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# The Carlyle Group LP (CG)

Q2 2018 Earnings Call

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Good day, ladies and gentlemen and welcome to The Carlyle Group's Second Quarter 2018 Earnings Conference Call. At this time, all lines 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'd now like to hand the conference over to Daniel Harris, Head of Investor Relations. Please go ahead.

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### 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 2018 earnings call. With me on the call today are our Co-Chief Executive Officers, Kewsong Lee and Glenn Youngkin; and our Chief Financial Officer, Curt Buser.

This call is being webcast and the replay will also 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 Factors 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.

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.

Let me quickly summarize the results for the quarter. We generated \$58 million in Fee Related Earnings and \$115 million in Distributable Earnings in the second quarter with DE per common unit of \$0.29. Economic Income in the second quarter was \$272 million with after tax ENI per unit of \$0.69. Our distribution for the quarter will be \$0.22 per common unit

Also this morning, we announced the acquisition of 19.9% stake in DSA Reinsurance from AIG which Kew will discuss in more depth during his remarks. To ensure participation by all those on the call, please limit yourself to one question and return to the queue for any additional follow-ups.

With that, let me turn it over to you Curt Buser.

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### Curtis L. Buser

*Chief Financial Officer, The Carlyle Group LP*

Thanks, Dan. Carlyle's results in the second quarter demonstrate continued progress in growing our business and driving sustainable earnings growth. Our funds performed well, we grew Fee Related Earnings, increased accrued carry and we remain on track to achieve the goals we have laid out for this year and 2019.

Specifically, during the quarter our carry fund portfolio appreciated 5% with particular strength in our Real Assets and Investment Solutions segments. We invested \$3.5 billion with more than half of that deployed outside Corporate Private Equity. We raised \$12.3 billion in new capital and we realized proceeds of \$7 billion in our carry funds.

Our quarterly financial results reflect our focus on growing Fee Related Earnings. We generated \$58 million in Fee Related Earnings in the quarter, nearly triple the FRE generated a year ago and we expect FRE to continue to grow over the next few quarters. We now believe we will exceed our \$75 million quarterly target by the fourth quarter this year. In fact, today, we see the potential for fourth quarter FRE to be around \$85 million on a run rate basis.

During the second quarter, we activated management fees on our newly raised U.S. Buyout and Asia Buyout funds, contributing to the \$41 million increase in base management fees compared to the first quarter of this year. These two funds alone will drive incremental net management fees of over \$20 million in the third quarter.

Catch up management fees which have not been significant for over a year, contributed \$12 million in the quarter. Our strong fundraising results drove total fundraising related expenses to \$37 million, \$18 million higher than the first quarter of this year.

Cash compensation expense in the quarter was \$17 million less than this year's first quarter although equity-based compensation expense increased \$12 million over the first quarter to \$50 million. Fee-Earning Assets Under Management of \$146 billion increased by 26% compared to a year ago reflecting our strong fundraising results. Pending Fee Earnings Assets Under Management declined to \$10 billion from \$27 billion last quarter as we moved our newly raised U.S. Buyout and Asia Buyout funds into Fee Earning Assets Under Management.

Total AUM increased to a record \$210 billion, up 24% over the last 12 months. As we achieve our \$100 billion target next year, our fundraising pace will naturally decelerate as our largest funds are now fully reloaded.

Now, let's turn to review of our business segments. In Corporate Private Equity, management fees of \$148 million represented the highest level in three years, with the growth driven by \$33 billion in new private equity capital raised over the past year. Our investment pace this quarter was roughly in line with the year ago and as of June 30 we had over \$4.3 billion in equity committed to sign transactions that should close over the next several quarters. Realized proceeds for fund investors were \$2.9 billion in the quarter and more than \$13 billion over the last year.

During the second quarter, we had a final close on Carlyle Asia Partners V at \$6.55 billion. And just last week, we announced the final close for our seventh U.S. Buyout fund at \$18.5 billion. As of today, we have raised over €4.8 billion for our latest vintage Europe buyout fund although fees on this fund have not yet activated.

In addition to continuing to raise Europe buyout, we expect several other funds in Corporate Private Equity to begin fund raising over the next year, while Fee Related Earnings in Corporate Private Equity were only \$4 million in the second quarter, inclusive of over \$30 million in fundraising costs. We expect Fee Related Earnings in Corporate Private Equity to move higher in the third quarter, once we see a [ph] fourth (06:44) quarter impact associated with the fees on our new U.S. and Asia funds.

For the second quarter, Corporate Private Equity's Economic Income was \$100 million, driven by 3% portfolio appreciation. Distributable Earnings were \$40 billion and net realized performance revenues were \$28 million,

both below recent levels while realizations increased this quarter as compared to a year ago, a greater percentage of the current realizations are from funds that are in accrued carry but not yet generating cash carry.

Now turning to Real Assets. Fund performance was strong this quarter with appreciation of 9% in our Natural Resources funds and 5% in our Real Estate funds. Year-to-date capital deployed of \$2.7 billion is more than 80% higher than the first half of 2017, though the second quarter slowed from a very active first quarter.

Fee Related Earnings were \$33 million up from a loss in the second quarter of 2017. Results this quarter included the positive impact at \$8 million in catch-up management fees compared to less than \$1 million in the second quarter of 2017. Fee Earning Assets Under Management were \$32 billion up 20% year over year driven by fundraising in our U.S. Real Estate and NGP funds. We produced a quarterly record \$144 million in Economic Income and Real Assets and net accrued carry in our Real Assets funds increased to \$580 million, up 51% over the past year.

Distributable Earnings of \$52 million was also a record attributable to the strength in Fee Related Earnings and \$19 million in net realized performance revenue, largely driven by our U.S. Real Estate funds.

Moving on to Global Credit. Our progress to scale and broaden this segment are increasingly visible in our financial results and operating metrics. We raised \$2 billion of new capital for Global Credit in the quarter, including two new CLOs and several other re-pricings. We also raised capital for Direct Lending and managed accounts. We grew management fees by one third to \$60 million compared to the second quarter of last year and we expect continued growth as newer funds scale further and we attract and grow incremental managed accounts.

Fee Related Earnings reached \$12 million in the second quarter, up from less than \$1 million last year. Economic Income was \$11 million in the quarter and Distributable Earnings of \$15 million, were nearly double the year ago level. We are pleased with our progress in Global Credit but much work remains to be done over the next few years as we continue to build this business. Our investments in new products and new people could put pressure on Fee Related Earnings in the near term but we believe these investments will pay dividends for years to come.

Moving on to Investment Solutions, which had an active quarter realizing proceeds for fund investors with \$2.4 billion realized for the quarter, bringing the total to \$9.6 billion over the last 12 months. These realizations contributed to the sequential decrease in Fee Earning Assets Under Management from last quarter. While the Fee Earning AUM of \$30 billion is higher compared to a year ago, we expect fee earning AUM to decline as legacy assets run off.

Investment performance has been strong with fund appreciation of 8% in the quarter, driving Economic Income to \$17 million. Second quarter net performance revenues were \$11 million and \$39 million over the last 12 months. Net accrued carry in Investment Solutions reached \$87 million, up 58% compared to last year, both Fee Related Earnings and Distributable Earnings were \$9 million in the quarter.

Before I turn it over to Glenn, I'll make two final comments. First, as you may have read in late 2020 or early 2021, we will be relocating our main New York office to new space at One Vanderbilt, Midtown. We're excited about the new space which will increase efficiency and collaboration among our employees.

In the third quarter of this year, we will incur a one-time lease related GAAP charge of approximately \$60 million. This third quarter charge will be excluded from our non-GAAP results, meaning there will not be a Distributable Earnings impact. And second, during the quarter we repurchased and retired 2.3 million units for \$51 million. And

as of June 30, we had almost \$90 million remaining under our current authorization to repurchase units. In sum, we're pleased with the results for the quarter.

And with that let me turn it over to Glenn.

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## Glenn A. Youngkin

*Co-Chief Executive Officer, The Carlyle Group LP*

Thank you Curt and good morning everyone. To pick up where Curt just left off, we are making good progress across the entire business. And as you will hear from Kew, we are also excited about the DSA Re announcement this morning. I want to highlight two big picture takeaways from the quarter. First, fundraising momentum remained strong and we are ahead of our targeted pace for 2018. As a result, our new and larger funds are driving growth in Fee Related Earnings. And second our funds continue to perform well, generating our highest level of accrued carry positioning us for increased future realized performance fees.

So first on our fundraising momentum. We have raised a record level of new commitments, \$52 billion over the past 12 months and even though we had fairly high expectations for 2018, we are raising more capital at a faster pace than originally anticipated. We now expect to raise about \$30 billion for the year, up from our prior estimate of \$25 billion, which would bring us by the end of the year to about 87% of the way towards our \$100 billion target.

At the same time, some portion of the capital we are raising this year is being pulled forward from what was originally planned for 2019. We recently finished fundraising for the latest vintages of both our Asia Buyout and U.S. Buyout funds. In Asia, we have one of the best investment teams in the entire region, one that has consistently delivered great performance for our fund investors over the last two decades. And in the United States, our Private Equity team is moving from strength to strength.

As we have just finished investing our sixth fund and now raise the largest fund in Carlyle's history, along with the closer to date in Europe buyout and our three large regional buyout funds have received commitments of over \$30 billion, over 45% larger than their three predecessor funds, highlighting the growth in this segment. Outside of Corporate Private Equity, we continue to see strong investor interest in our latest vintage, Real Assets, Global Credit and Investment Solutions funds, with \$3.4 billion in commitments in the second quarter and more importantly more than \$19 billion raised over the last year.

The growing momentum in these segments is critical to achieving our long-term goals. The success we are having in fundraising is accelerating Fee Related Earnings growth. And as you've heard us say before, we remain extremely focused on growing Fee Related Earnings.

Moving on to the second topic, our investment performance continues to be outstanding, despite the very challenging investment environment. Overall, our carry funds appreciated 5% this quarter, compared with a flat return on the MSCI All Country World Index. Our performance was broad based with strong appreciation across all of our segments, but especially in Real Assets, which appreciated 7% and Investment Solutions which are appreciated 8% in the quarter.

As we said before, specifically in our Private Equity like investment strategies, we try to outperform public markets over the long term by 500 basis points to 1,000 basis points a year and we continue to deliver on that metric. Strong underlying portfolio company performance, as opposed to multiple expansion, drove fund depreciation in both Private Equity and Real Assets in the quarter.

Over the 12-month period through Q1 2018, median revenue and EBITDA growth in our Corporate Private Equity portfolio was 11%. We saw similar metrics across our Direct Lending portfolio. Our fund performance drove accrued carry to a record \$2 billion, which is up more than 25% from last year. And as you've heard us say previously, we continue to expect 2018 realized performance revenues to be below 2017. However, the strength of our fund performance in this level of accrued carry, gives us confidence that realized performance revenues should rebound in 2019 and beyond. The environment for new investments remains challenging with high prices and heavy competition in most every asset class.

We have deep experienced investment teams around the world hustling hard every day to find the right opportunities. And during the last 12 months, we invested nearly \$22 billion in our carry funds, underwrote more than \$2 billion in new loans and had almost \$5 billion in CLO activity. And while anything but easy, we do remain confident that we can deploy our \$81 billion of available capital into investments that meet our risk and return hurdles. However, as you know, our investment pace will vary quarter to quarter and we do expect near-term investment activity to be somewhat lower than our recent trend. That said, we generally have five to six years to invest the funds committed capital, which provides us the flexibility to remain patient.

Before I hand it over to Kew, let me spend a quick moment on our corporate structure. Right now, we do not have anything new to say. However, we are paying very close attention to how the market is reacting to those firms that have converted to SEACOR and we continue to evaluate the pros and cons of this conversion. So as you've heard, we remain firmly on track towards achieving our objectives for the year. We feel good about where Carlyle is today and even better about where we are going.

And with that, I'll hand it over to Kew.

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## Kewsong Lee

*Co-Chief Executive Officer & Chairman of the Executive Group, The Carlyle Group LP*

Thanks, Glenn. Earlier this morning, we announced that Carlyle has entered into a definitive agreement to acquire a 19.9% strategic equity stake in Fortitude Group Holdings, the parent of DSA Reinsurance Company Limited, a reinsurer wholly owned by AIG. In connection with this deal, DSA Re has also entered into an investment management agreement whereby \$6 billion of assets will be committed into a variety of Carlyle investment strategies.

Over the past few years, we have explored several options to increase our exposure to managing assets in the insurance space which is a growing global market of about \$15 trillion. Our partnership with DSA Re and AIG helps in this regard by extending our investment capabilities into the insurance sector. DSA Re is Bermuda-based reinsurance company with \$36 billion in GAAP reserves as of March 31, 2018. The company manages a diversified and seasoned portfolio of life annuity and general insurance policies.

The average duration of DSA Re's reserves is 12 years and about a quarter of those reserves have over a 30-year life. In other words, this partnership has the potential to provide long-term sticky sources of investable assets for Carlyle to manage. Given DSA Re's primary responsibility to satisfy the obligations it has made to its policyholders, Carlyle's ability to generate attractive long-term risk adjusted returns will help DSA Re grow its capital base, maintain healthy capital ratios and prudently manage risk.

Let me provide more details on the transaction itself and in the process give you additional commentary on why we believe this is an attractive opportunity for Carlyle. We will fund our acquisition of the 19.9% equity interest with an upfront cash payment of \$381 million to AIG and an additional payment of \$95 million in approximately five years.

We will finance this transaction with cash available on our balance sheet and expect to close the investment in the fourth quarter subject to customary closing conditions and regulatory approvals. The carve-out of DSA Re from AIG which is a complex process should take about 12 months to 18 months and teams from all parties are already engaged on this important work stream. In addition, the transaction structure includes reserve protection and other features that help protect our equity investment.

With respect to the investment management agreement, we will become the preferred alternative asset investment manager for DSA Re which has committed to invest \$6 billion over a 30-month period for existing Carlyle investment teams to manage. While the asset mix is still being fine-tuned, we expect approximately 40% of the capital to flow into Global Credit with the remainder in Private Equity, Real Estate, and Natural Resources investments.

Now regarding the economic benefits of this deal, we anticipate three streams of revenue for Carlyle. First, we estimate that the \$6 billion in new assets will eventually lead to approximately \$50 million of annual management fee revenue after the full amount is invested over the next several years. Second, if the investment returns we produce are consistent with our track record, we should generate performance fees on these investments over time. And third, we believe our 19.9% equity stake will create an attractive return on our investment through growth in franchise value and as dividends are declared by DSA Re consistent with the company meeting its capital requirements and obligation to its policyholders.

Looking forward, this investment better positions DSA Re and Carlyle to serve other insurance companies, which just like AIG have large pools of long-term liabilities for which they need help to generate reinsurance solutions and attractive investment returns. We see this sector broadly as an interesting source of future growth. Further, we will now have on the ground capabilities to develop new investment management products with long durations that may be very attractive to a subset of our traditional pension fund and sovereign wealth investor base.

To summarize, we're very excited about this new initiative, which extends our investment capabilities into the insurance sector. The deal is financially accretive. It improves our operating leverage across Carlyle and we now have a platform that could be a large new source of long-term assets for management from the insurance sector.

Let me end our prepared remarks with the following thoughts on the quarter and our current trajectory. We are ahead of where we expected to be on fundraising and Fee Related Earnings. Our investment performance remains exceptional, and the increase in accrued carry positions us well to deliver performance fees and Distributable Earnings in the future.

Our ability to reload our funds has ensured we have a substantial pool of capital to invest and we can be patient and disciplined in what is currently a challenging investment environment. We are making good progress in Global Credit, but this initiative will take time to fully develop and we are excited about the DSA Re transaction which extends our private capital investment capabilities into the insurance sector.

Thank you. Let me now open it up for questions.



## QUESTION AND ANSWER SECTION

**Operator:** Thank you. [Operator Instructions] Our first question comes from Bill Katz with Citigroup. Your line is now open.

William Katz

*Analyst, Citigroup Global Markets, Inc.*

Q

Okay. Thank you very much for taking the question. Hi and good morning, everyone. So, just maybe picking up on some of the last area in terms of the insurance opportunity, thanks for some of that guidance. I guess maybe taking that guidance a little bit further [ph] makes me (23:54) – I apologize, [ph] but it's a bit of a (23:55) multipart question. You mentioned [indiscernible] (23:59) help us out sort of tying between FRE, the revenue is down due to maybe the FRE impact, what kind of hurdle rates you think you need to hit in terms of the carry? And then, more broadly, how quickly do you think you could scale this opportunity with some other type of either similar deals or scaling this one as well? Thank you.

Kewsong Lee

*Co-Chief Executive Officer & Chairman of the Executive Group, The Carlyle Group LP*

A

Sure, Bill. First of all, with FRE, I think I just laid it out in terms of our estimate. Once the \$6 billion is allocated over and gets fully invested, we do think it's about \$50 million in annual management fee revenue that comes from that and I just want to point out there's very nominal amount of incremental expenses that will be needed to be added as a result of this transaction because the vast majority of these assets are being managed by existing teams on our platform.

In terms of the hurdle rate, nothing has changed there. The same hurdle rates apply as our normal terms, and so we're quite confident that should we perform as we have in the past that we will be able to generate performance fees. In terms of the timeframe, this will take about 30 months to bring in those assets as we work in partnerships with DSA and AIG. And then, finally, I think your last question was scaling and other types of things like that. I'm chuckling a little bit. You know, we've got a lot of work to do to just get this thing closed, and then get this thing carved out. Clearly, this platform if prudently managed is a great platform for future growth and if that happens, Carlyle and AIG will benefit. I think right now that we got our hands full just getting this thing going and deriving the benefits from this particular transaction.

William Katz

*Analyst, Citigroup Global Markets, Inc.*

Q

Okay. Thank you.

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

Patrick Davitt

*Analyst, Autonomous Research US LP*

Q

Hey, thanks for the question. I guess, to the third point on how to make money from the insurance vehicle, I guess, on appreciation of this stake, would there be plan, I guess, over the long run for it to become an independent company? And how would you expect to fund future acquisitions to the extent they come into play?

Kewsong Lee

*Co-Chief Executive Officer & Chairman of the Executive Group, The Carlyle Group LP*

A

Good question, in terms of independent company, clearly, AIG set this company on a path for independence and we, in conjunction with AIG and DSA management, will figure out what the ultimate path is for this entity. Is it a possibility that it becomes public or is it a possibility it diversifies its shareholder base. Obviously that there could be scenarios that could happen. Again right now, we've got our hands full just getting this thing carved out and working with management team to get it all set up. So that was the first part of your question. And then in terms of funding, it's a very large company and it generates a lot of cash. And our current assumption is that it will be self-funding as it relates to its growth.

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

Kenneth B. Worthington

*Analyst, JPMorgan*

Q

Hi, good morning. I apologize just a little bit pie in the sky, but Glenn and Kew, you guys have been in the top seats for six months or so, things seem to be going really well. You know fundraising seems to be going well. Performance is going well. The firm seems to be as well positioned as I've seen you guys as a public company and you've given us an awful lot of details on how well things are going during the call. But from a higher level like how are you using this position of strength to position Carlyle for the future.

The move to One Vanderbilt seems like a subtle, but maybe important example here. What other sort of changes are you making like from reporting lines to empowering certain positions to efficiency capital structure like what else are you doing and thinking about behind the scenes that might not have come in the details that you've given us during the call?

Glenn A. Youngkin

*Co-Chief Executive Officer, The Carlyle Group LP*

A

Ken, thanks for that question. And by the way thanks for the accolades at the start of it. We'll let you join our team. We are really focused on executing against what we've told you we're executing against. We're focused on driving investment performance. And you can see from the quarter that that continues to actually demonstrate itself in our results.

We're focused on finishing our fundraising goals as we've said. We're focusing on building the Credit business and we are focusing on growing FRE and all of the things that you hear us talk about just underpin those goals. And there's no massive shift in strategy. We're just executing against what we've told you all that we would execute against. As Kew had said in an earlier call, we were focused on the insurance sector and here we are executing on the insurance sector. So I don't mean to not give you a whole detailed plan but we are just doing what we said we were going to do. And I think it's going well.

Kenneth B. Worthington

*Analyst, JPMorgan*

Q

Okay. Thank you very much.

**Operator:** Thank you. Our next question comes from Michael Cyprys with Morgan Stanley. Your line is now open.

Michael J. Cyprys

*Analyst, Morgan Stanley & Co. LLC*

Q

Hi, good morning. Thanks for taking the question. I guess just changing topics on Real Assets, record quarter for that division. Could you just talk a little bit more about what's driving the success there? Can we expect this sort of degree of ENI in the segment to repeat in the coming years ahead and how should we be thinking about long-term earnings power in Real Assets which really seems to be getting a lot of momentum here?

Glenn A. Youngkin

*Co-Chief Executive Officer, The Carlyle Group LP*

A

Yeah. Thanks, Mike. The Real Assets segment, as Curt said, had a good quarter, but it's also had a good year and we do see good momentum there. And as you know, our Real Asset segment really has a number of components, energy, infrastructure and real estate and we're just seeing good performance from all of them. I think the key to the success over the course of the last year has been underpinned by the scale of the business that we've been able to obtain by the investment performance, I have to say both, the Real Estate and the Natural Resources portfolio, continue to go from strength to strength. The Natural Resources business as you saw was up 9% in the quarter, it's up in the high 20s over the course of the last 12 months. The Real Estate business was up 5% in the quarter and that's just good underpinning.

I think the second thing that we've done is we build just great teams and these teams continue to find good things to do. And I think finally we have a long-term vision of continuing to build the sector and so as Kew and I continue to chart the path, you'll continue to see us invest behind this sector, grow this sector and we think it will continue to be a good performer for us.

Michael J. Cyprys

*Analyst, Morgan Stanley & Co. LLC*

Q

Great, thank you.

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

Michael Carrier

*Analyst, Bank of America Merrill Lynch*

Q

Hi, thanks guys. Maybe just a question on FRE, so good [ph] luck (31:31) this quarter. Curt you mentioned the \$85 million for the fourth quarter in the run rate. Longer term, I think when we look at Carlyle in the past, you had probably a little bit more cyclicalities here than some of the peers. You guys have been much more focused on trying to drive that growth and maybe sustain it. Just wanted to get some sense on how are you looking at FRE over the longer term maybe what are you putting in place to maybe sustain the level or mute some of the cyclicalities that we've seen in the past? I mean then Curt, just if you have any color on the catch-up fees like the fundraising costs just over the next few quarters that's helpful as well? Thanks.

Curtis L. Buser

*Chief Financial Officer, The Carlyle Group LP*

A

Hey Mike, thanks for that. So you're right. You know there has been some natural cyclicalities in the business and we are focused very much on that and that's where really, kind of, they're growing both kind of scale, growing our Global Credit business, really the transaction we just announced, all of these will help to under support really kind of the core level of much higher results and much higher Fee Related Earnings than we've historically done and minimize the cyclicalities that you've seen.

I think there will always be some cyclical in the business so to say that it will eliminate, it is probably leading you in the wrong place. What I am really pleased about is the – what we've already seen in FRE growth and what we're expecting here in the next couple of quarters. You're going to see that continue to go up and that's factoring in the continued fundraising that we have and it's factoring in really everything else from an expense standpoint, from a catch-up management fee standpoint very little from – I would say from the historical perspective, \$12 million during the quarter mostly in Real Assets, \$8 million.

We'll see some going forward. But it really – memory always comes back to tacking back from when you turned on the fees originally. So the catch-up management fees, I think will be somewhat helpful, but it's really not going to be – I don't think a big driver going forward.

Fundraising cost, look, I think, as we are focused on that along with all of our expenses in terms of managing fundraising costs but we're going to see FRE continue to grow, and we think we'll hit that \$85 million number by Q4. So I'm feeling really good about how we've underpinned things on a go-forward basis.

Michael Carrier  
*Analyst, Bank of America Merrill Lynch*

Q

All right. Thanks a lot.

**Operator:** Thank you. Our next question comes from Robert Lee with KBW. Your line is now open.

Robert Lee  
*Analyst, Keefe, Bruyette & Woods, Inc.*

Q

Great. Thanks. Good morning, everyone. Thanks for taking my question.

Glenn A. Youngkin  
*Co-Chief Executive Officer, The Carlyle Group LP*

A

Good morning, Rob.

Robert Lee  
*Analyst, Keefe, Bruyette & Woods, Inc.*

Q

Good morning. I mean, look clearly fundraising has been exceptional for you, and many of your peers, and going even faster than anticipated. But I'm just curious, are there any strategies or products where maybe it's been more of a slog or LPs have been more resistant, and then maybe the second part to that mean that you and the industry's been enjoying such robust capital formation, and working kind of – what do you – as you look ahead, what are you kind of concerned about or think about that could kind of dampen the party so to speak, if you look ahead over the next couple of years?

Glenn A. Youngkin  
*Co-Chief Executive Officer, The Carlyle Group LP*

A

Well, good morning, Rob. It's Glenn. First, the fundraising success over the course of the last year as all of you know is driven by number of factors. The first is great performance. And the industry has performed and Carlyle has really performed. And as a result, our LPs around the world are increasing their allocations, and it's not just one category of our LPs, and we're seeing it across the board with increased allocations and strong support

across product lines and across the globe. So, no single category of our investors are driving this, no geography is driving this, it is just across the board uplift.

I do think that, of course, not everything gets raised as easily as everything else and one of our key factors is launching new products into the market and you've heard about some of the new things we're doing in Credit and Natural Resources and those new funds of course take a little extra lift, because they're new. And so, when you're raising fund VII or fund VIII or fund V, there's just a much longer track record, and so new stuff takes a little extra lift.

And then finally, I think the key for our industry is just to continue to perform. You heard me mention in my remarks, this 500-basis point to 1,000-basis point premium to public markets and it's not going to be every quarter, but over a long period of time, the industry, and particularly, Carlyle has to continue to outperform. And so, that's where you see us really investing in our internal capabilities to do that. And the good thing is we have a high degree of confidence we can continue to do that.

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Robert Lee

*Analyst, Keefe, Bruyette & Woods, Inc.*

Q

Great. Thank you.

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**Operator:** Thank you. Our next question comes from Brent Dilts with UBS. Your line is now open.

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Brent Dilts

*Analyst, UBS Securities LLC*

Q

Hi, good morning. Could you guys just talk about where you think we are in the credit cycle and how you're balancing growth in the Credit segment with that?

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Glenn A. Youngkin

*Co-Chief Executive Officer, The Carlyle Group LP*

A

High, great question, Brent. I think you can't talk about the credit cycle without having some sense for what's happening in the real economy. And clearly, everyone is focused on trying to understand kind of what inning we are with the current economic expansion, and from my perspective, it feels like we're in the later innings, not in the first few innings.

But having said that, the growth that we're seeing and the underlying health of the economy that we're seeing globally not only United States but in Europe and in China, continues to motor along. And right now, when we look at our portfolios be it on the Private Equity side but also as we track very carefully are all the loans and all the credits we have throughout our credit platform. Performance continues to stay on track and delinquencies and defaults are kind of in line with what we want them to be. And so it's one of these things where everyone is worried about the credit cycle per se.

I'm kind of much more focused on and the institution is much more focused on the underlying real economy which still seems to be supportive. I would also point out that with the recent volatility that everyone has seen, we are starting to see some pushback with respect to terms, spreads, and softer terms with respect to credit. Meaning there is some discipline that we're starting to see coming back into the market. I'm not saying that that's a trend, I'm just saying we've observed that there seems to be a little bit of a flattening out of spreads as opposed to compression and push back on terms as opposed to just a constant of terms just continue to get worse.

So, I don't know if that's helpful color to you but we clearly are on the later stages but everything we're seeing right now seems to suggest the real economy is still performing steadily and well.

Brent Dilts

*Analyst, UBS Securities LLC*

Q

Okay. Great. Thank you.

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

Gerald Edward O'Hara

*Analyst, Jefferies LLC*

Q

Great thanks. Circling back to the insurance platform for a moment, and picking up on the comments that it would be self-funding with respect to future growth, clearly realizing its early days, but perhaps you could elaborate a little bit on what that growth opportunity looks like either by industry or perhaps geography and perhaps some of the market dynamics there that that make it attractive? Thank you.

Glenn A. Youngkin

*Co-Chief Executive Officer, The Carlyle Group LP*

A

Sure. Gerald let me, it is early days. So let me – but let me try to give you a sense. First of all – let's keep in mind DSA and there's a really good cultural fit here with respect to AIG and the partner and the management team of DSA are quite talented that that we are truly focused on doing what's best for DSA and ensuring that our policyholders of DSA are well taken care of and that the risk is managed prudently and capital is managed prudently. So that goes without saying.

With respect to where there could be growth, if you take a step back, there is a \$15 trillion market of reserves and in many cases, these books of business are orphaned and tying up enormous amounts of capital on insurance companies balance sheets and what DSA intends to do when it's a very well positioned platform to do that with its talented team, with its global footprint and with its very diversified and seasoned portfolio, what its very well positioned to do is go engage in dialogue with the insurance sector to provide a solution which is a comprehensive solution not only from a reinsurance capacity perspective but also in investment perspective to take on those liabilities in a more efficient way than the current owners of the liability. So it's an enormous market. It's very different what we're doing than what others are trying to do.

We do think that there's real growth here but I don't want to get ahead of ourselves. We need to get this thing carved out. We need to work in partnership with AIG and DSA. We need to get this thing stood up. We need to rotate assets into Carlyle and get the \$6 billion of working and I'm sure as we go through all this, there will be ample opportunity in a prudent way for us to find real ways to grow.

Gerald Edward O'Hara

*Analyst, Jefferies LLC*

Q

Great. Thank you.

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

Glenn Schorr

*Analyst, Evercore ISI*

Q

Hi. Thanks very much. Maybe just a follow-up on Investment Solutions performance was awesome, you talked about some closings in Alpinvest, but maybe just a little more color on what's going on behind the scenes there?

Glenn A. Youngkin

*Co-Chief Executive Officer, The Carlyle Group LP*

A

Glenn, it's Glenn. Thanks for that question. And the Investment Solutions group really is performing well as we have kind of highlighted over the last few quarters. There's been good momentum from the investing side there. Their returns are strong. They particularly have seen the secondary business gained some momentum here from an investment pace standpoint over the course of the last quarter or so.

The co-invest business continues to be strong and we're really seeing some good movement in the real estate secondary's and co-invest business, so all good. I will highlight and I think Curt made a comment in his remarks that there is a legacy set of assets that came from the original owners of Alpinvest that will continue to bleed off. And so the Fee Earning AUM number and the AUM number will continue to highlight for you all that those assets are burning off and we are replacing them with what we think are very attractive assets that we manage. But the underlying performance continues to be good and we will continue to give visibility on that asset stream as it burns off.

Glenn Schorr

*Analyst, Evercore ISI*

Q

And is the secondary business, is competition heating up at all. We've just seen some other funds open across the board. I don't know if that has any direct and immediate impact on bid-ask spreads as you're taking on new business, just curious on secondary specifically?

Glenn A. Youngkin

*Co-Chief Executive Officer, The Carlyle Group LP*

A

Yes. Well the secondary business like all asset classes is competitive. There's lots of capital that's been raised to remind you that the Alpinvest funds have \$6.5 billion secondary's fund which they closed last year and it's a competitive market. I will say the Alpinvest team has a very unique approach. They aren't buying single LP positions but they are doing far more big deals recapitalizing GP structure deals and they are competing well and the returns are good.

Glenn Schorr

*Analyst, Evercore ISI*

Q

All right. Thanks very much, Glenn.

Glenn A. Youngkin

*Co-Chief Executive Officer, The Carlyle Group LP*

A

Thank you.

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

Brian Bedell

*Analyst, Deutsche Bank Securities, Inc.*

Q

Great. Thanks very much. Good morning. I have just two-part question, one for Curt, just on the FRE bill as we go into 2019, appreciated with the guidance of getting that run rate up to \$85 million in the fourth quarter. As you

think about the trajectory of funds moving into seeping AUM in 2019 versus a lot of the different investment initiatives that you have certainly in Global Credit, should we be thinking of as sort of a little bit more of an investment spend given your success in the business as sort of a counterweight to growing that \$85 million on a quarterly run rate into 2019? Or do you expect that \$85 million to move up?

And then, just one follow-up question for Kew on the insurance initiative. Thanks for going into a lot of detail on that, but you did mention how you think you're differentiated in your effort versus the others? Maybe you can go into a little more detail on that? Thanks.

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**Curtis L. Buser**

*Chief Financial Officer, The Carlyle Group LP*

A

Brian, thanks. Look, we remain focused on FRE and as we've given guidance, we've also been careful to use terms like run rate. And so, trying to really kind of signal not like peak numbers and cyclicity in the like, but really kind of what can we sustain and generate. And so the \$85 million is a number that I feel comfortable with, and I also feel comfortable that that's a good number to kind of think about on a sustained basis.

I think there's a number of things that will drive growth here in the near term as we've already seen U.S. and Asia and you'll get the full quarter impact next quarter. Europe buyout is a big fund, we've not completed raising that, we've not yet turned on the fees for that, and so that's going to be another big contributor to growing fees.

We have a number of other products that are in the market and as those turn on, they will also contribute and those are across really all of the segments. Our Global Credit business is really going to also contribute. We have a number of new products there and we're going to continue invest. Now, the caveats that I wanted to put in is just as Glenn remarked on Investment Solutions on the legacy runoff, there could be some near-term pressure on FREs there and there could be some near-term pressure on Global Credit really as we continue to invest, but we really think that that's going to be a nice trajectory long term. Overall though, that FRE number, I'm feeling really good about and that takes into account all of those items that I just mentioned on the total basis.

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**Brian Bedell**

*Analyst, Deutsche Bank Securities, Inc.*

Q

Okay.

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**Kewsong Lee**

*Co-Chief Executive Officer & Chairman of the Executive Group, The Carlyle Group LP*

A

Hey, Brian. In terms of differences, we're just very different. We're not consumer facing at all, we don't need to set up origination or distribution channels or deal with wholesale channels to originate policy from the end consumer. So we're not consumer facing, and our DSA is a very broad and diversified book of business. It's not model line. It's in a broad range of both P&C and life product lines, as well as it's just extremely global.

So I'm not so sure you can really compare apples and oranges, we're just different. What we like about our platform is all about is that first and foremost this is a season book of really long tail – long duration liabilities and it sets up a really great path for potentially sticky assets to come to Carlyle in the future. And the platform itself, it's a real one of the leading companies in the industry. And so I'm not trying to avoid your question at all, I'm just trying to point out, it's just very different, the \$15 trillion market is humongous and we just have a differentiated and a different way of approaching, how we can extend our investment management capabilities into that sector.



Brian Bedell

*Analyst, Deutsche Bank Securities, Inc.*

Q

And just the timing, I guess, of doing, I guess, it's hard to assess completely because it's such a huge market and there's a lot of business that can move in that direction, but do you sense there's an urgency on the part of insurers to – need to do more of these types of arrangements or are they more thoughtful [ph] aren't (49:00) going to be relieved by this sort of a protracted long-term growth dynamic?

Kewsong Lee

*Co-Chief Executive Officer & Chairman of the Executive Group, The Carlyle Group LP*

A

My perspective is that there is a lot of interest from the sea level down in the insurance sector as to how to free up capital in managed capital more efficiently and how to take care of these types of liabilities in a fashion that is very favorable to policyholders. That is a huge need that a lot of companies in the insurance sector, quite frankly have faced forever, but the pressures of a low yield investment environment for a prolonged period of time, juxtaposed against regulatory and rating agency regimes in terms of capital consumptiveness of supporting the investments and these books of businesses, it's just a moment in time when I think you'll see a prolonged period where insurance companies are going to be looking for holistic solutions with trusted partners to figure out what to do with these types of long duration reserves.

Brian Bedell

*Analyst, Deutsche Bank Securities, Inc.*

Q

Great thanks very much for that color.

**Operator:** Thank you. [Operator Instructions] Our next question comes from Alex Blostein with Goldman Sachs. Your line is now open.

Alexander Blostein

*Analyst, Goldman Sachs & Co. LLC*

Q

Great, thanks. Good morning, everyone. Just going back to the discussion around FRE and scale. I guess looking at the \$85 million that you highlighted for the fourth quarter, feels like you guys will be 20-plus% FRE margin when you get to that point, you're still fundraising and investing in the business. So I guess looking out a year plus, once you're through the fundraising cycle, how do you guys think about FRE margins overtime and what do you guys think that could go. And then I guess more specifically, does the \$85 million include any contribution from the DSA transaction to FRE? Thanks.

Curtis L. Buser

*Chief Financial Officer, The Carlyle Group LP*

A

Alex, Thanks. So first the \$85 million does not include anything from DSA in that number, so that is incremental. Now regarding FRE margins, specifically, we have a lot more further work to do on FRE margins, before we really commit to a target. I remind you what I said last quarter, talked about a prior high of about 23%. If you look at the numbers this quarter we're at 17%. And I fully see this getting back to that 23% and pushing through that, probably pushing through that sometime in 2019 but not yet committed to putting a new number on the page. We need more work to do and look things like growing the Credit business, DSA Re, other thing that we are working on will hopefully all be additive.

**Operator:** Thank you. Our next question is a follow-up from Patrick Davitt with Autonomous Research. Your line is open.

Patrick Davitt

*Analyst, Autonomous Research US LP*

Q

Thanks for the follow-up. Will the DSA assets flow into new funds as they raised or kind of co-invest from some sort of separate account vehicle. And to what extent, should we think about it as incremental to money, you probably would have raised already, I guess, in other words is it just replacing money, you could have raised from another LP at some point?

Kewsong Lee

*Co-Chief Executive Officer & Chairman of the Executive Group, The Carlyle Group LP*

A

Hey, Patrick it's Kew again. That's a great question. Suffice it to say, we're pretty sensitive to understanding the difference between incremental versus cannibalization. And I think it's fair to say through in essence, an SMA like structure. We believe that a significant portion of the assets we manage on behalf of DSA will really be incremental.

So let me leave it at that and a large portion of this is going to be dependent on exactly what rotates over, exactly what asset classes it goes into et cetera. But we're quite cognizant of the important issue you raised, and we feel very good about the way we have structured, how we will be able to deploy the assets that come over to us.

**Operator:** Thank you. Our next question is also a follow-up from Robert Lee with KBW. Your line is now open.

Robert Lee

*Analyst, Keefe, Bruyette & Woods, Inc.*

Q

Great. Thanks for taking my follow-up. I'm just curious, I mean I haven't heard too much commentary about it on this call or in recent calls, but in the past you did talk about expanding the PE franchise into, what I guess we could call core PE into more long dated PE, and I think the same thing in Real Estate. Can you maybe just update us on some of those initiatives and your current thinking and then how they're going?

Glenn A. Youngkin

*Co-Chief Executive Officer, The Carlyle Group LP*

A

Sure. Sure, Robert. Great question. So, yeah, Carlyle was one of the first, if not the first firm to get into the long dated Private Equity business. We launched Carlyle Global Partners 1, although it didn't have a 1 at the time, because it was the first one. But we launched Carlyle Global Partners several years ago and it's now [indiscernible] (54:40) so well that we are imminently about to launch Carlyle Global Partners 2. And it's a fund that has close to \$3 billion already invested into the ground. And we have some very happy limited partners, and we see increasing demand from our LP base to allocate into a longer data type of a strategy in a very complementary way to traditional buyout strategy.

So on the Private Equity side, we feel we're very well positioned and are in fact trying to scale that strategy up. Clearly, you've also heard what we've done in other asset classes, CTI which has raised over \$1 billion already, \$1.6 billion, I believe, is – and it's an open ended fund, it's a form of permanent capital. It targets an ability to find not really core, but core plus rates of return in real estate with the benefit of a capital base which allows it to hold these assets for a much longer period of time.

Clearly, our BDCs got a lot of permanent capital in it, BDC 1 is already public as you know. The leverage ratio has just changed to the total asset in AUM, power so to speak of that franchise only has scaled up. And then initiatives like that from a permanent capital perspective are terrific. But to your first question on just longer dated

and longer oriented assets, I think the initiatives that we've put in – that we got started several years back on the Private Equity side and Real Estate side are actually doing quite well and continue to scale up.

Robert Lee

*Analyst, Keefe, Bruyette & Woods, Inc.*

Q

All right, thank you.

**Operator:** Thank you. And our next question is a follow-up from Michael Cyprys with Morgan Stanley. Your line is now open.

Michael J. Cyprys

*Analyst, Morgan Stanley & Co. LLC*

Q

Hi, thanks for taking the follow-up. Just wanted to circle back on the flagship funds that you're raising, if you could just talk to how the economics in terms on those funds differ from the prior generation maybe in terms of some of the step down dynamics [indiscernible] (56:53) et cetera, I think any color you can share there would be helpful. Thank you.

Kewsong Lee

*Co-Chief Executive Officer & Chairman of the Executive Group, The Carlyle Group LP*

A

Sure yeah. Hi, it's Kew and thanks for that question, Mike. Without getting into fund by fund details, let me just kind of lay it out like this. We feel great about the fact that we are raising our flagship funds on a fee basis that's comparable without real degradation of our weighted average fee from our previous fund. And if anything, I would say the softer terms in terms of periods and resets et cetera are all the same or in some instances better. So you should assume – and obviously our carry rate hasn't changed. You should assume the economics and the structure are the same or in some instances a little bit better than what we've had in the past.

Michael J. Cyprys

*Analyst, Morgan Stanley & Co. LLC*

Q

Okay. Thanks.

**Operator:** Thank you. I'm showing no further questions in queue. So I'd like to turn the conference back over to Mr. Harris for closing remarks.

Daniel F. Harris

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

Thank you all for your time and interest today. If you have any follow up questions, feel free to reach out to Investor Relations and we look forward to talking to you again next quarter.

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

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