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The Carlyle Group, Inc. (CG)

Q4 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by and welcome to The Carlyle Group Fourth Quarter 2019 Earnings Call. At this time, all participant lines are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions]

I would now like to hand the conference over to your speaker today, Daniel Harris, Head of Investor Relations. Thank you. Please go ahead, sir.

Daniel F. Harris

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

Thank you, Shannon. Good morning and welcome to Carlyle's fourth quarter and full year 2019 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's 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 a new detailed earnings presentation, which is also available on our Investor Relations website. In addition, we have added a new downloadable metrics disclosure, including all of our key metrics and financial summaries that you could find alongside our earnings release on our site.

For the fourth quarter, we generated $108 million in fee-related earnings and $172 million in distributable earnings, with DE per common share of $0.47. We have declared our first quarterly dividend, as a corporation, of $0.25 per common share.

To ensure participation by all on the call, please limit yourself to one question and then return to the queue for any additional follow-ups.

With that, let me turn the call over to our Co-Chief Executive Officer, Kewsong Lee.

Kewsong Lee

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

Thank you, Dan, and good morning, everyone. 2019 was a year of significant growth and positive change at Carlyle and our goal is to keep it all going this year. I'll start with our progress against our most important priorities and finish with some thoughts in the current environment. Glenn will then discuss our focus areas for 2020 as we build upon our strong momentum.

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Regarding progress in our priorities, first, we drove growth in fee-related earnings. The $453 million in FRE we produced in 2019 was almost 30% higher year-over-year and our operating margin expanded significantly. Growing our overall earnings capacity and improving our operating margins remains a core priority.

Second, we implemented shareholder-friendly actions. On January 1, we completed our corporate conversion and began the year with a best-in-class structure. It's simple, has a high degree of transparency and improved shareholder alignment and governance with our one share, one vote construct. While we are in the early innings of our corporate transition, our trading velocity has already more than doubled and we've expanded meaningfully our dialogue with a broader universe of investors.

And third, we remain focused on investing wisely in a challenging environment, consistency in good times and bad, and delivering attractive returns for fund investors is our goal. We begin the year with our performance on a solid trajectory. We are carefully deploying capital at a consistent pace having invested more than $21 billion in 2019, and begin the year with a record $155 billion of fair value of investments in the ground. As of year-end, we have accrued more than $1.7 billion in net performance revenues on our balance sheet that we expect will ultimately convert to earnings. Our largest funds continue to track generally in line with predecessor funds with respect to value creation, and we are delivering the kind of long-term performance our fund investors seek.

Over the past five years, our Corporate Private Equity carry funds have appreciated at an average 14% per year, more than 600 basis points higher than the MSCI All Cap World Index. Our US real estate funds have averaged 18% annual appreciation and our US CLOs have produced net IRRs of 16% for equity holders since inception. And over the past five years, our defaults have been about one third of the industry average.

Clearly, our objective in 2020 is to continue all of this strong momentum. Before Glenn's thoughts on how we intend to do this, let me provide three comments on the current environment based on our data and portfolio companies. First, the global economy continues to grow albeit at a slower rate than observed in prior years. Global GDP growth decelerated steadily over the course of 2019, but our data provides clear signs that growth rates have stabilized. While we haven't seen a rebound as of yet, we are cautiously optimistic that we will eventually see such an upturn later this year.

Second, the private capital investment industry remains well positioned as fund raising and deal flow continues to be strong. As you know, we exceeded our $100 billion multiyear fundraising target earlier than planned. And while significant dry powder has contributed to elevated valuations for new investments, it is important to stress that deal flow has similarly increased, with the opportunity set for private capital continuing to expand across global industry sectors. As a result, our investment teams have been successful in deploying capital at a similar or even higher pace relative to historical levels.

Recently announced investments include: Hilb, a middle market LBO of a leading insurance broker in the US; HireVue, a growth investment in a disruptive video-interviewing platform; CEPSA, a significant minority stake in the largest privately-held integrated energy company in Europe; and Candela, a direct loan into a company selling cosmetic medical devices. These deals are just a very small sampling of the significant capabilities of our broad, deep and diverse platform, which will drive our ability to deploy available capital into attractive deals around the world.

My final comment, we are regularly reminded that the environment continues to be characterized by a constant namely the presence of uncertainty. We're seeing that now with the current situation in regards to the coronavirus, which we are monitoring very closely and doing what we can to help. In addition, there's a mix of other ongoing

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challenges issues like global trade tensions, the impact of negative interest rates, and the politics of the day. All of this is a reminder that our most important priority as an investment organization is to avoid complacency and remain vigilant as we navigate this complex and high valuation environment against a slow economic backdrop.

As we look towards 2020, we are well positioned to continue doing what we do well which is to raise, invest, and manage large amounts of capital and generate attractive performance at scale in order to deliver for all of our stakeholders over the long term. For our people, we are proud of our strong culture and diverse workforce that makes Carlyle a great place to build a career. Our people are what make Carlyle special and we are constantly striving to strengthen our teams and culture.

Last year, 50% of new hires were women, including almost 30% at the senior level, and we are rolling out new training throughout the entire organization to help our teams make better decisions by mitigating unconscious bias. There remains more work to do on many fronts, but we're on the right path.

For our communities and companies, everything we do is about impact as we partner with management teams to build great companies and improve all aspects of a business. From more diverse boards and workforce, to more sustainable practices at companies and throughout supply chains, to improvements in governance, to name just a few ways we help our companies. This impact, at every level, makes good businesses even better, and the impact of improving businesses drives value for all, including strengthening the communities in which we live and work.

For our shareholders, Carlyle's stock more than doubled during 2019, yet we see room for further upside as we drive earnings growth, deliver on results, and improve our shareholder base. As I have mentioned before, we believe we are well-positioned to be included in the largest number of widely followed benchmark indices.

And for our fund investors, we remain vigilant with a long-term focus as we seek to generate attractive and sustainable returns by investing wisely and responsibly. Our clients rely on our performance to help secure the retirement of millions of beneficiaries and we will continue to build our capabilities to position us well to capture opportunities as our industry continues to grow and evolve.

With that, let me now turn the call over to my partner, Glenn Youngkin.

Glenn A. Youngkin

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

Thank you, Kew. And let me add my welcome to Kew's, to everyone, thanks for joining us. To build on our 2019 momentum that Kew just described, we have a clear set of priorities for 2020 and beyond. Those priorities are: First, growth; second, fundraising both in 2020, and importantly, through the next multiyear fundraising campaign; and third, continuing to build out and institutionalize the Carlyle platform. Let me expand on each of these and then Curt will frame our financial expectations for the next few years.

First, we remain focused on growing our platform. We have several sources of near-term and long-term growth. We expect global credit to generate improved financial results both revenues and earnings in 2020 and thereafter. We have made significant investments over the past few years and we should see solid FRE contribution as AUM and revenues grow. We will continue to scale our next-generation funds. For example, this year includes among others substantial fundraising targets for several AlpInvest and Aviation funds, helping drive the Investment Solutions and Global Credit segments.

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We will launch new strategies, leveraging our established platforms. In addition, to new products across the Global Credit platform, Carlyle Infrastructure Group, which now has more than $4 billion of AUM across six different focus areas has launched a renewable energy strategy. Again, in each case we already have talented investment teams in place. We'll drive additional scale across Carlyle through our insurance platform Fortitude Re, adding more permanent capital for us to manage. The planned capital rotation to our investment strategies is on schedule, and we expect to close our latest transaction with AIG in the middle of this year subject to certain regulatory approvals. And we will evaluate select acquisitions that could complement our existing investment activities and add incremental growth opportunities much like Carlyle Aviation Partners has done for us. All in, we have a multitude of initiatives underway laying the foundation for attractive, long-term growth.

Our second priority is fundraising, which, of course, remains critical to our success. The global fundraising environment remains very healthy. Private capital continues to post attractive relative performance to other asset classes. A large percentage of investors, estimated at over 40%, are increasing allocations to the various private capital asset classes. The largest institutional investors continue to reduce their number of GPs to focus on a smaller number of larger, strategic relationships. And certain investors, such as sovereign wealth funds, high net worth individuals, and insurance companies are growing their private capital portfolios even faster than the rest of the market.

These trends underpin expectations that industry AUM growth should continue at an 8% to 10% annual rate. This attractive backdrop gives us a high degree of confidence in our ability to raise significant new capital. In 2020, we expect to raise at least $20 billion with the majority of the focus on Global Credit and Investment Solutions strategies. And looking mid to longer term, we expect the next multiyear fundraising campaign to begin to ramp in late 2021. While it's too early to discuss specific fund targets or timing, our goal for platform growth is for a 20% to 30% uplift in fundraising compared to the prior multiyear campaign.

Third on our priority list is to further build and institutionalize our business. We're making great progress here on a number of fronts: adding resources to our investment teams, as I mentioned, in areas like global credit and renewables; deepening our One Carlyle value creation platform with enhanced digital capabilities, procurement expertise, impact reporting, and operating executive talent around the globe; and driving efficiencies and streamlining processes. This focus both furthers Carlyle's ability to invest wisely and create value in our portfolio while at the same time ensures each of our segments is best positioned to operate at the most effective level in a competitive world.

By pursuing these priorities and achieving our goals, we expect the result to be continued growth in both FRE and DE in the short term and over the long term. Curt will frame our financial outlook. But stepping back, let me say that we are exceptionally well-positioned and we look forward to the year ahead.

With that, let me turn the call over to our Chief Financial Officer, Curt Buser.

Curtis L. Buser

Chief Financial Officer, The Carlyle Group, Inc.

Thank you, Glenn. In my remarks, I will first discuss 2019 results including Q4 then I will frame growth prospects for FRE and DE before wrapping up with comments on our C-corp conversion. Let's begin with our results for the quarter and 2019. Fee related earnings were $108 million in the quarter and $453 million for 2019, an increase of nearly 30% year-over-year. The comparison of the fourth quarter of 2018 is not straightforward, as Q4 2018 FRE of $175 million included several abnormal items as we discussed last year. Adjusting for these items, FRE in Q4 2018 was approximately $90 million compared to the $108 million in Q4 2019, a 20% uplift, and our Q4 2019 FRE is a relatively good run rate to consider as we enter 2020.

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Distributable earnings were $172 million in the quarter and $647 million for the year. Q4 2018 distributable earnings was $211 million or about $125 million when adjusted for the same abnormal items affecting Q4 FRE. So on a like-for-like basis, Q4 2019 DE is up about 35%. We believe 2019 was a low point for both net realized performance revenues and distributable earnings, both of which we expect to grow over the coming years.

For the year, management fees increased 15% year-over-year to $1.6 billion even as fee-earning AUM was only modestly higher at $161 billion. We benefited from a full year of revenue from Carlyle Aviation Partners, as well as the full year fee impact from our largest carry funds, which activated throughout 2018.

For 2019, FRE margins expanded by about 300 basis points to 28%. Cash compensation expense, exclusive of the investments made in building our global credit platform, grew by just 1%. Going forward, we expect cash compensation and other expenses for the entire business to grow in the mid-single-digit range over the next few years, a slower growth rate compared with recent years as many of our platform build-outs have been substantially completed.

We're also working to manage equity-based compensation expense and shareholder dilution by granting fewer shares. In 2018, we granted 13.3 million units versus approximately 6.7 million units in 2019, and we expect to grant less than 5 million shares in 2020.

Stock grants generally vest over periods of up to three and a half years, and as a result, we fully expect to see a decrease in shareholder dilution and equity-based compensation expense over each of the next two years as fewer shares vest.

With fewer shares issued and continued share repurchases, we will seek to manage share dilution to no more than 1% annually over the next several years. Equity-based compensation expense was $35 million in the fourth quarter and full year equity compensation expense of $151 million declined 17% year-over-year. And to be clear, our higher stock price is offsetting some of the expected improvements in equity-based compensation, a good problem to have.

Now, turning to fee-related earnings growth in 2020 and beyond, before we raise the next generation of our big buyout and real estate funds beginning in late 2021, we expect FRE to reach about $475 million in 2020 and at least $500 million in 2021.

Over the next five years, we are targeting to achieve average annualized FRE growth of about 10% or more, with slower growth in next year or two and higher growth thereafter. FRE margins should exceed 30% in the next few years and then move higher into the mid-30s over our next multiyear fundraising campaign.

In 2020, we should see growth in fee-earning AUM and FRE in both Global Credit and Investment Solutions, with some downward pressure on Corporate Private Equity and Real Assets, especially with our expectation of increased realizations. Beyond the obvious positive impact of driving more predictable and sustainable earnings growth as both Kew and Glenn have mentioned, growing fee-related earnings will position us to potentially increase our fixed dividend beyond our initial $1 per share annual level.

Now, let me frame projected growth and net realized performance revenues and distributable earnings. Our funds remain on track to deliver a much higher level of carryover the next few years. We expect net realized performance revenue in 2020 to approximately double our 2019 results. Thereafter, we expect further growth in 2021 and then reaching and exceeding our long-term average of $600 million. We expect pre-tax distributable

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earnings should grow at an average annual rate of 20% to 25% over the next several years although a little slower in 2020.

Moving on to expectations for the impact of our corporate conversion which will appear in our first quarter results. We'll have only a single class of common shares with all income allocated to these shares, thereby, simplifying our GAAP financial statements, and all shareholders will receive a Form 1099 rather than a K-1 for their 2020 dividend income. We expect our first year as a corporation will lead to a current tax rate on distributable earnings in the high-single-digits and will then move higher into the mid- to high-teens in 2021 before a further increase into 20s in several years. Last, as we transition into our new corporate structure, we will maintain our balance sheet light orientation with increased capital flexibility to accelerate our growth and drive shareholder value.

Let me also convey what we expect to occur over the next few months regarding our likely addition to various indices. We expect to be added to the various CRSP indices, whose ranking date is early March, with reconstitution in mid-March. Our market cap and one share/one vote governance should position us to be added to the Russell 1000 indices with their annual ranking day likely in mid-May and reconstitution in June.

We expect to be added to the MSCI and S&P total market indices, as well as several smaller indices, which will occur in the March to June timeframe. And we continue to believe we have met the criteria for inclusion in the S&P 500, but that of course is a more subjective evaluation for which we cannot predict an outcome.

Before I turn the call over to the operator, on behalf of our board and management team, I want to take a moment to thank all of our shareholders for their support in 2019. We remain excited about our opportunity to grow the business and our stock price over time.

With that, we are now ready for your questions.

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QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes from Ken Worthington with JPMorgan. Your line is open.

Kenneth B. Worthington
Analyst, JPMorgan Securities LLC

Q

Hi. Good morning. Thank you for taking my question. I was hoping you could speak about – more about Fortitude. Can you talk about the ownership structure you've chosen with the increased exposure? It's a bit different than what we've seen in insurance at some of your peers. And then maybe you can finish up with some discussion about the organic and inorganic growth opportunities you see in the market for Fortitude say over the next year or so.

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

A

Hey, Ken. It's Kew. Good morning. Thanks for the question. Overall, we're very pleased with where Fortitude is going. You are right. We are taking a different strategy and approach than some of our peers. Fortitude is a much more diversified insurance company and it is not only diversified by product line but is diversified around the world globally. It is also much more of an institutional business as opposed to some of our peers which are selling insurance directly to the consumer in a more monoline fashion.

The strategy we have is right on track which is earlier as you know we announced late last year, we raised additional funds from our LPs in addition with the strategic investor in T&D. We have negotiated to secure approximately 75% of the shares of AIG, such that upon completion of that, which we expect regulatory approval for some time mid-2020, we will be in a position where we and our investors would control Fortitude moving forward. As Fortitude grows, we would expect that Fortitude would rotate investable assets into Carlyle with respect to alternative investments.

With respect to that rotation thus far, we have a little bit over $2 billion already invested in Carlyle funds, more will be added this year. And everything about the strategy right now I can say is on track. The carve out continues to do well. We expect full separation and the stand-up of Fortitude some time later on this year. And perhaps most importantly, our balance sheet investment is doing just fine as Fortitude is generating approximately 14%, 15% ROE, and the reserves are exactly as we expected when we struck this deal a couple of years ago.

Kenneth B. Worthington
Analyst, JPMorgan Securities LLC

Q

Great. Thank you very much.

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

Patrick Davitt
Analyst, Autonomous Research LLP

Q

Hey. Good morning, guys.

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

A

Good morning.

Patrick Davitt
Analyst, Autonomous Research LLP

Q

So, it looks like you have a lot of IPOs in the pipeline this quarter. I count five, but maybe you can confirm that and update it. But could you remind us how we should think about the framework for how much these events can add to net accrued carry for you guys? In other words, a view of like how much higher the average pricing is than the previous market such as some other PE firms have given us a guide around that.

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

A

Hey, Patrick. It's Kew. Let me start. Maybe others will jump in. Broadly speaking, the capital markets right now are pretty robust and open. We, as a firm, are trying to take advantage of it as many of our portfolio companies in the US and Europe have refinanced in the debt capital markets. Clearly, the IPO market is more open now than it was last year. It's inappropriate for me to comment on any situation given the fact that some of these companies are in registration and or in the quiet period.

But stepping back what we've said all along is that we have invested very well over the past several years that it's going to take a little bit of time for those companies to mature and then be available and ready for realizations.

From my perspective and from our perspective, it feels like this is a year where we're definitely going to see some pickup in realization activity which supports Curt's comment earlier in the call where he expected last year to be a low watermark and with there to be a doubling of net realized performance fees this year.

So, we feel very good about our pipeline. I don't want to comment specifically on any individual situation, but we do expect there to be a pickup in realizations this year.

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

A

Patrick, just to add – it's Curt. So, your comment on top or increase in valuation. So as the CFO, it's my job to make sure we value things at fair value. So, when we have companies that are in the pipeline for a public offering, we're often really looking at what can we sell or how can we move these companies or positions or really more theoretically what would a market participant pay for our position in these companies at the point in time [ph] of mark (00:28:45).

The IPO process, as you know, there's all kinds of discussions, and comments, and pricing, and ranges. So it's really hard to take that fully into account until it's really done and priced in the market. Generally speaking, when you do look back, you will see favorable movements, but it's hard to kind of say it's X percent et cetera, our look-back testing from our valuations clearly supports the valuation methodologies and approaches that we have. So hopefully, that's helpful.

Patrick Davitt
Analyst, Autonomous Research LLP

Q

Thanks.

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

A

Thanks.

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

Michael Carrier
Analyst, Bank of America Merrill Lynch

Q

Hi, good morning and thanks for taking the question. Do you guys continue to see good growth in credit? And you mentioned fund raising growth ahead both in credit and solutions. Can you provide me some color on the strategies? And I didn't see the old performance table in the new deck? So any color on just credit performance, whether it's for the quarter or the year just given the strength that you're seeing on the fundraising side.

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

A

So Mike, it's Curt. Let me just start and then Kew can add in. So there's a number of our traditional strategies we feel really good about, whether it's in liquid credit, illiquid credit, or some of our asset-backed programs, especially in aviation. Performance there has been good. What we – generally what we have provided you before is the carry fund appreciation which is just a portion of really the business. So the data is online to support all of the appreciation for all of the segments just as we have done before, but it's really not the right thing to kind of look at from the carry business.

We're deploying a lot of capital in that business, continuing to raise more funds. It's a very good FRE business for us especially as we go forward and really expect to see improvements there. And what you can see is the appreciation in the earnings release is on each of the segment pages really for those segments which are really carry businesses. So, hopefully you had some help. Kew, I don't know if there's anything you want to add to that.

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

A

Well, Mike, hi. It's Kew. Let me just add a little bit of color to our credit business which is the headline is we're really – we're exceptionally pleased with the team that we brought in and the progress that we've made. And we're also pleased with the patience that all of you have given us as we try to build this business out in the right way. As you know, we are building a broad platform and we have very important core strategy setup from CLOs to direct lending, to credit opportunities, distressed, and now in the real asset side of the thing – of the equation with our aviation and launches in infrastructure credit.

It's a broad solutions-based platform and we have found real good traction with a lot of our existing LPs, but also new LPs, as we grow the business. AUM is a little bit less than $50 billion right now. We have added virtually all of the expenses we've wanted to add to build this team out over the past two, three years. We are expecting to see revenues grow much faster than expenses moving forward as the benefit of our patient and organic approach starts to pay off.

This is going to be important year for our credit business. I hope the environment is conducive but we will, I think, see strong growth coming out of this unit and then eventually, much more accretive FRE contribution moving forward.

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Michael Carrier
Analyst, Bank of America Merrill Lynch

All right. Thanks a lot.

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

William Raymond Katz
Analyst, Citigroup Global Markets, Inc.

Okay. Thank you very much and I appreciate the expanded disclosure. Maybe just coming back to sort of your framework as you think about FRE margins looking a bit longer term and appreciate your sort of the timeline you're laying out there. As you sort of institutionalize the business and scale a little bit more, just sort of wondering, as you think about your business versus peers, what is sort of the structural differential that couldn't help close that FRE margin gap a bit more?

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

Bill, it's Curt, I'll start, and maybe Glenn or Kew will add in. So first, I think it's important to kind of think about how we approach FRE. We are very focused on growing FRE and, as the CFO, I want nothing more than to be leaning forward and really pushing the business to grow FRE and our margins.

We've grown FRE from $192 million in 2017 to $350 million in 2018 to $453 million in 2019. That's like an over 50% growth rate for the past two years. And we're looking forward to continue to do that. We've put – we've given you guidance in terms of what we think is reasonable to do going forward. And as you think about margins, we've made the same kind of progress. Over the last two years, our FRE margins went from 17% in 2017 to 25% in 2018, 28% this year. And as I said, we're going to push these up above 30% and get to the mid-30s during our next multiyear fundraising campaign.

Now obviously, we would like to do more, but what we're also doing here is making sure that we do right in terms of how we manage our portfolio. We continue to invest, institutionalize the business, make sure we drive the right results. We have more funds, more investment professionals, and we're doing the things that Glenn can elaborate on in terms of – that he already spoke about in terms of really institutionalizing that. And so, I think that's really key to what we are as an investment firm.

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

And Bill, it's Glenn. Let me just add two comments. The first is we've said before that we have no aspiration to be the low cost provider in this industry from an FRE standpoint and yet we recognize that we have great opportunity to continue to increase our margins, which Curt has elaborated.

But from a structural standpoint, let me just repeat, we have an incredibly global footprint. We have a presence around the world plus through our One Carlyle network that allows us to fundamentally improve companies and projects in a way that we think is quite unique and that supports a multi-fund platform that we think provides an advantageous realized performance fee profile as well so we can grow both FRE and realized net performance fees over time. We think that model is actually unique. We think we do it very well. And so, yes, we'll continue to drive margins up. We'll continue to grow FRE, what we also think a holistic approach to driving our financial results is in the best interest of all of our stakeholders.

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

Thank you.

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

Thanks, Bill.

Operator: Our next question comes from Craig Siegenthaler with Credit Suisse. Your line is open.

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

Thanks. Good morning, everyone.

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

Good morning.

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

Good morning, Craig.

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

Could you give us an update on your long-term strategy both in – at aviation and also your appetite to enter into additional asset-based lending segments which could also be attractive for insurance companies including Fortitude?

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

Hey, Craig. It's Kew. Yeah, let me just touch on your good question. Aviation again, I think the headline is it's right on track. It's doing everything we wanted and we're quite pleased. Revenues last year were about $40 million, and bottom line or FRE contribution was $10 million, and obviously we think it's going to go up from there.

Most importantly, last year, we fully integrated and successfully integrated the business into Carlyle Global Credit. The teams are functioning quite well. And we're in the midst right now and I don't want to be specific about it because some of these funds are in registration there that we are in. We're fundraising for not only successor funds but new product launches in early life aircraft, securitizations, as well as to capture some fundraising as it relates to pre-delivery financing opportunities. So we're very pleased with the progress and the prospects are there to do a lot more with this platform. And it's on track vis-à-vis the expectations we had for this company when we acquired it.

In terms of other areas in Real Assets, the particular area of focus for us this year – but we're going to be quiet about it, is to develop our infrastructure credit business. I don't want to really talk about a lot of that right now more

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when we have more details to share with you. But suffice it to say, we have some teams that we have put in place and we are starting to think about how we're going to bring that strategy to our LPs this year.

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

Thank you, Kew.

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

Alexander Blostein
Analyst, Goldman Sachs & Co. LLC Q

Thanks. Good morning, everyone. Just another follow up around the incentive fee outlook for 2020. Thanks for the updated guide. So it looks like about $500 million in the pre-tax incentive fees. Can you help us gauge maybe degree of confidence around that? Naturally, Carlyle is obviously going through the realization cycle which is, of course, good to see. But how much of that is dependent on public market exits versus some of the kind of strategic sales either at corporates or other sponsors? Thanks.

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

Thanks, Alex, for your question. So look, I feel really good about our ability to grow in net realized performance revenues. Our big funds are on track. They're consistent with the predecessor funds. But just to make sure everyone's clear, 2020 I think is like a double to 2019. So your $500 million number, we're going to get probably not in 2020. So again, double off of the $164 million that we have for 2019 and then we'll grow through that. Our prior average was $600 million I think we're going to grow through that and then thereafter.

All that's going to do is going to lead to distributable earnings growth in the 20% to 25%, a little lower here in 2020. But over the next five years that growth rate is the right growth rate because our DE and our realized performance revenues are what we think is at a trough level. And we're feeling really good about the capital that's in the ground, which is higher than all of our prior years and the performance of the funds. So hopefully that frames it right for you.

Alexander Blostein
Analyst, Goldman Sachs & Co. LLC Q

Great. Thanks.

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

Brian Bedell
Analyst, Deutsche Bank Securities, Inc. Q

Great. Thanks. Good morning, folks. I guess if you want to – if we can sort of characterize the next fundraising campaign, I know it's not starting till late 2021, but is that also – are you thinking about that is also roughly a four year timeframe and does that imply $120 billion to $130 billion based on the growth rate you mentioned?

And just in terms of characterizing that, maybe if you can just give some color on how much you think credit and other new areas can contribute to – over the next round of your flagship funds and whether there's any other elements like insurance transactions within that or those could be over the top from that guidance?

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

Thanks, Brian. It's Glenn. First of all, we do continue to see a very healthy fundraising environment, as I said. And as a result, we expect all aspects of the business across the segments to in fact grow over this time period. The 20% to 30% is indeed an apples-to-apples kind of comparison in our mind over a period of time, and that's why we wanted to frame it for you.

To be clear, over the last four years or so, we were running at $25 billion to $30 billion a year on average with a range that was kind of $20 billion to $40 billion during that time period. And we just expect that average to increase although there will be much bigger years during the period of time.

I think, finally, as I've mentioned, we do see strong support from sovereign wealth funds, our high-net-worth-individual channel, and the insurance area. And those are – those investors seem to be growing a bit faster than the overall market. But overall, we feel good about this outlook. I can't give you a framing specifically on funds and sectors right now, but that will unfold over time.

Brian Bedell
Analyst, Deutsche Bank Securities, Inc.
Q

Okay. And, obviously, there's no other sort of acquisitions embedded in this in terms of deals with insurance companies were – is there basically an organic view for the campaign.

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

Brian, yes, it is.

Brian Bedell
Analyst, Deutsche Bank Securities, Inc.
Q

Okay. Great.

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

Thank you.

Brian Bedell
Analyst, Deutsche Bank Securities, Inc.
Q

Thank you.

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

Gerald Edward O'Hara
Analyst, Jefferies LLC
Q

Great. Thanks for taking my question this morning. I was hoping to get an update around Carlyle's strategy as it relates to retail, actually. This approach seems to very pretty significantly across the peer group. So perhaps you can give us an update on approach, outlook, expectations, perhaps solutions currently in the market, that sort of thing. Thank you.

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

A

Great. Jerry, it's Glenn Youngkin again. So, first of all, in general, we have focused on the high net worth individual side of individual investors. We think that, that segment really does match our investment strategies well. Historically, it's been about 13% of what we've done, call it $40 billion of our current AUM. And we anticipate that it'll continue to play that kind of role in our fundraising. Of course, there are some strategies that tend to appeal more to individuals and others that tend to appeal slightly less. But we're going to continue to tap that market as it's a growing one. And we have good products and good performance that I think will continue to attract those kinds of investors to us.

Gerald Edward O'Hara
Analyst, Jefferies LLC

Q

Thank you.

Operator: Thank you. [Operator Instructions] Our next question comes from Robert Lee with KBW. Your line is open.

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

Q

Great. Thanks, and thanks for taking my questions this morning. Just curious in Investment Solutions, I mean – and, I think, you touched on it on the initial comments, but it's a business where you've been raising some capital. It's a pretty good amount of assets but the profitability, FRE, DE there is pretty modest. So, talk a little bit about what's been holding that down and maybe how we should expect that segment to accelerate. And then, I'll squeeze in the second one, Kew also, Curt, maybe update us on your tax rate assumptions when you're talking about DE for the next couple of years?

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

A

Great. And so, while I start with the tax rate, and then we'll follow up on Investment Solutions. So, on tax rate, just as I said in our prepared remarks, 2020 would be a high-single-digit tax rate. Now, that's a current provision, what we currently expect to pay measured against distributable earnings. Then, it'll increase really to the high teens in the next year, and then it'll be a little harder to kind of tell but it'll move, over several years, it'll move into the low 20s on a current provision basis, as measured pursuant to DE. That's what we've been saying. There'll be some fluctuations on a quarterly basis within that. But that's – I don't really see anything kind of really moving that significantly from where we are today.

On Investment Solutions, you're right. It is a little bit [indiscernible] (00:44:56). But keep in mind, from a carry perspective, we [ph] didn't buy (00:45:00) their historical carry when we acquired AlpInvest. And those funds are European-style waterfalls. And so, you will start to see more of that come to Carlyle over time.

Secondly, from an FRE perspective, I expect to see fee-related earnings increase here in 2020 especially considering the fundraising campaigns that are in place. I don't want to talk about those campaigns too specifically. But we're going to raise a fair amount of money for our AlpInvest funds, in particular. That will drive FRE in 2020 for that business and fee earned in AUM [indiscernible] (00:45:42).

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

The only thing I would add is stepping back over the last couple of years there's been a specific evolution in the Solutions business as some of the old AUM that we acquired has been kind of running off. It doesn't really have a lot of fees with it. So, we've seen kind of AUM flattish. But the big picture evolution has been the growth in secondaries and coinvestment in the industry, and we've just seen extraordinary growth in these sectors. And that really does play to the strengths of both our private equity and real estate activities within the Solutions group. So, as I said earlier, in our fundraising targets for 2020 the Solutions business does have a big role in that. And so, I think we would expect to see a real pickup in some financial contribution over the course of this year and even more into 2021.

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

Great. Thank you.

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

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

Hey. Good morning. Thanks for taking the question. I guess just when you think about the net realized performance fees doubling in 2020 and then heading to $600 million or so it sounds like that's perhaps more like 2022-2023 timeframe. So, I guess when do you anticipate the 2014 vintage flagship becoming a more meaningful contributor in your view? I imagine 2020 near term probably not as much so. But is it more meaningful fair to say in 2021 or 2022?

And then could you also touch upon some of the net IRR dynamics in your 2014 Europe and Asia flagships? I guess what's holding that down to 8% and how much is those IRRs need to improve to hit your $600 million performance fee expectations looking out a couple of years?

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

Michael, thank you. So, as I said, we're feeling really good about the increase in 2020 roughly a doubling. That's mostly from funds prior to that. So, Carlyle Partners IV and V, our US real estate platform and a number of other funds across the platform. So, the older vintage seeing lots of realizations there in Carlyle Partners VI. Europe IV – I'm sorry, yeah, Europe IV and Asia IV, you will also see lots of realizations this year, with the potential for some of that to start to generate carry. Hard to say exactly on which year, probably it's really more 2021, 2022 timeframe.

The net IRRs as long as we're above 8%, that's the hurdle. So, staying above 8% is key from being in accrued Carry. I'm feeling really good about where these funds are now. Keep in mind these are long life funds, takes generally four to seven years from a maturation perspective on any given investment. And so, over time I'm feeling good about how these will play out. They're on track with the prior generation funds and you'll see on Carlyle Partners VI, it's doing very well, well above its hurdle. And that's the big fund. And so, I'm feeling pretty good about these projections that I've just given you.

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

A

Yeah. Hey. Hey, Michael. It's Kew. Let me give a little bit more color to what Curt just said, which is – first of all, let's just take a step back. Predicting precisely carry and realization is not incredibly – it's not a precise science. What we are trying to tell you is that with all the assets in the ground over the years and with all of the hard work that we see our investment teams as they're on these deals day by day, we're actually seeing last year being the trough year. And as business activity picks up, as markets continue to be open and robust, as value-creation plans continue to be implemented, we are seeing a trajectory on our performance fees or realizations and eventually performance fees, which is up into the right. And so, I think everything that Curt has told you is right on, it's directional, and you are seeing that trajectory that we feel pretty good about as we sit here today.

As it relates to your two specific questions in Asia and Europe, these are two very important flagship funds for us, we're not in the quarter-to-quarter annual basis, we're in the long-term business. Our focus is very much on creating value over a long-term timeframe. As we sit here today, we feel good about how each of those portfolios are constructed. They are on track with what predecessor funds have created in terms of MOIC and value creation. And so – and we also feel very good about the construction of those portfolios. So, to support what Curt said as it relates to those two funds, we do see performance value creation and eventually realizations in line and tracking to what we're expecting and what we've always been able to do at these funds.

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

Q

Great. Thank you.

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

Patrick Davitt
Analyst, Autonomous Research LLP

Q

Hi. Thanks for the follow-up. Could you update us on how much of your invested capital in PE and Real Assets is in mainland China? And also any broad thoughts on how the portfolio is performing or is exposed to the coronavirus would be helpful.

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

A

Sure, Patrick. It's Kew. I mean, look, clearly, the coronavirus is having a short-term impact in the global economy. It's hard not to say that there isn't an effect on travel or retail establishments or the potential disruption for supply chain dynamics. I think it's way too early to draw conclusions on the longer-term impact, and it's dangerous to speculate at this point in time.

The most important thing for us is to focus on our people and to make sure they're safe. We, at Carlyle, have taken some prudent steps to establish some protocol, and we're doing what we can to help in China. We're monitoring the situation closely, and we're going to continue monitoring it closely.

As it relates to kind of our presence there, we've got about 20 companies and portfolio in Corporate Private Equity. About I think a little more than 110 employees in China. It represents about 1.6%, a little less than 2% of our total asset base and about 5%, 6% of the fair value of our Corporate Private Equity portfolio. Hopefully, that's helpful color for you. Good.

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Patrick Davitt
Analyst, Autonomous Research LLP

[ph] Very (00:52:32). Thanks. Yeah.

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

Alexander Blostein
Analyst, Goldman Sachs & Co. LLC

Great. Thanks for taking the follow-up as well. So, another one for you guys around performance trends. I guess taking a step back, Corporate Private Equity appreciated about 8% in 2019. Natural resources were down a little bit. So, both a little below that kind of longer-term track record that you have highlighted. So, any areas in particular that weighed on performance in 2019? I'm assuming some of that was energy related. So, maybe secondly, give us an update on your overall energy exposure maybe as a percentage of fair value invested capital for Carlyle as a whole. Thanks.

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

Alex, it's Glenn. Let me start and Kew will jump in I'm sure. So, first of all, the energy portfolio is a little bit less than 10%, about 10% of our overall AUM. And to say that the backdrop was choppy over the course of the past year might be a bit of an understatement. But I think the key to that choppiness in the market was where it fell and how we've invested. The choppiness was really seen most in exploration and services companies and in public companies. And while that had a knock-on effect over our performance in 2019 over the last five years, our energy portfolio has appreciated in excess of 10% annually and that compares to a benchmark of minus 10% over that same period. So, we are very closely paying attention what's happening in the energy world today, but we think our portfolios are well constructed. The funds are all in positive territory. And in fact, some of our funds are performing extraordinarily well like our International Energy Fund, which has got well over a 20% growth in the mid-teens net return.

The interesting dynamic in energy right now is really the investment opportunity. One of the great assets we have is we've raised a fair amount of good capital in the last couple of years which puts us into a front-foot position with investing. So, from a traditional energy, oil and gas particularly, we see lots of good companies with really low prices, entry prices and high cash flow. And our operating approach and hedging approach provides a very attractive I might say value opportunity in investing in traditional energy. But at the same time, the energy transition is creating a ton of opportunities in renewables, and that backdrop is accelerating. And so, we also have strategies in renewables. And so, at this time, where we hear people talking about the energy transition, we think we're really well-positioned to invest well in both sides of it. So, I hope that gives you a good frame.

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

Yeah, not much more to add to what Glenn just said on the energy side, but just taking a step back. Investment performance is the most important thing we do across the entire firm. On the Private Equity side, over the past five years, we're up 14% on an annualized basis, and our large funds are tracking in line with predecessor funds with respect to value creation.

I could also tell you, our newer funds in US real estate, in our buyout, both US, Asia and Europe, and as well as in our credit side of the equation with [ph] credit ops (00:55:59), they're all off to tremendous starts. And we also, at

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Carlyle, have a bunch of private equity funds that are smaller but are quite focused, funds targeting Japan, Asia growth, financial services and European technology, all of those funds are doing really well, 20%, even 30%-type of returns. And so, we feel very good about how our funds are positioned.

Now, that doesn't mean that in any given fund, there isn't one or two situations that aren't going as we'd expected, but that's where portfolio construction comes in and we are very focused at Carlyle, across all of our asset classes through our investment committees and our fund heads, to make sure that each fund is well-diversified by its deal size, sector, and vintage year. And as a result, we construct our portfolios to perform well and to be consistent in both good times and bad.

So, we are very focused on this. It's the most important thing we do. We think everything is on track. That's not to say there won't be a bump here or there, but we feel that our approach at Carlyle and the way we think about deals and the construction of our portfolio serves us quite well to keep doing what we've done in the past in the future.

Operator: Thank you. And we're currently showing no further questions at this time. I'd like to turn the call back over to Daniel Harris for closing remarks.

Daniel F. Harris

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

Thank you very much. We appreciate your time, and thank you for joining us. This is our first call as a corporation. If you do have any follow-up questions, feel free to contact investor relations. And, otherwise, we'll look forward to talking with you again next quarter.

Operator: Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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