David M. Rubenstein

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

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Our investors are sophisticated. Yes, they are aware of it. Let me explain. I would say, in the 1980s and the 1990s on average, private equity funds in the United States probably had net internal rates of return in the high-teens or low-20s, on average, obviously top quartile or better.

Today, the average returns that people are getting are roughly in the 14%, 15% range net. And I think investors say at 14% or 15%, we'd be very happy today, given low inflation rates and low interest rates. Obviously, if inflation changes in the next couple of years, those rates – they go up.

Today, investors are pretty comfortable with those rates of return of 14%, 15% net. Now, obviously, they expect in a top quartile fund, it might do somewhat better. But if the industry is averaging 14%, 15% net, which is what it's doing, investors are saying, that's pretty good compared to everything else they see. So yes, they are fairly familiar with it.

William E. Conway, Jr.

Co-Founder, Co-Chief Executive Officer and Managing Director & Chief Investment Officer, The Carlyle Group LP

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And I would say, if we can do 14% to 15%, we can raise \$200 billion or \$300 billion or \$500 billion, because in these markets, it's really, really tough to continue to earn the types of returns that have been earned in the past, so I think that it's – when the government makes the – the central banks have caused really all rates to head towards zero, the rates even in private equity begin to go down as well.

So I think, we'll be able, I believe, to achieve double digit, maybe mid-teen double-digit kind of rates of return. It depends on the fund and the timing and everything else. But I think, it's really tough for us to do the kinds of returns we did over 10 years, 20 years ago.

David M. Rubenstein

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

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The final comment, what I'd call the paradox of private equity is that returns are coming down, prices are high. There's a lot of dry powder by normal standards. So why are so many people giving so much money to people like us? It's because they see everything else being less attractive. So at 14% or 15% net, if we can achieve that, I think, people think that probably we can, they're pretty happy given everything else they have.

Glenn Schorr

Analyst, Evercore ISI

Q

I appreciate that. That actually leads to my follow-up of, I noticed a report out last week talking about insatiable demand for products like yours and how the industry is able to charge either higher management fees or get more interesting terms. Are you seeing much in the way of pricing and/or extended terms, longer locks, anything like that?

David M. Rubenstein

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

A

Some people are, I think, maybe perhaps trying to take advantage of the situation, there's no doubt. It's a seller's market in a sense that you probably have stronger marketing advantage. In our own case, we've been through this through good and bad times and we're trying to basically say to our investors, we're going to basically have largely the same terms we've had before.

We're not trying to take advantage of the situation. I'd say that fees are probably roughly in the range they've been in the last couple of years. Transaction fees have largely gone away. But preferred returns are still reasonably high and that's in fact, a disguised fee and co-investment is still very important to people and that's in effect a disguised fee discount.

So I'd say that, maybe some smaller funds that are trying to raise money can probably take advantage of some situations if they really want to and they have a good track record. But if you're trying to raise as much money as we are, I think it's probably a good policy to kind of stick with your standard rules in terms of transaction fees, in terms of preferred returns and co-investment, and that's what we're really trying to do. We're saying to our investors, look, with the good and bad times, we're basically going to have the same terms with modest exceptions.

Operator: Thank you. Our next question comes from Brian Bedell with Deutsche Bank. Your line is open.

Brian Bedell

Analyst, Deutsche Bank Securities, Inc.

Q

Great. Thanks. Good morning. Maybe just to get started off and maybe just a clarification a little bit on the acceleration comment, David, that you made on the fundraising pace for the second half, is that on 2Q or first half? In other words, if it was on the 2Q pace then you'd be implying about a \$30 billion total roughly for the year, if it was on the first half, it would be more like a \$25 billion number, which I think is your annual run rate.

And then just, Bill, I appreciate your comments on the ability to deploy that and your sort of \$25 billion of framing from the U.S., European, and Asian fundraise in terms of what you feel like is a good amount for what you see as the opportunities. I guess, would that – as you raise the funds over the course of the back half of the year if we do get a substantial market correction later in the year, would that change your sort of deployment outlook that would then therefore circle back and potentially raise what you could do in, say, CP VII?

David M. Rubenstein

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

A

Well, I'll answer that first, and Bill can comment on it. I don't know if that was a disguised question to get me to change my earlier answer. But we expect that we'll raise the money at roughly the levels I discussed and we discussed earlier for those buyout funds. It will be somewhere in that range for those three buyout funds.

Now, if the market were to go down and making prices much cheaper, would we go raise more money? I don't think we would do that. We don't change our fundraising targets based on things that might happen over one or two months. There may be people who might want to give us more money, because it might be seen that prices are cheaper.

But we have, for example, in the U.S. Buyout, Bill can comment on this, I think over the recent years, we've been averaging roughly \$3 billion a year or something like that. And we think that we can probably deploy roughly \$3 billion a year and that's why we targeted that fund of that size. But Bill, you want to comment on that further.

William E. Conway, Jr.

Co-Founder, Co-Chief Executive Officer and Managing Director & Chief Investment Officer, The Carlyle Group LP

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Yeah, I'd say, \$15 billion is a good number for the U.S. Buyout fund. We've got a big team, 60 people. We don't tend to do giant deals. In fact, in the second quarter of the – I guess, roughly \$3.5 billion or \$4 billion were invested in the second quarter. There were only two deals in there that were over \$300 million in size. So we tend to do a lot of deals, that's why we have a relatively big team.

In terms of the impact of a market correction on the business, well, first of all, we have the existing portfolio, what happens to the value of the existing portfolio. And then you have the availability of doing new deals. Interestingly, when a market correction happens, generally, you don't do a lot of new deals; either you're afraid that gee, is this

going to continue, is it going to get worse or the sellers think this is very temporary, it's going to bounce right back. And therefore, they're not really anxious to sell.

So, by the way, I'm not expecting a market correction. But of course, you're never expecting it until it occurs. So I think that we can still find suitable deals to do, but it's really hard. I think we've moved to do a lot more structured deals, deals that would give us some downside protection.

Sometimes we've done more PIPEs. We've been more in deals that might have a debt component even in our private equity funds, or a preferred component in various ways to improve our structure, we might sit on top of the founder or something like that. But I don't want to underestimate how tough it is to put the money to work in today's market conditions.

David M. Rubenstein

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

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On the buyout funds, we've talked about them. But I don't want to ignore our credit funds and our real asset funds, and our solutions funds. They are all receiving pretty good receptivity in the market, and we expect that they will do quite well as well. And we make sure that our fundraising team doesn't lose focus on that either, because it's obviously probably a little easier to sell a U.S. Buyout fund, when it's eighth generation or seventh generation or real estate fund when it's eighth generation. Some of our credit funds are newer, but they're doing pretty well also. And I think we're pretty comfortable with the fundraising environment and the fundraising capabilities we have to get the \$100 billion.

Operator: Thank you. [Operator Instructions] I'm not showing any follow-up questions. I'd like to go ahead and hand the call back over for closing remarks.

David M. Rubenstein

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

Thank you, James, and thank you, everyone, today for joining our call. We look forward to speaking with you next quarter. If you have any additional questions, feel free to call Investor Relations at any time.

Operator: Thank you, ladies and gentlemen. That does conclude today's conference. Thank you very much for your participation. You may all disconnect. Have a wonderful day.

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