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The Carlyle Group, Inc. (CG)

Q1 2020 Earnings Call

CORPORATE PARTICIPANTS

Daniel F. Harris
Managing Director & Head-Public Investor Relations, The Carlyle Group, Inc.

Glenn A. Youngkin
Co-Chief Executive Officer & Director, The Carlyle Group, Inc.

Kewsong Lee
Co-Chief Executive Officer & Director, The Carlyle Group, Inc.

Curtis L. Buser
Chief Financial Officer, The Carlyle Group, Inc.

OTHER PARTICIPANTS

William Raymond Katz
Analyst, Citigroup Global Markets, Inc.

Craig Siegenthaler
Analyst, Credit Suisse Securities (USA) LLC

Kenneth B. Worthington
Analyst, JPMorgan Securities LLC

Gerald Edward O'Hara
Analyst, Jefferies LLC

Glenn Schorr
Analyst, Evercore ISI

Michael J. Cyprys
Analyst, Morgan Stanley & Co. LLC

Patrick Davitt
Analyst, Autonomous Research LLP

Dean Stephan
Analyst, Bank of America Merrill Lynch

Daniel Jacoby
Analyst, Goldman Sachs & Co. LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen. And thank you for standing by. Welcome to The Carlyle Group First Quarter 2020 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 follow at that time. [Operator Instructions]

I would now like to hand the conference over to your host, Mr. Daniel Harris. Please go ahead, sir.

Daniel F. Harris

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

Thank you, Tiffany. Good morning and welcome to Carlyle's first quarter 2020 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 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 Factors section of our annual report on Form 10-K and other SEC filings that could cause actual result to differ materially from those indicated. Carlyle assumes no obligation to update any forward-looking statements at any time. Early this morning we issued a press release and detailed earnings presentation which is also available on our Investor Relations website. For the first quarter, we generated $129 million of fee-related earnings and $175 million in distributable earnings, with DE per common share of $0.48. We have declared a quarterly dividend of $0.25 per common share. To ensure participation by all those on the call, please limit yourself to one question and then return to the queue for any additional follow ups.

And with that, let me turn the call over to our Co-Chief Executive Officer, Glenn Youngkin.

Glenn A. Youngkin

Co-Chief Executive Officer & Director, The Carlyle Group, Inc.

Thank you, Dan, and good morning, everyone. Thank you for joining us. To describe the current global health and economic crisis as unprecedented feels wholly inadequate. The human toll is tragic and the economic damage has been extensive. I want to start by thanking all of the healthcare professionals and frontline workers helping to protect and heal our communities. Our thoughts and prayers are foremost with the people and families across the globe that have been and continue to be impacted by this pandemic. As the situation has continued to unfold, our top priorities at Carlyle have been and remain the health and safety of our people and their families, as well as supporting our portfolio in every way we can, and ensuring that we can continue to deliver for investors and all stakeholders by mobilizing our extensive global platform and every resource at our disposal.

Carlyle was in a position of strength leading into this crisis, which has provided us great stability. The pandemic has shocked the world over the past four months, but we've been able to mobilize quickly and decisively, thanks to the great work and continuity across our entire global platform. Kew and I are incredibly proud of The Carlyle team. We have found an even greater level of both collaboration and commitment, and compassion and service. The first quarter of 2020 started off exceptionally well with our 2019 momentum continuing. At the firm level, our outlook for the year was developing as envisioned with solid earnings growth, substantial dry powder from our $110 billion fundraising campaign, our successful transition to a C-corp and a sturdy balance sheet. In addition, our portfolios were in good shape and performing well with strong investment and exit pipelines.

In the first quarter, we were able to execute several IPOs, secondary trades and announced transactions, including the IPO of One Medical and the sale of Sundyne from our US buyout portfolio, block trades in China Literature and MicroPort in our Asia buyout portfolios, and numerous sales from our US real-estate funds. Fundraising momentum continued into the early part of the year with $7.5 billion of new capital raised in the first quarter. So while the pandemic has shocked the world, Carlyle was sturdy and steady going into the storm. Upon the onset of the crisis in January, our China team took decisive action, which set the precedent for our other regions and accelerated our decision-making process in Europe and the United States. In March, we quickly moved all of our US and Europe employees to work remotely. We then activated our business continuity plans and to-date have seen near-perfect execution.

Early on, Carlyle's investment teams were active, stress testing every equity and credit position in our portfolio and making decisions for each asset based on varying levels of business disruption. And One Carlyle, our global resource platform, has been in action like never before, using all of our capabilities to provide support for our portfolio companies. We've also been leveraging many of the company's unique offerings particularly in healthcare and technology to help provide solutions to the most pressing issues as many of our companies have also been out-front in the fight against the virus. For example, PA Consulting has done great work coordinating efforts to source ventilators for patients in the UK, and most recently, Ortho Clinical Diagnostics announced breakthrough work to rapidly deploy antibody tests

With that said, it is clear that the next few months and quarters will be challenging. It is our view that the recovery will progress in fits and starts and will take longer than what we all would have hoped. With this in mind, we remain fully committed to our top priorities, but also to our strategy as long-term investors and partners to our portfolio companies and our LPs. We're planning for and preparing for a wide range of outcomes, and we do remain in a strong position with $74 billion of dry powder, a $1 billion of cash on our balance sheet and $525 million in capacity in our revolver, a global team and platform that are stronger than ever, and deep experience across Carlyle as we have previously operated successfully through economic, financial and market crises.

There's no doubt that we have much work to do, and I'll hand it over to Kew to walk you through some of our thoughts for the future. I again want to reiterate that our leadership team is active and focused on driving value for our fund investors and shareholders. And we thank you for your commitment to us and we assure you that The Carlyle team remains equally committed to all of you.

With that, let me turn the call over to Kew.

Kewsong Lee

Co-Chief Executive Officer & Director, The Carlyle Group, Inc.

Thank you, Glenn, and good morning, everyone. And let me echo our sentiment of gratitude towards our healthcare professionals and frontline workers serving our communities around the world. I'm going to discuss our views on the impact of the current situation on our business, and after some financial commentary from Curt, we'll wrap up with thoughts on the future. As Glenn noted, Carlyle was well-positioned before the crisis. Our momentum has slowed but not stalled. We believe that could be a continuing and significant impact from this pandemic. The severity and duration of various health and economic issues and the shape and nature of the recovery are still unknowns, and therefore, all of this will take longer to play out than not.

Our experience managing through disruptions in cycles in the past inform us of our past now. We are taking a cautionary stance in maintaining a balanced and patient perspective. By doing so, we are confident that, over time, our shareholders as well as public pensions, endowments and foundations will benefit as we use our well-positioned global platform to drive value from our existing $143 billion of assets in the ground, and put our $74 billion of dry powder to work towards attractive opportunities as they emerge around the world across various sectors in all asset classes. We'd like to share our thoughts on how our business and the industry could be affected by this crisis in an effort to be as transparent and helpful as possible.

So let me address three important dimensions; deal activity, valuations and fundraising. First, the volume of traditional private equity investments is likely to decline significantly in the short term. Investors will step back and assess the real economic impact of the pandemic on businesses, their prospects and valuations. In our experience, financial buyers mark-to-market faster than sellers, and thus there's likely to be reduced traditional deal activity for several quarters or more until some of this uncertainty abates. The majority of our $74 billion of dry powder was recently raised. We can afford to be patient and disciplined, and we look forward to many attractive opportunities, but it will take some time.

Similarly, traditional [indiscernible] (00:09:33) activity will be put on hold as IPOs are delayed and sale processes are put on pause until M&A activity and more confidence returns. Keep in mind, our fund structures do not have liquidity risk, and at Carlyle we are never forced sellers and have the ability to hold assets through periods of market volatility and continue to build value in our companies and portfolio. We believe investment activity will recover at different rates and vary by asset classes, regions and sectors as the path to recovery becomes clear. One bright spot is that credit deployment has already seen a significant increase as several of our funds are exceptionally well positioned to capitalize on current market dislocations, particularly in credit opportunities, distressed and special situations.

In addition, we are starting to see interesting new opportunities in Asia and in our secondaries business, and certain global sectors benefiting from structural changes like technology and healthcare may present opportunities earlier than more cyclical sectors. Certain industry sectors may experience more than just a short-term impact. Notably, the energy sector is undergoing a significant structural dislocation on both the supply and demand side that is likely to take more than a few quarters to play out. However, over the long term, we have more than $4 billion in dry powder to invest into new opportunities across our energy-related funds and what could be attractive valuations.

Let me now turn to the second important factor and speak to valuation challenges that could last beyond the quarter. As the full impact of global shutdowns and an uncertain recovery becomes more evident, there could be additional pressure on fund valuations. While interim marks are important, the more significant driver of realized earnings in the future is the improvement in growth and performance of our portfolio companies over the long term, which is why one of our major priorities as an investment organization is to focus on our invested assets and drive value creation at our portfolio companies. We thought it would be helpful to share with you the diversification and how some of our most important portfolios are constructed in aggregate.

With respect to the remaining fair value of our entire Corporate Private Equity portfolio, we have very little direct consumer retail exposure at about 5%, relatively low exposure to commercial aviation at approximately 7%. We have very little energy exposure at 2%, and less than 1% exposure to lodging and hotels. Finally, only 7% of the remaining fair value of our Corporate Private Equity portfolio is in publicly-listed securities. Similarly, in our United States real-estate portfolio which represents far and away our largest holdings of real-estate assets, we had only 2% of our US real-estate fair value invested in hotels, 2% in traditional office and only 1% in retail. Our energy exposure is largely concentrated in separate funds which account for approximately $13 billion of fair value or roughly 9% of total firm-wide fair value. The segregation of these energy-focused funds, which is a conscious design of our investment platform, is important because the performance and carry potential of our Corporate Private Equity and other carry funds is independent of the results from these energy funds.

Without a doubt, we will have some issues and troubles in each of our funds that will be problematic and need to be worked through, but our diversification and the way we have constructed our portfolios gives us confidence that over the long term we are well-positioned to continue driving performance and significant value creation. And having done so in the past, we believe our limited partners have come to appreciate our ability to deliver relative outperformance compared to public market indices.

Finally, let me address fundraising, which in aggregate is likely to slow down in the short term as investors try to understand the current environment and their own specific needs. LPs are assessing the impact of this crisis on their portfolios and evaluating the denominator impact, allocation targets and liquidity schedules in light of market volatility.

Our experience is that their pace of new commitments will slow down temporarily while they continue to fund their existing commitments. Having said this for the industry as a whole, some LPs will be more aggressive about continuing to lean into alternatives, and there will be opportunities to raise capital for tactical strategies in the near term to take advantage of dislocations, particularly in the credit asset class.

In the short term, we are in good shape as we have just completed a multi-year $110 billion fundraising campaign. And over the medium to longer term, and what we have great confidence in, is that fund investors will ascribe increased value to relationships with their most trusted, well-resourced and experienced partners. We believe this positions Carlyle well for the potential to gain more wallet share from our limited partners as the fundraising environment stabilizes in the future.

Given these comments with regards to deal activity, valuations and fundraising, it's understandable there is more uncertainty with respect to near-term financial results. And we feel it is therefore prudent to remove prior guidance and, for the moment, refrain from providing comprehensive guidance for the future. We have a strong handle on our business and the factors affecting us, but believe it is appropriate to take our time to better understand the nature and path of recovery in the real economy and markets. To be clear, removal of our guidance should not be interpreted as anything other than our continued desire to build long-term credibility with our shareholders.

Before I hand the call off to Curt, let me conclude with this. The private capital industry has experienced attractive growth over the past several decades. This trend is likely to continue as private markets will remain an important source of capital and play an important role as the economy recovers. With every investment we make, we drive value creation and serve the pensions, endowments and foundations that will need our performance now more than ever.

Let me turn the call over to Curt to go through our financial results and then I'll come back with some final thoughts. Over to you, Curt.

Curtis L. Buser

Chief Financial Officer, The Carlyle Group, Inc.

Thanks, Kew. In my remarks, I will briefly discuss first quarter 2020 results and then frame some of the important issues we're watching. Let's begin with our results for the quarter.

Fee related earnings were $129 million with a 33% margin, up from $103 million in the first quarter of 2019. We recovered $30 million of litigation costs in connection with the final settlement of the Carlyle Capital Corp. litigation, which is included as a reduction of G&A expense. Excluding this recovery, FRE would have been $99 million with a 25% margin, which reflects some specific revenue shortfalls that developed in March due to the pandemic related to CLOs and transaction fees, both of which I will comment on further in a minute.

Net realized performance revenues began the year on plan with several carry-producing exits, which then slowed as the crisis emerged globally in March. Overall, pre-tax distributable earnings were $175 million in the first quarter compared to $101 million in the first quarter of 2019. With markets still unstable and exit slowing, the pace of realizations over the next few quarters is expected to slow and quarterly realized performance revenues are likely to be below this quarter for the next several quarters.

Our valuations were lower in the quarter. Our Corporate Private Equity funds depreciated 8% in the first quarter compared to the MSCI All Country World Index decline of 23% over the same period. Real estate was generally stable, down 1% in the quarter, while our natural resources funds, which have a large energy component, depreciated 22%. Investment Solutions appreciated 1% in the quarter, reflecting the standard one-quarter lag in portfolio valuation for this segment. As a result, in total, net accrued performance revenue on our balance sheet declined to $1.2 billion from $1.7 billion at year-end. It's important to note that our accrued clawback remained insignificant and unchanged from year-end. And while it's possible that our net accrued carry could further decrease, should values continue to decline, we do not expect a material change in our accrued clawback.

As Kew said, given the very high level of uncertainty for the rest of 2020, we are not able to provide comprehensive forward guidance at this time, but let me frame certain aspects of our fee revenues and expenses, starting with fee revenues. One key point is that approximately 98% of our management fees arise from fee-earning AUM located in closed-end fund structures with no redemption risk.

Furthermore, approximately 90% of our fee revenues are from traditional closed-end, long-dated funds for which our fees are highly predictable and stable and have very little exposure to fund valuations. While we have $12.5 billion of pending fee-earning AUM that has not yet activated fees, further management fee growth relies on new vintages or new carry fund families. To the extent fundraising is delayed, growth of this revenue base will be similarly delayed.

With regards to the other 10% of fee revenue, we earned about $120 million annually from management fees on our CLOs in the form of base fees and subordinated fees. Subordinated fees represent about 70% of this revenue base. Credit rating downgrades across the industry may cause the subordinated fees to be deferred. These deferred fees can be subsequently turned back on and recaptured based on the actual default rates and cash returns within the CLO structures.

During this quarter, we did not recognize $4 million of subordinated fees which were deferred. If the rating agencies further downgrade bonds and loans in which the CLOs have invested, it's likely that CLOs across the industry will experience revenue deferrals over the course of this year. During the Great Financial Crisis, we saw the majority of CLOs across the industry shut off subordinated fees, but 100% of our CLO subordinated fees were turned back on and all of our deferred revenue was recovered. Finally, transaction and advisory fees generated $53 million of fee revenue in 2019 and are likely to trend lower with a slower pace of closed investments.

Shifting now from revenues to expenses. Cash compensation was $204 million in Q1 2020, generally in line with the first quarter of 2019. In a given year, a little over half of total cash compensation and benefits expense is due to variable year-end compensation. We will actively manage this level based on actual results for the year. We have control over our professional fees, travel and entertainment, and general and administrative expenses, which in some cases, like travel, will be lower and, in other cases, where we'll even more tightly manage expenditures. When you put all of this together, it's really hard to say where exactly our 2020 distributable earnings will land. Forecasting FRE is more doable. But given the current economic uncertainties, we are currently estimating a wide range of $400 million to $450 million for our 2020 FRE outlook.

Two last items. First, we continue to manage equity-based compensation expense. And the $32 million in equity-based compensation expense compared to $39 million in the first quarter of 2019 represented a 19% decline. Second, as Glenn noted, we are in a strong liquidity position and accordingly declared a dividend of $0.25 per share, in line with our planned fixed dividend of $1 annually.

With that, let me turn the call back over to Kew.

Kewsong Lee

Co-Chief Executive Officer & Director, The Carlyle Group, Inc.

Thank you, Curt. Let me end with a few thoughts on the future. The crisis has slowed, but by no means stalled the momentum we've established coming into this year. Our focus has not wavered and we are uninterrupted in our work of driving value in our companies. Our 2020 financial results will reflect our solid start to the year and the relative stability of our fee earnings as we now adapt to emerging opportunities and trends and take advantage of our strong position to deliver on 2021 and beyond.

To that end, our investment strategy remains on track. We are a global investment firm with a long-term orientation, seeking to generate attractive and consistent performance for our investors who are relying on us now more than ever. We are focused on generating as much value as possible from our existing and highly diversified portfolio for our fund investors and our shareholders. We are also patiently investing our dry powder and believe many attractive investment opportunities will emerge in the years to come.

Our business strategy remains on track. We are growing our best positioned and most scalable investment funds, managing our expenses prudently and finding the right opportunities to selectively expand and diversify our business.

Our financial objectives are unchanged. We are focused on driving FRE each year, generating significant distributable earnings over the medium to long term, which in combination with FRE provides for a long-term attractive earnings growth profile, continuing to control equity dilution over time and protecting and increasing our dividend over time on a lagging basis to our FRE as it grows.

No one could have predicted this pandemic, but we had already been preparing our organization and investing with the mindset that we were late cycle in the economy. Over the last three decades, we have become an industry leader, given our ability to build better businesses in partnership with great management teams through all sorts of economic and market cycles.

We have confidence that our platform positions us well to navigate through and adapt to a new environment as we continue to find attractive investment opportunities and fund our strategies by raising significant amounts of new capital. We thank you for your support and partnership and hope that all of you stay safe and healthy.

With that, let's turn the call over to the operator and take your questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Bill Katz of Citigroup.

William Raymond Katz
Analyst, Citigroup Global Markets, Inc.
Q

Okay. Thank you very much and I hope everyone is safe and healthy on your end as well. Thank you for the commentary. Just maybe Curt for yourself, relatively wide range on the FRE. I was wondering if you might be able to help us sort of frame the upside/downside of that range, what some of the underlying assumptions might be either micro or company-specific that would range it between the $400 million to $450 million?

Curtis L. Buser
Chief Financial Officer, The Carlyle Group, Inc.
A

Thanks, Bill, for your question and good to talk to you this morning. So, first, I just want to reiterate, we remain really focused on growing fee-related earnings and also improving our FRE margin over time. We have a great handle on our business. But even with having a great handle on our business, there's still much that we don't know about how the pandemic will play out and how it will impact us.

So, for example, I don't know what further downgrades to expect from the rating agencies and how that could potentially affect our CLO subordinated fees, as I described in my opening remarks. I'm hopeful that it has really no material effect, and you can kind of see it was only $4 million here in the first quarter. But if you look back to the Great Financial Crisis, obviously, it had a bigger impact.

That said, there are a lot of great aspects of our business model that clearly help. 98% of our fee-earning AUM has no redemption risk, 90% of our fee revenues is from predictable and stable management fee streams and our LP defaults have historically been non-existent. So, we remain committed to growing FRE. But right now, it's hard really to kind of exactly see how this plays out, and we have a lot of good levers. And right now, I think it's the right thing to kind of appropriately set this in the $400 million to $450 million. Bill, it is a wide range. I wish I could give you much more precision, but it's just too early in the year to give you that kind of precision.

William Raymond Katz
Analyst, Citigroup Global Markets, Inc.
Q

Okay. Thank you.

Operator: Your next question comes from the line of Craig Siegenthaler with Credit Suisse.

Craig Siegenthaler
Analyst, Credit Suisse Securities (USA) LLC
Q

Thanks. Good morning, everyone, and hope you're all healthy. I just wanted to start with the credit marks. With a 21% mark for your credit carry funds, I wanted to see what were the marks in the businesses that are not in carry funds like CLOs, direct originations, and I'm not sure if you include aviation and structured credit or not, but I was interested in that mark too.

Curtis L. Buser
Chief Financial Officer, The Carlyle Group, Inc.

A

Craig, hey, thanks for your answer. So, again, as we think about our Global Credit carry funds, the 21% is just the carry funds, and the carry funds are about 25% and that number is inclusive of the aviation business. But it doesn't include the direct lending. It doesn't include the other aspects of the business including the CLOs. The CLOs fundamentally really don't drive off of their marks, right. They drive off of the default rates within the underlying CLOs and so really not as relevant.

I need to be a little careful about disclosure around the BDC at this time because it's a separate public company and hasn't separately released its earnings. The key thing in that business is managing those portfolios over time. Key thing is managing default rates and how it all plays out over time, we remain really optimistic about it. Lots of great opportunities to come. And I think that you got to put that 21% clearly in perspective. It has a high energy concentration. That's from our energy mezz funds, and so I wouldn't let that distort the whole thing. And that's why we only give you the carry funds because it's the only thing that's really comparable here.

I don't know if Kew or Glenn if there's anything you'd like to add to that?

Kewsong Lee
Co-Chief Executive Officer & Director, The Carlyle Group, Inc.

A

Hey Craig, it's Kew. How are you? Let me just give you a little bit more color and Curt did a good job of laying out the numbers and making a big distinction as to the performance of carry versus the other strategies we have in the portfolio. And remember, credit is a platform-based strategy.

With respect to the marks that you saw, a large portion was driven in our energy mezzanine strategy, which several quarters ago we've already announced it's not a continuing strategy of Carlyle. The other main driver of the marks within our distressed business, which had a little bit of energy exposure, in the one fund that we can talk about its performance, which is a mature and fully invested fund, I can tell you the gross IRRs in that fund even after these marks is in excess of 20%. And the newer fund, about half its capital is still available to invest. And I think it's fair to say, distressed is one area where there's lots of great opportunities right now. And so having that dry powder is terrific. So, if you look at that with some color, a lot of the marks are driven by what I would call strategies that we're not really going to be fundraising to into the future. And the other major driver was in the business, which actually has more opportunities now than ever before.

Craig Siegenthaler
Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you, Kew.

Operator: Your next question comes from the line of Ken Worthington with JPMorgan.

Kenneth B. Worthington
Analyst, JPMorgan Securities LLC

Q

Hi. Good morning. Wanted to ask about the implications of both lower rates and the impact of coronavirus on your recent acquisitions. So, you pursued both Apollo Aviation and Fortitude Re. What is the outlook for earnings from both of these businesses? And I don't know if I'm completely off the reservation, so please tell me if I am, but is there any risk of write-down from either of these investments due to the market actions that we're seeing out there? Thank you.

Kewsong Lee
Co-Chief Executive Officer & Director, The Carlyle Group, Inc.

A

Hey, Ken. It's Kew. I'll take on both of those. It's actually a great question. And the short answer – I think the headline answer to your question on write-down is no, but I think it's important to go through each one of them. And so, if you don't mind, I will peel into each and give you a little bit of color.

Let's start with Fortitude first. It's well-capitalized. We have excess capital ratio of 210%, which is far above the 150% target ECR ratio. Our adjusted book value was up significantly from when we did this deal a year-and-a-half, two years ago. And the ROEs of the underlying business are strong and, let's call, in the low to mid-teens. The biggest issue in the industry and quite frankly for Fortitude is the impact on – from all the volatility and the rate movements we've all experienced over the past several months. And I think it's really important to note, Fortitude did a tremendous job of putting into place hedges and risk management maneuvers, which really insulated the capital in this business. In particular, when we first announced this transaction, we entered into hedges on interest rates, hedges to help us with our asset liability duration mismatch and hedges which protect against spread volatility. And when you throw all of that together, we have a company which has weathered the volatility that you've seen remarkably well and we find the company in a position of strength on capital preservation, which is really fortuitous and really an advantageous position for that platform to be in in this current environment.

The reserves are performing as expected. It does not have any material COVID-19 risk, particularly from business interruption. The carve-out is proceeding on plan. We expect it to really be fully separated from AIG sometime this year. And two last points. We do expect the closing of an important element of this transaction, which is capital that we raised from our limited partners and some strategic partners to effectuate ownership of up to 97%, close to 100% of this business from AIG. That transaction is expected to close, I'd say/ sometime by midyear.

With respect to the investment management aspect of Fortitude, the rotation that we talked about in previous calls of rotating assets over into Carlyle from an investment management perspective remains on track and we're quite pleased with the strategic partnership that we have with Fortitude. So I think in Fortitude's case, we're in pretty good shape as we sit here today.

Let me talk to aviation, which is the second aspect of your question, and I apologize for the length of the answer, but it's an important question that you asked. Look, this business is performing really well. In 2019, it generated approximately $40 million of revenue and over $10 million of FRE to Carlyle, and the acquisition has met or exceeded our expectations. There is fundraising going on for aviation so I want to be careful what I say, but let me just state it's off to a great start. And these are closed-end carry funds with locked-up capital.

Now, of course, there's tremendous disruption that's occurred in this sector – travel, flights being curtailed, airlines taking planes off of – out-of-capacity, canceling orders, et cetera. This new fund that we've raised or in the process of finishing raising is a source of critically important financing to this market, and we believe it's really well-positioned and the timing is quite good. We have about $1 billion of dry powder to help finance important businesses to this vital sector for our economy. So we're hard at work managing this portfolio. The team is going beyond the call of duty, working with our airline partners, helping them keep aircraft on lease. As we sit here today, we feel very good about our aviation business and the future prospects in that company for us.

Kenneth B. Worthington
Analyst, JPMorgan Securities LLC

Q

Great. Well, thank you much for taking my questions.

Operator: Your next question comes from the line of Gerry O'Hara with Jefferies.

Gerald Edward O'Hara
Analyst, Jefferies LLC

Q

Great. Thanks and good morning. Glenn, you mentioned activating a business continuity plan as you kind of start to identify some of the issues that began to evolve early in the quarter. Perhaps you could give a few examples of how that actually works structurally or perhaps some of the steps that were taken to shore up portfolio companies identify risk or just kind of [indiscernible] (00:37:48)?

Glenn A. Youngkin
Co-Chief Executive Officer & Director, The Carlyle Group, Inc.

A

Great. Gerry, thanks for the question, and good morning. So, first of all, the primary step of transitioning was to get everybody working remotely and stood up. And so, over the course of the January, February and March period, we had 100% of our workforce move to remote working, and that's over more than 30 offices on 6 continents, and that was a big step and it worked extraordinarily well. I think in the first week of activity, we had 40,000 video conference calls.

The second big step was to move through the portfolio aggressively and really triage and we categorize the businesses into – and real estate assets and energy companies and loan positions into one of three buckets: a bucket that it was going to have a limited impact from all of this; a bucket that it was going to have a much more severe impact; and a bucket that it was going to have potentially a large impact. And I do think that that first amount of work allowed us to really focus on liquidity and where we needed to spend our time.

And then the second – the final big area [indiscernible] (00:39:07) use the global resources at Carlyle in order to really support these companies. And just a couple examples. Early on, we convened a global meeting with all of the chief information officers of the big companies and helped them figure how do we in fact help you transition into remote working environment. We also did an enormous amount of work in helping kind of clean up some supply chains that were interrupted. We had a number of companies that literally couldn't source key components to their manufacturing process. And so, the global Carlyle resource team went to work to help people source components. And then, of course, we were supporting a number of these companies that were bringing some really innovative ways to support frontline virus initiatives. One Medical all of a sudden was able to provide remote COVID-19 diagnostics for people and it wasn't in place beforehand.

So, it was across the whole portfolio. But the very first steps were getting people stood up, then the heavy work on the portfolio and then using the big broad Carlyle platform in order to support each and every one of the companies.

Gerald Edward O'Hara
Analyst, Jefferies LLC

Q

Great. Thanks for that color.

Operator: The next question comes from the line of Glenn Schorr with Evercore ISI.

Glenn Schorr
Analyst, Evercore ISI

Q

Hi. Thanks very much and I appreciate all your realistic outlook and transparency upfront. So, I guess, the question I have is on LP behavior and I wonder if you could talk to it from the standpoint of commitments to current funds appetite as they re-undertake an underfunded position and think about asset allocations. And then lastly, on just the concept of dedicated funds in general and that's a private equity and credit comment of – I understand the good and the bad they self-select in. But any given dedicated fund could have ups and downs and it kind of highlights it. I'm just curious if there's any rethink on your or the LP part there. Thanks so much.

Glenn A. Youngkin
Co-Chief Executive Officer & Director, The Carlyle Group, Inc.

A

Okay. Glenn, thanks for that question. Let me get started, but I have a feeling Kew will be able to jump in and provide some thoughts as well. So, first, the LP universe, the fund investor universe, has broadly gone into this pandemic in much better shape than they went into the Great Financial Crisis, and the primary reason is the Great Financial Crisis educated a lot of investors on how to manage liquidity especially and particularly how important their private capital portfolios are. And in fact, coming out of the Great Financial Crisis, it was the private capital portfolios that performed extraordinarily well that enabled many of these investors to get back ahead of some losses that they had in other parts of their portfolio.

What we hear from our investors is, of course, different across the whole set. But in general, as Kew mentioned in his comments, they're catching their breath a bit and they're making sure they understand what they have in their portfolio. But some of them really are leaning in. And so, we do see investment processes continuing, commitments continuing, as Kew said. I think the frontend of that is in credit. We also see it in secondaries. I would call those sectors that are really able to take advantage of the dislocation. The next area of interest from investors is what's going to come during the rebound. And I think we're starting to see some real interest in investing into that phase. But as Kew said, we do think that traditional private equity type investing will be at the backend of this recovery. And investors recognize that.

My final comment and then I'll invite Kew in for a comment is – my final comment is, the most important aspect of this has been the intimacy that we share with our investors. And one of the things that in fact happened during this period is we were very quick to inform them where the portfolios are, very quick to interact with them on the status of the various portfolio companies, and I think that's the long-term relationship that really does underpin their confidence in having us as one of their core, core, core private capital partners.

Kew, anything else you'd add?

Kewsong Lee
Co-Chief Executive Officer & Director, The Carlyle Group, Inc.

A

Yeah. Glenn, that was really good. Two or three additional points, Glenn. First, obviously, we've been in very close contact with all of our LPs, as Glenn just mentioned, and we have, in fact, issued some significant capital calls and all of them have been met with no problems. So, just so you know, we have been functioning, we have been issuing capital calls, and those calls are being met.

Second, look, every crisis is different. And who knows how this will play out versus the GFC. For whatever it's worth, if you go back to the Great Financial Crisis, similar questions were asked of us, and we can tell you in hindsight all capital calls were in essence met and no material, if any, significant defaults occurred with respect to our funding base with respect to LP commitments.

And then finally, with respect to your question on dedicated funds, look, this is an interesting question. And different LPs are set up differently and some have different ways of allocating and prefer focused strategies for their portfolios. But also for us, it's a conscious way that we've designed our investment platform, recognizing that certain strategies are distinct and have their own inherent characteristics. But the importance that having energy and dedicated funds brings out in periods like this is that the volatility of those funds does not help nor impair the ability of our other funds to drive value and get to carry. Because remember, the way funds work with their press and their hurdle is its cumulative and aggregated rates of return across all deals in that fund. So, to the extent you have over-exposure to certain sectors or deals that take the fund, the performance overall down, that fund would be in jeopardy of not getting to carry.

So, it's a very important point, Glenn, that you just touched on. And so by having inherently more volatile strategies and more focused funds, we think it does two things; one, it helps our LPs from an allocation perspective because many of these do want those types of strategies broken up; but second, from our investment performance, but more importantly our ability to deliver distributable earnings in the future, it does have the effect of insulating our more traditional strategies from the downside and upside from these more volatile strategies. So hopefully, Glenn, that gives you a little bit more color.

Glenn Schorr
Analyst, Evercore ISI

Q

Yeah. That was great. Thank you.

Operator: Your next question comes from the line of Michael Cyprys with Morgan Stanley.

Michael J. Cyprys
Analyst, Morgan Stanley & Co. LLC

Q

Good morning. Thanks for taking the question. I was just hoping we could dive in a little bit more on the three funds that fell out of carry in the quarter. Maybe if you could just give us a sense if that's due to a single or a handful of portfolio companies, and any color you could share around those three funds that fell out. And if you can remind us maybe of a time in the past for some of your fund saw carry and eventually went back in, how often has that happened. And if you look back in time, which funds, if any, in history at Carlyle, did not actually go back into carry and why was that the case?

Curtis L. Buser
Chief Financial Officer, The Carlyle Group, Inc.

A

Mike, It's Curt. Hey. I'll start and then one of the other guys can also join in. So just to be clear, in the quarter, I would say that we had four significant funds fall out of carry; our Europe buyout fund, the fourth version of that; our international energy buyout fund, that's the first version of that; our long-dated fund; and then credit opportunities fund. Now, the point isn't always ever where is something marked today, it's obviously where it performs over time, and in each of these have different strategies, they're very unique, but we are working hard on all of them to position them back into carry. And if you go back to the great financial crisis, we had the same thing happen. Our fourth US buyout fund fell out of accrued carry.

Well, guess what? I am really happy that I was invested in that fourth US buyout fund because it did great. Also, our fifth US real-estate fund fell out of accrued carry during that time and it came back and has done well, and it's in the accrued carry to even to this point in time. So these funds – look, the energy implication on international energy, I mean, you understand that story. The long-dated funds got a long time for this to play out. It's actually still deploying capital. Our credit opportunities fund is incredibly well-positioned, and it's also in a place where there's a little bit more capital to deploy, but also as the nature of that portfolio over time, we like it. And our Europe buyout portfolio, it will have some challenges, but its diversity in terms of structure is good. So hopefully that solves – answers your question. I don't know if Glenn or Kew can add.

Glenn A. Youngkin
Co-Chief Executive Officer & Director, The Carlyle Group, Inc.

A

No, Curt, you did a really good job there.

Kewsong Lee
Co-Chief Executive Officer & Director, The Carlyle Group, Inc.

A

That was pretty good, Curt.

Michael J. Cyprys
Analyst, Morgan Stanley & Co. LLC

Q

Great. Thank you.

Operator: Your next question comes from the line of Patrick Davitt with Autonomous Research.

Patrick Davitt
Analyst, Autonomous Research LLP

Q

Hey. Good morning. You mentioned the kind of bucketing of the portfolio into those, the refined, some of that's is more severe and some might be a large impact. Could you maybe frame how that process, I mean, the result of that process as a percent of your fair value or even more broadly kind of talk to the relative sizes of those buckets?

Curtis L. Buser
Chief Financial Officer, The Carlyle Group, Inc.

A

Patrick, it's Curt. So here is how we thought about it, and look, it differs by each portfolio and segment. And the first thing that I'll say as a general comment is that, from a valuation perspective, our process, it's systematic, consistent, lots of third-party reviews we take it incredibly serious, and guess what, this was a hard quarter. A couple of specifics in terms of this quarter; first, very much of a forward looking. So what is our confidence around forward projections of earnings or cash flows and to the extent that that was less certain, we took discount rates up. We also were very focused on near-term liquidity, and to the extent that there were any near-term liquidity challenges, we obviously factored that into our thinking. With respect to bucketing, most of that was really in our Corporate Private Equity portfolio.

And as we did that, roughly 27% of the Corporate Private Equity portfolio was categorized as low impact, meaning, generally those investments experienced low single-digit movement, whether up or down. Some of them was up, some of them was down, but kind of think of it as low single-digit movement either way. About 40% of the portfolio was categorized as medium impact, and those investments generally were modest negative appreciation or modest depreciation in the quarter. But about 30% of the portfolio was categorized as high impact, and that drove most of the quarter's depreciation with some of that being 25% or so down. And that also kind of helped gear us in terms of where we're focused, in terms of providing help and support across the portfolio. And in the other areas, I mean, it was really the portfolio construction that really helped us as Kew already mentioned. And I'll stop there.

Patrick Davitt
Analyst, Autonomous Research LLP

Q

Thank you.

Operator: Your next question comes from the line of Mike Carrier with Bank of America.

Dean Stephan
Analyst, Bank of America Merrill Lynch

Q

Hey. This is Dean Stephan on for Mike Carrier. Just a question around the realization outlook. I understand that at this point the outlook is quite blurry. But can you help us understand and maybe a V-shaped recovery versus a U-shaped recovery areas that can potentially bounce back quicker? And then what type of recovery are you guys kind of forecasting at this point in time? Thanks.

Kewsong Lee
Co-Chief Executive Officer & Director, The Carlyle Group, Inc.

A

Dean, it's Kew. I'll take that one. I mean, I think it's fair to say nobody really knows. It's going to take longer than that. This is my personal opinion. It's probably not a V-shaped, but we're still early on, and obviously there's a lot of dialogue going on exactly what the nature and path of the recovery is going to be. And so you're asking the right question, and I'm not trying to hide behind saying we don't know. But I think it's fair to say, we got to work this all through. We feel really good about our visibility across the world in all different regions and all different sectors. We had really teed up a lot of companies to hit the IPO market and/or to be sold. And we are feeling really good about the momentum we had and that pipeline still exists. These companies are still chugging along, and it's a matter of when and how the markets open that we'll be able to access some of that with respect to realization activity. But as Curt pointed out, it just wouldn't be right of us to try to forecast realization activity at this point in time because we still need to see how this is going to play out before we can give you more color on that.

Dean Stephan
Analyst, Bank of America Merrill Lynch

Q

Right. Thanks.

Operator: We do have a follow-up question from the line of Patrick Davitt with Autonomous Research.

Patrick Davitt
Analyst, Autonomous Research LLP

Q

Hey. Thanks for the follow up. On the wide kind of FRE guide, if I take another tack at it, I think you said the core in 1Q was $92 million, and the midpoint of the new range is $425 million. So can you kind of bridge to maybe where you see the growth coming from from 1Q? Because I think, all I have of size in my numbers is the [ph] up invest raise (00:54:41) this year.

Curtis L. Buser
Chief Financial Officer, The Carlyle Group, Inc.

A

Patrick, it's Curt. Let me give you some help. First, the starting point for this quarter [indiscernible] (00:54:50) is $99 million. So there's $30 million of recovery, so $99 million is the place to start. The second thing I'd say is, we raised $7.5 billion in the quarter. Our pending fee-earning AUM went up to $12.5 billion. So there's a lot of capital that we haven't activated fees on yet that we did want to spend all the money to kind of get a raise, and that's going to come through here in the balance of the year. The other two things I'd point out, our transaction fees were light in the quarter, but probably be light for the balance of the year because it'll be tied to exits in activity and the like.

But one never knows, and that's clearly the way I planned out the year. I was expecting more out of that and expecting more here in the first quarter and hopeful for some recovery. And then the third thing that hit us here in the quarter was the $4 million on the CLOs. And so I think if you put those things together, that's kind of the difference. And again, that fee-earning AUM is going to help glide us forward. If you think about, I'm still optimistic in terms of our opportunities both in the solutions business as well in the credit business, and both of those can help continue to drive growth. Hard to predict, hard to call it out, hence the wide range. That's why I'm still optimistic about what we can do in the balance of the year.

Patrick Davitt
Analyst, Autonomous Research LLP
Q

Helpful. Thanks.

Operator: We do have a follow-up question from the line of Michael Cyprys with Morgan Stanley.

Michael J. Cyprys
Analyst, Morgan Stanley & Co. LLC
Q

Hey. Thanks for taking the follow up. I was just hoping to get a little bit more clarity and color around the credit business build-out, and how the current environment has slowed or impacted that build-out. And if you can give us maybe a sense of maybe what's on your to-do list next for the build-out and how that is evolving.

Kewsong Lee
Co-Chief Executive Officer & Director, The Carlyle Group, Inc.
A

Sure, Mike. It's Kew. I'll take that. With respect to the credit business, clearly, the most attractive from a fundraising but also from a deployment perspective right now is in the more opportunistic, distressed, special situation, rescue capital type of strategies. It's more tactical strategies. We receive reverse inquiry already, and have, in fact, launched to raise more money in the opportunistic strategies as well as distressed. And given that they're in end-market I don't really want to comment on it. But suffice it to say I do believe we're well-positioned there in terms of not only on how we're positioned but also the appetite from LPs. With respect to the CLO business, I think it's fair to say, there's no real issuance of CLOs at the moment, and if the market's really at a standstill. But many of these structures are repositioning into higher yielding loans, and you're going to start to see really interesting much more yield being obtained in these structures that we have. And I think it's important to point out, Carlyle has no warehouses outstanding or hung warehouses at the moment. So we're very fortunately positioned in our CLO business.

The direct lending business is a business that I do think has opportunity. I think it's fair to say, that's the one strategy where I wish we had more dry powder. So we are thinking through at the moment how we intend to go obtain the dry powder for that strategy because, let's face it, it's as with all the turmoil and the stresses in the markets, the ability to have private credit play a role to provide really important financing for companies, [ph] especially all the (00:59:05) mid-market as traditional sources like the banks have really dried up, it's going to be really important role as our economy restarts. And I do think that's the strategy that we are putting our heads together to figure out how we're going to go and get more dry powder for that team. So hopefully, that gives you a little bit more color. There are more opportunities than not on a credit platform. And we've already moved to start trying to figure out how to raise capital against some of those strategies, particularly on the opportunistic side of the equation.

Michael J. Cyprys
Analyst, Morgan Stanley & Co. LLC
Q

Great. Thank you.

Operator: Your next question comes from the line of Alex Blostein with Goldman Sachs.

Daniel Jacoby
Analyst, Goldman Sachs & Co. LLC

Q

Hi. Good morning. This is Daniel Jacoby filling in for Alex. Thanks for taking our question. Just kind of a bigger question on the FRE outlook, which is to say that, last quarter's earnings call you guys had spoken to kind of the next fundraising supercycle commencing at the beginning of or at the end of 2021, kind of beginning 2022. Obviously, there's a lot of uncertainty, and I totally appreciate that. But just, if you had to kind of put a guess together based on the information that we have at this point in time, any kind of color as to when that next fundraising supercycle is going to play out? Is it fair to think that that's been pushed out somewhat or, are we looking at kind of that less commencing as anticipated? Thanks.

Glenn A. Youngkin
Co-Chief Executive Officer & Director, The Carlyle Group, Inc.

A

Great. Daniel, this is Glenn, and thanks for the good question. So as we've said a number of times today, we're sharing with you everything that we know, but we're also quite aware of the many, many, many things we don't know. And I think that question is going to depend materially on the length of this recovery. Our funds, as we've talked about today, I think have performed well, they performed relatively well, and they're well positioned from a construction standpoint and portfolio support standpoint. And so I think our investment performance will be attractive over the long term, which will set us up well for the next multi-year fundraising campaign.

But at this point, it's really hard to tell whether that's going to land in the same spot or it may be delayed a bit, and that's going to fully be dependent on what happens here in the second half of this year from a recovery standpoint. So again, we really don't want to skirt the question. We're thinking about it all the time. But the reality is, until we get a little bit more water under the bridge from this recovery pace, we're really not going to able to give you a much more guidance than we think we'll do well in the next multiyear fundraising campaign. We think our funds will be attractive to investors. But when that exactly starts is kind of hard to tell right now.

Daniel Jacoby
Analyst, Goldman Sachs & Co. LLC

Q

Got it. Thank you. And can I sneak in one more, is that possible?

Daniel F. Harris
Managing Director & Head-Public Investor Relations, The Carlyle Group, Inc.

A

Yeah. Go ahead, Dan.

Daniel Jacoby
Analyst, Goldman Sachs & Co. LLC

Q

Just kind of on the – thank you, just on the FRE outlook, so kind of thinking about that $400 million to $450 million guidance. If I just compare that to the prior guidance is I think was $475 million for 2020, I'm just trying to kind of bridge from the prior guidance to current guidance, and I appreciate the color that you guys have provided on the CLO dynamics. If you were to kind of help me break this up in terms of really just on a directional basis between kind of the CLO dynamics versus the kind of near-term slowdown in new commitments versus the lower transaction fees, kind of what is that breakdown look like as I try to kind of bridge from prior to current guidance?

Curtis L. Buser

Chief Financial Officer, The Carlyle Group, Inc.

A

So look, I fully appreciate the question, and now it sounds like you're doing what I do on a daily basis, which is trying to get the exact precision on a variety of variables, and that's why we gave a wide range. If I could give you – if I could kind of narrow those things much more specifically in this environment, I would have given a tighter range, and maybe not even move kind of the guidance. But there's just too much in terms of some of those pieces, in terms of how they'll play out. But again, I just point you back to the strength of our management fees, the pending fee-earning AUM and the overall position of where we are. I think that we can count and our focus is very much on growing FRE for the long term and improving our margins.

Daniel Jacoby

Analyst, Goldman Sachs & Co. LLC

Q

Got it. That's helpful. Thank you.

Operator: I am showing no further questions at this time. I will now turn the conference back over to Mr. Daniel Harris.

Daniel F. Harris

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

Thank you all very much for your time, attention and focus today. We do look forward to speaking with you after the call. Any follow ups, please contact Investor Relations. Stay safe and healthy, and we'll talk to you again soon.

Glenn A. Youngkin

Co-Chief Executive Officer & Director, The Carlyle Group, Inc.

Thanks, everybody.

Kewsong Lee

Co-Chief Executive Officer & Director, The Carlyle Group, Inc.

Thank you.

Operator: Ladies and gentlemen, this concludes today's conference. Thank you for your participation and have a wonderful day. You may now disconnect.