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Other Participants

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Kenneth B. Worthington – Analyst, JPMorgan Securities LLC
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MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to The Carlyle Group Second Quarter 2013 Earnings Conference Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and answer session and instructions will be given at that time. [Operator Instructions] As a reminder, this call maybe recorded.

I'd now like to introduce your host for today's conference, Daniel Harris, Head of Investor Relations. You may begin.

Daniel Harris, Managing Director & Head-Investor Relations, The Carlyle Group LP (Corporate Private Equity)

Thank you, Ashley. Good morning and welcome to Carlyle second quarter 2013 earnings call. With me on the call today are our Co-Chief Executive Officers, Bill Conway and David Rubenstein; and our Chief Financial Officer, Adena Friedman.

Earlier this morning, we issued a press release with our second quarter 2013 results, a copy of which is available on the Investor Relations portion of our website. Following our remarks, we will hold a question-and-answer session for analysts and institutional unitholders. 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.

Please note that any forward-looking statements made today do not guarantee future performance and undue reliance should not be placed on them. These statements are based on current management expectations and involve inherent risks and uncertainties including those identified in the Risk Factors section of our Annual Report on Form 10-K that could cause actual results to differ materially from those indicated. Carlyle assumes no obligation to update any forward-looking statements at any time.

And with that, let me turn it over to our Co-Chief Executive Officer, David Rubenstein.

David M. Rubenstein, Co-Chief Executive Officer & Director

Thanks very much for joining this quarter's earnings call. Carlyle's second quarter was solid and generally in line with the expectations we outlined on our last quarterly call. During this quarter, we continued to focus intensely on performance across the four components of the Carlyle Engine. We also continue to build out and to expand our platform for future growth. The numbers for and the events which occurred during the second quarter demonstrate this solid performance and progress. Let me be more specific by reviewing the highlights for the quarter.

Our fundraising, the first part of the Carlyle's Engine accelerated in the second quarter to a total of $6.9 billion, building on already strong first quarter and giving us a total of $19.7 billion over the past 12 months. Our fundraising pace is the strongest it has been since 2008, demonstrating the breadth and attractiveness of the products we're offering to fund investors as well as the satisfaction that so many of our current investors have with their existing Carlyle funds. The investments we made this quarter, the second part of our Engine tended to be in smaller transactions, leading to total invested equity capital of $1.3 billion across our carry funds in the quarter, $3.8 billion for the first half of this year and $8.8 billion over the last 12 months.

On the third part of our Engine, asset appreciation, our carry fund portfolio appreciated by 3% in the quarter and 9% for the first half of this year. Our Corporate Private Equity funds appreciated by 5% in the quarter, 14% in the first six months of the year and 24% over the last 12 months. Our largest fund, Carlyle Partners V appreciated by 8% in the quarter, 18% in the first half of this year and 33% over the last 12 months. The strong appreciation, our Corporate Private Equity segment was somewhat offset by relatively flat performance in real estate and depreciation in our Legacy Energy Funds. Our production of realized proceeds, the fourth part of our Engine also continued to be robust at approximately $3.9 billion for the quarter and $8 billion for the year-to-date, resulting in almost $20 billion in cash realizations for our fund investors over the past 12 months.

What do all of these numbers mean for our unitholders? First, on Distributable Earnings, we continue to demonstrate our ability to generate cash for our unitholders. Distributable Earnings for the firm were $163 million for the quarter and $334 million for the first half of this year leading to a total last 12 months Distributable Earnings of $729 million. Of the $163 million for the quarter, $118 million came from Realized Net Performance Fees. Second, on economic net income that metric, not one on which we run our business, was $156 million for the quarter, up from a loss of $57 million in last year's second quarter. Economic net income on a last 12-months basis increased 139% to $950 million over the prior 12-month period.

Now, a bit on the future. We continue to expect our Distributable Earnings performance this year to be roughly similar 2012 with Distributable Earnings increasing towards the end of the year through the realization of performance fees in both carry and hedge funds. We continue to expect reasonable growth in Distributable Earnings in 2014 and we will continue to execute on the new initiatives that I discussed in detail last quarter, that is to say building out our global energy capability and platform, raising and investing our business development company and expanding our Global Solutions business and our capacity to distribute our funds to a credited retail investors. These remain important firm priorities which will enable us to continue to remain an industry leader and to grow existing and new businesses into the future. We will continue to invest resources, time, and management focus on these initiatives this year and beyond.

Turning to some of the key elements of our performance in the second quarter. First, our fundraising results continued at a strong pace in the quarter. Alongside the healthy carry fund appreciation that I mentioned earlier, assets under management at Carlyle grew to a record $180 billion at the end of the second quarter, up 16% compared to last year. Our fee earnings' asset under management, were up 18% compared to last year at a $132 billion and also a record level for us. Last quarter, I noted that we were highly confident that our latest U.S. buyout fund would reach its $10 billion target by the end of the year. In fact, we have now closed on $10.3 billion for that fund, and have a strong pipeline for additional commitments. Importantly, the fee rates associated with Carlyle Partners VI, which are now turned on are in line with those in the predecessor U.S. buyout fund. Our fundraising period expires for Carlyle Partners VI in the fourth quarter, and we have a hard cap of $12 billion in external commitments. Beyond Carlyle Partners VI, we have 12 carry funds in various GMS and Global Solutions products in the market. And as I will shortly describe, we believe that we have the resources to raise all of these funds.

In other notable developments, thus far in the third quarter, we have held a first close in our third Japan fund, and expect very shortly to have a first close in our fourth European buyout fund. We also continued to make real progress on a number of other funds, including our new international energy fund and our fourth Asia buyout fund. We also held a final close in our third distressed debt fund, which we call Carlyle Strategic Partners III. We have an outstanding team in each of our distressed funds that performed well to-date. Our first two funds have a multiple on invested capital of 1.9 times and a gross internal rate of return of 23%. Total distributions from these funds for the first half of the year were almost $600 million. Carlyle Strategic Partners III is already in an accrued carry position, and the team is working on a number of very interesting investments. We launched two CLOs, including one in Europe, during the second quarter with a combined value of nearly $1 billion. Year-to-date, we have issued more than $2 billion in new-issue CLOs and since the beginning of 2012, we have raised $4.5 billion across eight new-issue CLOs.

Fundraising for our new business development company has also started off well. And we are optimistic we will exceed our $1 billion fundraising target for the company. In our Global Solutions business, AlpInvest continues to receive new mandates across its platform and is expecting to close – complete closings on commitments for the secondary program, which when combined with earlier closers will total approximately €3.5 billion. We completed our acquisition of the remaining 40% stake in AlpInvest on August 1. Had we owned all of AlpInvest since the beginning of this year, our Fee-Related Earnings would have been $10 million higher in the first half of the year.

To help raise all of these funds, Carlyle has added professionals to our fundraising team. At the time of our public offering in May of 2012, we had 60 individuals on the fundraising team. Today, we have 79 individuals. The additions we made in 2012 were primarily to increase our focus on larger investors and sovereign wealth funds. In contrast, our more recent additions were primarily to increase our focus on the smaller investor segment, including high net worth individuals and feeder funds from larger banks and private wealth organizations.

We're now truly beginning to sense a shift among investors in terms of a growing appetite for allocations to alternatives, especially for those firms which have an established record of performance. According to Prequin, 27 buyout funds raised $43.1 billion worldwide in the second quarter of 2013, an increase of almost 85% from the first quarter of the year. This was the most active fundraising quarter since the fourth quarter of 2008.

Carlyle has also seen this trend with respect to our own funds. More specifically, we have seen a substantial number of fund investors willing to commit large sums to funds in blocks between $100 million and $500 million. This isn't yet a repeat of what we saw in 2007 or 2008, but the fundraising environment has definitely improved and we're clearly a beneficiary of this trend.

In sum, I feel good about our second quarter performance, especially fundraising and our continued ability to generate real cash earnings. We also continue to make progress on our various growth initiatives and our portfolio, as Bill would discuss in more detail, is in a strong shape as it has been since the Great Recession began. Bill?

William E. Conway, Co-Chief Executive Officer, Co-founder Washington, DC

Thank you, David. Over the years, Carlyle has built a team of 650 investment professionals, coordinative to their geographies and experts in their respective sectors and investment approaches. Their job is to do three things: first, seek out new investment opportunities; second, build value; and third, exit and distribute the profits back to our investors.

In terms of our investment professionals, first – excuse me, seeking out new investment opportunities. We've been active in Asia, recently closing one and announcing another public-to-private transaction in China. In Europe, where we announced three bio transactions in the last three months and we continue to invest in U.S. and Asian real estate assets and in Energy Mezzanine transactions and in growth companies.

Europe is a particularly interesting place for investing today precisely because investment sentiment is so negative toward the region. However, the overall investment environment has grown more challenging particularly in the United States for large transactions. With the world awash in liquidity, interest rates at rock-bottom levels and asset prices being bid up. It has become increasingly difficult for us to compete when underwriting our investments particularly in the United States to a 20% to 25% internal rate of return.

Our investment teams have experienced competition globally from financial sponsors and strategic investors willing to pay more. As a result, we have, for now, guided our investment teams to stay firm on our due diligence or in a disciplined style focusing on the fundamentals and investing in industries we know, to be comfortable paying more high-quality assets, and to be creative. Year-to-date, we have only invested $3.8 billion. Based upon what I see today, I expect our investments total for 2013 to be lighter than 2012.

In the second quarter, we invested $1.3 billion in new equity, more than half of which was invested outside the United States. A few notable investments. Focus Media, the China-based advertising company, which we and another investor took private; Addison Lee, a UK-based car service company; Duff & Phelps, a global financial advisory and investment banking firm, too attractive energy investments backing upstream oil and gas projects in United States and more than $200 million in various real estate assets around the world including additional investments focused on the housing recovery in the United States.

In terms of our investment professional second job, building value, looking back over the past few years, it is clear to me that we've built an exceptional portfolio. Our U.S. buyout fund, which – our U.S. buyout portfolio, which is by far our largest business, is as well-positioned as it has been in our 26-year history. Carlyle Partners IV, a $7.8 billion 2005-vintage fund bore the brunt of the Great Recession, yet has performed well. It is fully invested and marked 2.15 times multiple of invested capital as of June 30. I expect the fund will continue to distribute large amounts of cash returns to our fund investors and performance fees for our unitholders.

Our most recent U.S. buyout fund Carlyle Partners V is a $13.7 billion 2007-vintage fund. Despite having some relatively recent investments, which generally are valued at close to cost, the fund is currently marked at 1.57 times multiple on invested capital. Carlyle Partners V is performing as well or better than Carlyle Partners IV dated a similar stage in its evolution. Carlyle V generated another $186 million in gross performance fees this quarter and now has accrued $1.14 billion in gross carry.

Outside of the United States buyout funds, our portfolio continues to strengthen. As detailed in our earnings release, Carlyle Asia Partners III, Europe Partners III, our most recent U.S. real estate funds, and other Carlyle funds are continuing their march toward exceeding their preferred return hurdles and producing performance fees. Our hedge funds also performed well in the quarter, and hedge fund AUM has reached $13.6 billion at the end of the second quarter, up from $9.6 billion a year ago. So far this year, as David mentioned, our carry fund portfolio appreciated 9%.

In terms of our investment professional's third job, exiting, year-to-date, we produced $8.0 billion in realized proceeds with almost $20 billion in the last 12 months. In the second quarter alone, our fund investors benefited from block sales in a number of portfolio – of public portfolio companies, including our final exit from Hertz and the sales of shares in Nielsen, SS&C, Cobalt, Wesco, and Boston Private. Each of the sales relates to investments where we have returns of approximately 2 times to 5 times our invested capital.

We sold close to $500 million in RMBS securities. We realized proceeds through the IPO of Broadleaf, a software company based in Japan, and a number of our portfolio companies issued dividends in the quarter. Following the second quarter, we recently closed the sale of our position in Yashili, a China infant-formula company. And we have a number of portfolio companies preparing to go public around the world, assuming markets remain open.

Lastly, I have guided our investment teams to prepare for the inevitable rise in interest rates, even though, I do not believe that will happen imminently. Our existing buyout portfolio refinanced a substantial portion of its debt in 2011 and in early 2012, and just when we thought rates couldn't go lower, they did. So we refinanced a number of the companies again in late 2012 and early 2013. Through these re-financings, we limited our exposure to rising rates across our corporate private equity business as the majority of that debt was locked in or hedged at low fixed rates. And in general, we believe that the GMS business with $34.7 billion in AUM is positioned to benefit from a rise in rates.

In summary, although our investment pipeline is weaker than I would've expected, our investment teams are executing as they should, building value across our portfolio and taking advantage of high asset prices by exiting. This of course allows Carlyle to continue our history of distributing billions of dollars in profits back to our investors.

Let me now turn it over to Adena.

Adena T. Friedman, Chief Financial Officer, Managing Director Washington, DC

Thank you, Bill. My remarks today will focus on three elements of our second quarter financial results: Distributable Earnings, Fee-Related Earnings and accrued carry.

Starting with Distributable Earnings, year-to-date pre-tax Distributable Earnings of $334 million are up 13%, compared to $295 million in the first half of 2012. On a post-tax basis, including the $0.53 in after-tax Distributable Earnings pre-unit generated during the second quarter, Carlyle has now generated a $1 in post-tax Distributable Earnings per unit for the first half of 2013.

We've announced cash distributions of $0.32 per common unit relating to our results for the first half of 2013, and tend to announce another $0.16 per unit at a fixed distribution related to the third quarter and at least a $0.16 distribution for the fourth quarter. Our distribution policy and payout expectations remain unchanged. And for the full year 2013, we expect to distribute between 75% and 85% of our [ph] post-taxable (17:58) earnings to unitholders, which will be accomplished through a true-up distribution based on full year 2013 results.

Additionally, beginning this quarter, we adjusted our Distributable Earnings calculation to add back equity compensation expenses. Though, this expense line item remains in Fee-Related Earnings and Economic Net Income. We've provided this adjustment for all prior periods as part of our second quarter earnings release and it will be reflected in our 10-Q. We made this change for two reasons. First, we believe this adjustment brings Distributable Earnings closer to a true cash earnings measure. And second, it brings Carlyle in line with the majority of the firms in our sector.

Turning to Fee-Related Earnings, we generated $26 million in the second quarter and $63 million for the first half of the year, down 10% from the first half of 2012. As I mentioned last quarter, we have a number of expense and revenue effects that will impact Fee-Related Earnings throughout the year, primarily related to several groups related initiatives, including fundraising efforts across our platform, as well as our new efforts in international energy and power.

On the revenue side, our year-to-date management fees are up 6% from the first half of 2012, and portfolio advisory and transaction fees are up $6 million compared to last year. In early June, we initiated the collection of fees for our sixth U.S. buyout fund and our fourth Asia buyout fund. In connection with turning on the fees for the successor funds, the investment periods for the predecessor funds Carlyle Partners V and Carlyle Asia Partners III have ended, which results in a change in the fee basis for those funds. The net result after these changes will be positive from a Fee-Related Earnings perspective, particularly as we continue to drive higher fundraising results for these funds. We expect to remain active in fundraising for the foreseeable future, as we have 13 carry funds and other global market strategies and solutions products in the market. Our fundraising efforts this year will – should result in a boost in our management fee revenues as we enter 2014.

On the expense side, there are three main drivers of the change in non-performance fee-based expenses, which totaled $240 million in the second quarter up from $221 million in the first quarter.

Professional fees was $13 million higher, compared to the first quarter driven by higher legal fees, consulting costs and non-recoverable fund expenses related to new fund initiatives and fundraising activities. Direct fundraising costs were $12 million higher than the first quarter owing to major fundraising efforts across many of our carry funds including the use of feeder funds in some cases.

And, compensation costs excluding compensation associated with fundraising were $11 million lower than the first quarter, which includes an adjustment to our non-performance related compensation expense expectations for the full year based on business activities and core trends.

As I discussed last quarter, we expect to continue to have elevated fundraising and new initiative expenses over the coming months leading to some pressure in Fee-Related Earnings for the remainder of the year. Some of this pressure will abate as we enter 2014 with increased revenues arising from our fundraising efforts.

In the meantime, during 2013, we will remain vigilant in our efforts to control our operating costs wherever possible to improve our Fee-Related Earnings margin, though in periods of heavy fundraising we view related expenses to be a necessary investment to track long term fee earning assets.

Examining our accrued carry balance this quarter, overall it remained relatively unchanged from the prior quarter due to a balance of a 3% appreciation in our funds coupled with realization activity across our funds. Accrued carry is driven by realization activity, which lowers the accrued carry balance as well as the unrealized performance of the funds that are in a carried position.

In the second quarter, the primary positive driver of our accrued carry balance was Carlyle Partners V particularly with its 8% appreciation this quarter. However, we had several funds appreciated nicely in the quarter that are not yet in an accrued carry position such as Carlyle Asia Partners III and Carlyle Europe Partners III. And we had several other funds that are in an accrued carry position with a flat or slightly negative performance for the quarter including our legacy energy funds. The net result was a relatively unchanged accrued carry balance on the balance sheet.

Our gross accrued carry balance net of [ph] give back (22:34) remained at approximately $2.6 billion and the net accrued carry balance remained at $1.4 billion. This is roughly $4.66 per unit assuming all current non-public units were exchanged for public units. In sum, this quarter our financial performance demonstrated strong cash generation from realization activity, some short-term challenges in Fee-Related Earnings primarily as we invest to grow and a stable accrued carry position across our portfolio as we watch some key funds move closer to an accrued carry position.

And with that, I will turn it back over to David for some concluding remarks.

David M. Rubenstein, Co-Chief Executive Officer & Director

We've been public for more than a year and we believe our performance this past quarter and these past 14 months is consistent with what we said we would do at the time of the IPO, operate and grow a truly global multi-discipline alternative investment company, distribute significant funds to our fund investors and produce meaningful and steady distributions to our unitholders.

In working to honor these goals, we've tried to be as transparent and as accessible as possible. As part of this effort, we will hold an Investor Day in New York on November 12. And it'll be very easy for everyone to remember that day 11/12/2013. In the near future, we will provide logistical details and now we are available for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question is from Howard Chen of Credit Suisse. Your line is open.

<Q – Howard Chen – Credit Suisse Securities (USA) LLC (Broker)>: Hi good morning, everyone.

<A – Bill Conway – The Carlyle Group>: Good morning.

<A – Adena Friedman – The Carlyle Group>: Good morning.

<A – David Rubenstein – The Carlyle Group LP>: Good morning.

<Q – Howard Chen – Credit Suisse Securities (USA) LLC (Broker)>: My first question is for Bill. With respect to deployment a year ago, you're really very direct about the relative attract in this investment in the U.S. and so far it looks like you've improved [ph] and raised (24:29) with all of what you put in the ground. It sounds like Europe is becoming relatively more attractive. So given the dynamics of that market, I'm just curious, how large do you think that opportunities set could be for Carlyle in coming years and do you think you're right sized from a dry powder perspective today?

<A – Bill Conway – The Carlyle Group>: Well, first of all I do think that Europe is – I've said for a while; I thought United States was the best place to invest. For a lot of reasons the energy, the housing, the system of rules, the interest rates you name it, but, just because it's a great place to invest doesn't mean it's easy to do that. And certainly, we've had our struggles with finding enough really good deals in United States to invest in this year. At the end of last year, we did three or four wonderful transactions that have worked out great. Right now, because a lot of people frankly hate Europe in terms of its investment, the way they think of investments in Europe, we actually see very good opportunities there. Now, the European economy is roughly the size of the U.S. economy. We are working to raise our European fund, our fourth European buyout fund. We're still investing the balance of the third one. I expect this fund will be a little smaller than the last one, but the time will tell on that. If we can raise the fund size we're hoping to do, then I would expect we would have enough dry powder.

Still even with that, Howard I don't expect that the European business will be able to invest as much as United States business does. When the U.S. buyout fund let's say is, the current fund is raised $10 billion but let's say we invest, we could invest $3 billion a year out of that. I see no possibility of investing that size in Europe. We have a big team, a good team, we've five offices, we've been there more than 10 years, we've made a lot of money for our investors in Europe. So, we feel pretty good about our business. But it's – even though, the economies are roughly the same size, I'd say the investment opportunities are smaller in Europe in terms of number of – amount of money we could put to work in any given period of time.

<Q – Howard Chen – Credit Suisse Securities (USA) LLC (Broker)>: That's really helpful. Thanks, Bill. And separately, you touched on this a bit, but given the amount of investor questions I've gotten about the impact of higher rates on your model, I was hoping you, David and the team could perhaps elaborate a bit on how you think about near and longer-term puts and takes of higher rates on fund raising, deployment, value creation and ultimately harvesting?

<A – Bill Conway – The Carlyle Group>: Okay. Well, that's a lot to talk about. First of all, the current status of the portfolio I'd say to, may be elaborate on what I said in the prepared remarks. In the United States of our existing portfolio, roughly 60% of it is fixed rate or hedged, the debt against our portfolio companies. And we will, and when we look at our exits and when they're likely to occur, we feel, we're very well protected in terms of that.

In Europe, our portfolio is about 75% hedged against a rise in interest rates either through fixed rates or through hedges that we have in place. Frankly, the businesses in Asia tend to lose a – use a lot less leverage. So, I don't have the data on that, but it would not dramatically change the numbers.

Now, I don't expect the increasing rates to happen right away. I actually think the Federal Reserve can do what it says it's going to do, which is to keep rates low, even when it begins to – to taper. But, I think you have to be prepared because who really knows what's going to happen, the future is, it hadn't happened yet. So, we don't know what's going to happen there.

In terms of rises in interest rates though, I would say that generally that means that the economies are tending to improve. And economic improvements can and should frankly over time, overwhelm the impact of most of the rate movements that I would expect. So, when I see the ability to exit in the portfolio, I think that, I think an economic improvement will hopefully offset a rising rates, or rates aren't going up.

In terms of the interest rate increase on fundraising, I think there's a – David may have a little more on this, but what I would say is that, people have talked frequently about the impact of the hurdle rate. And, the importance of achieving the hurdle rate, I would call everybody's attention to earnings release, in terms of the fund level performance, which really I want to be looking for there, our Net IRRs exceeding roughly an 8% hurdle. If they are, then those funds are making a lot of money. If they're not, you can still be a great deal for the investors, but it wouldn't be such a great deal for Carlyle, because we wouldn't be able to hurdle. And a rise in interest rates might, and probably would over time make it easier to exceed the hurdle. But, David?

<A – David Rubenstein – The Carlyle Group LP>: We've seen that investors who are worried about the rise in interest rates are beginning to think that maybe they should get out of some fixed income products, they're worried about some other bonds and other corporate instruments that are fixed income, their holdings going down at value as interest rates go up. So, we are beginning to see a general shift of people to more equity products and really more alternative equity products. So I won't say fundraising is as easy as it was in 2007 or 2008, but we're seeing around the world, more concerned about rising interest rates meaning that people should get out of some fixed income products and really go into alternatives. So it's been helping somewhat, but I wouldn't overstate it.

<A – Bill Conway – The Carlyle Group>: Yes. I might also add on our GMS business. That business tends to invest and is far more invested in floating rate assets. And therefore, I think that over time it's pretty well positioned for a rise in interest rates. It will depend how it happens, how steep the curve is, and lots of other things, but generally, we think that business pretty well positioned us well.

<Q – Howard Chen – Credit Suisse Securities (USA) LLC (Broker)>: Great. Thanks for all those thoughts. And then just my final question. David, on the AlpInvest buy-in, I was hoping you could talk through why now was the right time to complete that deal and perhaps a progress report on just the two main goals of – as I think about it, one, using it to help bolster winning strategic mandates; and two, penetrating a deeper relationship with AlpInvest prior owners as well? Thanks.

<A – David Rubenstein – The Carlyle Group LP>: Well, on the latter part, one of the reasons we wanted to make the acquisition was because we thought it would help us strengthen our relationship with the two main owners of AlpInvest, and in fact that's happened. We have raised a fair amount of money into our direct funds as a result of the relationship we developed by owning AlpInvest. So that – that part has certainly worked out and we're quite happy with that. We originally bought 60% of AlpInvest and the management team owned 40%. And we think that worked well as we began to work together, but we just think – thought that it would make better sense if they were completely on the same page as Carlyle in the sense that every other employee at Carlyle really is. So we felt it was a good time after the transition to make the change. It really puts them on – working at Carlyle at the same basis as other investment professionals. And we think it's probably going to help with our fund-raising effort for AlpInvest, because it's clear that they are 100% Carlyle professionals, and we think that probably will help as we raise more money for AlpInvest and in fact the fund-raising for AlpInvest has really done quite well in recent months.

<Q – Howard Chen – Credit Suisse Securities (USA) LLC (Broker)>: Great, thanks for taking the questions.

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

<Q – Ken Worthington – JPMorgan Securities LLC>: Good morning. You spoke a lot about the opportunities in Europe, but you also have a large and I'd say differentiated presence in the emerging markets. So can you give us an update on that region? It seems like emerging markets have fallen out of favor with some investors. So how does the investment environment look for you guys in these regions? And from a fund-raising perspective, how do the opportunities look from emerging market base investors given the less even opportunities recently for them locally?

<A – David Rubenstein – The Carlyle Group LP>: Let me answer the latter part and Bill will do the first part. We are raising more money from emerging markets than we have ever raised before. In fact, we are doubling the amount of money we're raising from the emerging markets probably for our U.S. buyout funds. And my point is that a lot of the emerging market countries are investing money not necessarily in their emerging markets. They're investing money outside. So I don't think that the concerns about emerging market growth or GDP growth rates is adversely affecting our ability to raise money in those markets. They have large sovereign wealth funds, as everyone knows. And they are deploying a lot of that not only in their own backyard but a lot of it outside. And so we are seeing a real pickup in money that we're raising from the emerging markets, particularly Asia and the Middle East, and I don't think that will abate anytime soon, even if emerging market growth rates should go down a bit. Bill?

<A – Bill Conway – The Carlyle Group>: In terms of investing in emerging markets, first of all, I do think that the bloom is gone off the rose a little bit on emerging market investing. And I think that the consensus would be that when the United States starts to taper and rates start to go up in the United States that that will be a tough time for emerging markets, certainly public emerging market investing; that's what the consensus believes and I suppose I believe that as well in terms of the economic view. I think it could affect the currencies, the equity markets, the debt markets of the emerging market countries.

But I think that the investment environment and the economic environment can be very different. And when everybody thinks things are going to be great in a market, it's tough to find deals to do, people overpay, things get crazy, and it's really hard to make money. When there is a little volatility and people are a little bit concerned about what's going to happen, it's easier to invest and make some money in those markets. We've done a number of studies that show for example that there is no correlation, no correlation, maybe a negative correlation, frankly, between growth rates in an emerging market and the performance of the equity markets in those emerging markets. Fastest growing market in the world recently, big market has been China. Its stock markets have been down and that's been true for the last several years and that's one example, but there are many others.

In terms of the opportunities we're seeing in emerging markets to invest, I would say in Asia – in China [ph] it's become (35:04) a lot of local competition, but the local competition most of it can't do what Carlyle can do in terms of our global network of 650 professionals, 200 portfolio companies, the senior advisors we work with, we have some advantages that the local players don't have. We were actually able to find interestingly some opportunities in China in the public market. Where the public market had been beaten down, we could find companies that maybe shouldn't have been public or the public market didn't appreciate to buy them, hopefully make them better and then exit down the road.

In Africa, which is a relatively new market for us, we've done two transactions in Africa. We have a third one that we're working diligently on that I expect to come to conclusion. I think that Africa is really far more – if China is a developed market almost and one end of the spectrum, Africa is nearly a frontier market at the other end. But we've been able to find some actually big companies in Africa to make investments and that we've been pretty happy with at least so far.

In terms of the Middle East, obviously the Middle East is in enormous turmoil. I think that there we've concentrated, frankly, and started out [ph] with some (36:22) Middle Eastern fund and what's currently developed into which is primarily Turkey and to a lesser extent Saudi Arabia. We think that those are the best markets in the Middle East to invest.

In terms of Brazil, we have a nice portfolio. We've already made a lot of money in Brazil. Clearly, that – the consumer there is beginning to run out of steam. We have – we're proud of the current portfolio we've got, watching it very closely. But I do think that the turmoil in emerging markets will create more opportunities and we'll actually be a net beneficiary of that.

<Q – Ken Worthington – JPMorgan Securities LLC>: Great. Thank you very much. And then maybe similarly in alternative credit, you've got a nice and growing presence there. Maybe describe the growth opportunities in credit, both organically and inorganically? And because you are growing the corporate buyout business with your flagship fund so rapidly, do you think it's possible for credit to be a stable part of the mix or is it just going to get overwhelmed by the fund-raising you're doing elsewhere in Carlyle?

<A – Bill Conway – The Carlyle Group>: Let me answer the first one first. It's interesting, the Global Market Strategies business has really been our fastest-growing business, and I expect that to continue to be the case. And will it be as big as the Corporate Private Equity business? No, but at least well, who knows whether or not it will be. I don't think it will be anytime soon in terms of profitability, but we've grown the business to $34 billion of assets under management today and I think that we have extremely good prospects for continuing to grow that business.

There are several different parts of it, Ken. First of all, we have the CLO business. Generally, we've been doing a CLO every quarter or so, maybe a little more frequently that – than that, now that the European market has opened up. In order to make the CLOs attractive, you have to obviously have the real credit skills to be able to make sure that your defaults stay within a reasonable range; you have to be able to raise the senior debt, which is the cheapest debt in the CLO; and you have to be able to raise the rest of the capital structure; and then you have to find the equity.

The restrictions on equity and CLOs have really increased pretty dramatically recently, because of the various rules going in around the world, Dodd-Frank like rules, which really are going to require people like Carlyle to own 5% of the capital structure of the CLO. And so, if you're doing, let's say, a couple of billion dollars of CLOs a year, that's just a lot of money for people have to put up and I think maybe size may help us there.

By the way, the other thing you have to do on the CLO is you have to take care of the asset side of the balance sheet. Can you acquire assets at reasonable spreads, at reasonable quality such that the mathematics all works. Today we still think that does work in the United States and Europe. The European market has just opened up. I think our CLO business is about $20 billion roughly in size. We obviously have some old CLOs that are running off until we replace them with a lot of these new CLOs, which as I said, we've done I think several of them this year and we expect we'll do several more.

In terms of the rest of the GMS business, that's the hedge funds, and there are – our biggest hedge fund is Claren Road where we have a great team. We own 55% of that business and the team owns 45%, which actually is kind of the model that we have with most of our buyout funds around the world. They've had wonderful performance, they've grown. When we acquired it, I think, they had assets of about $4.5 billion and now they're about $7.5 billion, so it's been a very good business. And a lot of that growth has come because they make money for investors. Our other hedge funds, ESG, which is emerging markets hedge fund has done a great job so far in 2013. Hope that continues and Vermillion is our newest one, which is the commodities hedge fund, total of about $12 billion or so, $12 billion to $13 billion in hedge fund assets.

The balance of the GMS business is our distressed business, our mezz business and our BDC. Let me just talk a little bit about our BDC. We are in the market raising that now. We have high hopes that we will get to the target we've established, and we think also we can put the money to work kind of in the middle market loan space, which frankly the banks are not yet back lending to the middle market. So there's a real need for another lender to get into that market.

<Q – Ken Worthington – JPMorgan Securities LLC>: Great. Thank you very much.

Operator: Thank you. Our next question is from Michael Carrier of Bank of America, Merrill Lynch. Your line is open.

<Q – Michael Carrier – Bank of America Merrill Lynch>: Thanks. Just maybe two questions on some of the things that you went over. You said if we look at the in-carry ratio this quarter, you saw the dip and there is obviously a bunch of things that are going to be impact it, probably the most important is when new funds are coming on board. But I guess, if you can just break down sort of the moving pieces there, because from one standpoint you're looking, the performance is strong in the quarter, so that's the good thing. But on the flip side you've got distributions and new funds coming on board. So just want to kind of understand that and then any kind of future looking deltas, obviously that's a lot tougher. And then also just on the tax rate, seemed like it might have been a little bit higher than expected. So just any nuances there?

<A – Adena Friedman – The Carlyle Group>: Sure. So I'll start with the in-carry ratio. So the in-carry ratio is 61% and as – just as a reminder, that's essentially the amount of fair value of our assets that are from funds that are in-carry versus the total fair value of our assets today. So it doesn't include dry powder, but it would include if we do investments into a fund, let's say investments into a fund that's not yet in-carry and then it would increase the denominator without increasing the numerator. And we did do some investments in the quarter in funds that are not yet in-carry, so the denominator would increase, so that's one thing to think about.

Also in terms of exits, however, most [ph] realization (42:48) activity occurred in funds that are in-carry such as CP IV, so the denominator and the numerator were declined and that would bring down the in-carry ratio. And then we had one fund that went essentially – it's one of our energy funds had a small claw-back position that developed during the year – during the quarter and that was – that essentially moved them from in-carry to in claw-back out of carry. So those three things combined are really driving that ratio to a different level. And that's going to happen. I mean, it's just a little bit of volatility in that ratio and as you said there are lot of things driving at.

In terms of looking forward – I can – I think one thing to think about with that ratio though is we have for instance Carlyle Europe Partners III which is now at a 7.5% Net IRR. And so if that fund continues to appreciate, which we're sure – hope it will, then it will cross into a carry position and once it does, that's a large fund that will certainly fall into the carry bucket. So – the numerator will fill up with that fund and so that ratio could change meaningfully once that fund crosses into carry, which we hope will happen. So that's another thing to look for in the future.

In terms of the tax rate, actually the tax rate on the corporate side was lower. I mean for Distributable Earnings, the tax rate is negative for the quarter on the quarter blocker. The reason for that is every – actually every second quarter as our DRUs vest, it generates a tax deduction and given the fact that the nature of the earnings that were taxable this quarter in the corporate blocker were relatively low because most of the carry came off of our Carlyle Private Equity Funds. That means that we – that deduction is essentially towards their earnings and therefore we had a loss from a tax perspective and therefore we were actually able to take a bad tax benefit for the quarter on Distributable Earnings.

In terms of statutory taxes, these were slightly lower this quarter as well. So maybe you're looking on an ENI basis and that's just based on, I guess, effective tax rates which are done, as you know, on a different basis altogether.

<Q – Michael Carrier – Bank of America Merrill Lynch>: Yep. Okay. That makes sense. And then maybe just as a follow-up. Just on the fund raising side, obviously a strong quarter. You mentioned some of the hiring that you've done and not that we're going to get this on every quarter, but when you look at the trend, on the $6.9 billion that you are raising, and you look at the areas that you've focused on in terms of the head count, maybe the smaller investors, the high net worth, just where is that trend shifting, meaning in terms of how much the new capital is coming in from those channels versus it's still relatively early in that process and you're still building that out for the rest of this year and into 2014 and 2015?

<A – Bill Conway – The Carlyle Group>: Okay. First, with the biggest increases in our fundraising money that's coming in, they're really coming from high net worth individuals who are coming to us through so called feeder funds that organizations like those representative on this phone are raising for us. Second, sovereign wealth funds, they have dramatically increased their commitments to alternative investment funds such as ours. And so, I don't want to make it sound-like it's easy to raise money for them, but we are seeing big increases in those two areas. Public pension funds are still the large – U.S. Public Pension Funds are still the largest source of capital for all private equity funds of our type and our peers, but they're not increasing as a percentage as they once were and they're relatively stable, it's kind of percentages are not increasing, their percentage and their allocations as much as let's say sovereign wealth funds and high net worth individuals are.

What we intend to do is to focus on the individual fundraisers in three categories really, one is increasing what we have with respective feeder funds from the largest organizations JPMorgan, Credit Suisse, Citicorp, Goldman Sachs, Morgan Stanley, and so forth, all of them are involved or have been involved with feeder fund for us. Then we are increasing our focus on regional firms that are not as well known as those organizations, but someone, let's say like a Raymond James which are very good firm, they are – they have high net worth individuals as well and we're working on those regional brokerage firms to do the feeder funds with them. And then we are working on products that are only for investors that might be less wealthy than the wealthiest people that we can approach, but who can invest directly in our fund with Carlyle and we have products in the market now for that and developing others. So we're working on across the range to try to expose ourselves more to individual investors, and we think that trend will continue and obviously our peers are doing the same thing.

Sovereign wealth funds have really stepped up to the plate and dramatically increased their allocations, and I think their percentage in Carlyle Partners VI from sovereign wealth funds will probably be doubled what we had in Carlyle Partners IV, and I think that trend is evident around the fundraising world.

<Q – Michael Carrier – Bank of America Merrill Lynch>: Okay. Thanks for taking the questions.

Operator: Next question is from Michael Kim of Sandler O'Neill. Your line is open.

<Q – Michael Kim – Sandler O'Neill & Partners LP>: Hey guys, good morning. First, just curious to get your take on broader allocation trends with an alternative, so, on the one hand your comprehensive suite of products allows LPs to customize their portfolios by – for picking and choosing amongst a range of more specialized funds, but more recently, it seems like there's been a step-up in demand for more flexible multi-asset class funds that can maybe capitalize on more opportunistic investments, maybe a bit quicker versus traditional dedicated funds, so, no it's not necessarily one-for-one trade-off. But just wondering how you think those dynamics play out and how you may be positioning the firm from a product development standpoint. In light of those trends recognizing that you already have some flexibility with some of your separate account relationships?

<A – David Rubenstein – The Carlyle Group LP>: There are some funds that other firms like ours have in the market that basically say, give us the money and we'll figure out what to do with it when we can find the appropriate opportunity, it will be very opportunistic. And those funds seem to have met some favorability in the marketplace. Our approach has been to say to each investors, we have dedicated funds, you decide what area you might like. This has enabled us to grow the firm and offer highly skilled professionals in each area.

However, now we see some investors coming to us and say, I like three or four of your strategies. I am not sure which one is the best. What would you think? And what we are doing is, targeting them into or allocating them according to their choice into three or four products at once and we will sometimes do a managed account where they can and we can in advance agree, that they will put X percent into fund A and Y percent in the fund B and so forth. So they get effectively the same thing as if they went into a one opportunistic fund. But they will have dedicated teams, who really know those areas extremely well and investing those funds on their behalf.

So I can't say one approach is better than the other. We'd met a lot of favorability in the marketplace with our approach, but I am not saying that it's necessarily better than anybody else's, but it's worked well for us.

<Q – Michael Kim – Sandler O'Neill & Partners LP>: Okay. That's helpful. And then just, may be given more involved fund raising process on the institutional side of the business here in the U.S. And you talked about your focus on retail and high net worth individuals as well as the sovereign wealth funds from a fund raising standpoint. As your LP base continues to evolve, just curious if you have any insights into to kind of potential shifts from an economic standpoint, as it relates to fee rates, distribution cost or ultimately margins over time?

<A – David Rubenstein – The Carlyle Group LP>: Okay. Let just talk about – let say Carlyle Partners VI which is the largest fund we have in the market. We haven't seen as I said in my statement earlier. I think we'll shift in the fee rate. In the end, it'll be roughly the same as Carlyle Partners V, maybe marginally higher but roughly in the same, it depends on the level of funding. The change – the principal change between Carlyle Partner VI and let's say Carlyle Partners IV and the change in the market for fees is this. In the old days, let's say before the recession, everybody paid the same fee, everybody. If you're a $1 billion investor or $5 million investor, that has shifted. And now the larger investors generally get a slight fee break.

Second, another change that has occurred is if you invest earlier, you'll get a slight fee break and that is a change from a few years ago. We're also seeing that deal fees which we're not a big consumer of and didn't really benefit all that much from deal fees relative to some others in this industry, they are largely going away or they go to 80% 20%, if not a 100% 0%. So that it's a bit of fee shift to some extent and not so much for us. We do think that the carried interest is pretty inviolate, we don't see a big change in that.

The one thing that is – there are two changes that I think are worth noting. I don't think it's adversely affecting us, but it's in effect a fee change or slight fee change and that is this, one, the preferred returns are staying roughly where they have been. So, and you could say that's a pretty attractive thing for investors because preferred returns have crept up over the years and they're now roughly at 7% or 8% and they're not going down anytime soon even though interest rates are relatively low. You could say that's a fee change and the benefit of limited partners.

The second is co-investment, when we first started Carlyle and for many years, co-investment was something that one paid a fee and a carry on. Now, it seems like no one will really want to pay a fee or carry on co-investment, so it does have the effect, if you're an investor putting money into co-investments, you will overall lower your fees and your carries and that is an attractive thing for investors. But generally, I'd say the most investors that we talk to are more interested in the rate of return, the net rate of return, and your ability to produce that than the fee things. Yeah, some people negotiate fees, but it's really more on what is your likelihood of getting the rate of return back and what is the likelihood of getting cash back to me in a relatively prompt manner. And that's the things that most investors focus on.

On Carlyle Partner VI, I might add just for some background for people who're interested, 69% of the capital that we have in that fund has come from, today from investors who are invested in previous funds. So, we see a lot of our money coming from investors who were in our funds before, but obviously about 31% is coming from new investors, which is I think a good sign for us. About 41% of that money, [ph] I think it's (54:03) Carlyle Partner VI is coming from the Americas, 23% from Asia Pacific and about 35% from Europe and Middle East and Africa. And so those trends are slightly different than before I I'd say Carlyle Partners V had more money from the Americas, but not all that much more, but somewhat more for the Americas, we're seeing a slight pickup from money outside the United States in that product. And probably we're going to see more of that over time, because more and more people who funds in the emerging markets are now getting into private equity investing and a lot of those opportunities are from funds that are based in the United States.

<Q – Michael Kim – Sandler O'Neill & Partners LP>: Great, that's helpful. And then, just one final one maybe for Adena. I understand there's upfront cost related to fundraising and kind of building out the platform. But just trying to get a sense of how far along you are in that process, I know you talked a bit about this earlier, but any additional color in terms of the outlook for expense growth as you think about the back half of this year and into next year? Thanks.

<A – Adena Friedman – The Carlyle Group>: All right. So, we as you know we don't give guidance on our Fee-Related Earnings. But I would say that the fundraising activity that we've experienced in the first half of the year, we would expect to continue to have significant fundraising actually in later half of the year, because we continue to have our largest funds in the market. And we have a lot of new growth initiatives that we're underway with that will result in funds being raised. So I don't anticipate that the fundraising activity will diminish as we go through the rest of this year, and in fact as we go into 2014, if we have 13 funds in the market, we're going to continue to have some of those funds in the market as we go into next year, and we'll hopefully have new initiatives next year as well.

So it is definitely a period where we are reloading and driving growth and those two things will result in an expense level that is elevated compared to prior periods. I think that – but other than that I don't think we can give a lot of guidance there.

<A – David Rubenstein – The Carlyle Group LP>: We will slow down fundraising only when every single person on the face of the earth is already a Carlyle investor. Until that, we're not going to slow down.

<Q – Michael Kim – Sandler O'Neill & Partners LP>: There you go. Thanks for taking my questions.

<A – Adena Friedman – The Carlyle Group>: Thanks.

Operator: Thank you. Our next question is from Robert Lee of KBW. Your line is open.

<Q – Rob Lee – Keefe, Bruyette & Woods, Inc.>: Great. Good morning everyone.

<A – Adena Friedman – The Carlyle Group>: Good morning, Rob.

<A – David Rubenstein – The Carlyle Group LP>: Good morning, Rob.

<Q – Rob Lee – Keefe, Bruyette & Woods, Inc.>: Hi. The question I have is actually on the distribution policy, just kind of curious what your thoughts mean, clearly some of your peers or a lot of your peers have kind of migrated towards the kind of more, I guess I'd call it, pay as you earn, kind of policy and I'm just kind of curious in your thoughts on, if you have been given any thought or would give any thought to maybe kind of shifting the policy, so it's in line with some of your peers?

<A – Adena Friedman – The Carlyle Group>: Sure. So the reason we have the policy the way it is, it's for two reasons. One, because of the fact that we would like to make sure that our investors feel confident that they can have a minimum yield on the stock, just like a dividend stock although these are not dividends or distributions. They – we like to get the sense that there is a minimum yield that they can rely on. And then, we can also look at our cash flow needs throughout the year and manage our cash flow appropriately. And then at the end of the year once we know what we've been able to retain we can then distribute it. By giving guidance of 75% to 85%, we'd like to think that people can add some predictability of what the year-end distribution will be. And every quarter we provide you some guidance around that, but we also, we view our stock as a long-term stock, not a quarterly stock. We view our performance as long-term performance, not quarterly performance and our distribution policy is consistent with that. Will we ever change or never – will we never change that policy, I never say never, but as of right now we feel confident and comfortable with the policy we have.

<A – David Rubenstein – The Carlyle Group LP>: Some of our peers that have this policy that you referred to. I went to that policy after they have been public for a few years. We've been public for relatively short period of time and we just like the public a bit longer before we assess whether any change is appropriate.

<Q – Rob Lee – Keefe, Bruyette & Woods, Inc.>: I appreciate the color. And may be looking at the Real Assets business, I'm just kind of curious, I mean, you've had across, I guess a lot of markets may be not all industries, but a lot of markets look pretty good in our asset performance, the past year or year-to-date certainly yet, that business seems to be struggling from performance perspective. Can you maybe dive down a little bit into that and kind of maybe why that's kind of business has been lagging performance wise.

<A – Bill Conway – The Carlyle Group>: Well, first of all, let me – this is Bill, let me -- maybe look at things in a longer term perspective. Over the course of all the years we've been in business, we've invested about $30 billion in Real Assets in our funds. And if you looked at what we realized or what we say it's worth today, it's about $45 billion. So, we've made about $15 billion in the Real Asset business for our investors over that period of time, that includes real estate and it includes energy and infrastructure. Now, when we look at real estate, in United States we have a great business where I think we're on about our seventh United States real estate fund, really consistent track record and a very good business. Europe real estate has struggled, because the biggest driver, commercial real estate certainly, and actually somewhat to housing, residential real estate is jobs. And in many of the countries in Europe there are – the jobless rate can be 20% or 25% even in places like Spain. So that business has struggled.

In Asia real estate, we continue to build that business and I'm quite satisfied with that. I would say of course we wish we were bigger and making more money for us, but we're very pleased with the businesses we have and hopefully they'll get bigger and better. In terms of the energy business, we have the residual impacts of our Riverstone joint venture and we're now building our next energy business, and we've begun to put the pieces in place. We have a power business, we have energy mezzanine business, we own the largest refinery on the East Coast and Philadelphia Energy Solutions. We have NGP which is a great business in the United States oil and gas business. And then we're going to be building out and have already begun to build out an international energy business as well.

In the last quarter, the energy business had – the legacy energy business, a lot of it was Riverstone, had some temporary drops in the value of some of its portfolio companies. But I wouldn't put much emphasis on the effects of any one quarter in terms of the energy business. They've got a great track record for a long time making a lot of money for investors, and hopefully, that'll continue as well.

So I think it's – a little bit of this in the most recent quarter anyway, I would say temporary impacts that I don't expect to be sustained. And then, good future plans for the rest of business.

<A – David Rubenstein – The Carlyle Group LP>: You put your finger on a good point. We have had a struggle, as Bill mentioned in Europe real estate. But the important point we'd like to emphasize to people and I think is important, we have no struggles in anything else. Everything else in our portfolio is in very good shape and appreciating.

So we don't really have to spend that much of our management time fixing things. And, therefore. we are really able to spend a lot of time figuring out how we can grow the business and do some things that are, I think, strategic. I don't think any time since the beginning of the firm we've had our portfolio in as strong a shape and heading into the right direction in every one of our areas, with the one exception of Europe real estate, and that's one thing we're obviously focused on. But it's a relatively small part of our business overall. So yeah, we're working on it, but when you look at everything else going in the right direction, we're actually pretty satisfied with the investment portfolio now.

<Q – Rob Lee – Keefe, Bruyette & Woods, Inc.>: All right, great. And then just one last simple question. With about 80% of a fair value kind of in privates and I believe this to be the case really, just wanted to confirm. I mean, I guess your general experience is when something moves out of kind of a private to a public, there is usually a – I think some type of valuation improvement. So as we see over time how the things get sold out to private or migrate to the public that usually gives you some relative valuation improvement as well?

<A – Adena Friedman – The Carlyle Group>: I mean, I think it's a case-by-case basis, Rob. In the most recent case with HD Supply, we had a significant valuation improvement upon taking it public. But in other cases, frankly, we might find that it goes public at exactly the value that we carried it out the quarter before, and it could be that it goes public right after we value the portfolio. So, therefore, we're exactly right. So, honestly, it's a case-by-case basis, but in this particular quarter we did have actually a big benefit of taking issues quite public.

<Q – Rob Lee – Keefe, Bruyette & Woods, Inc.>: Great. That was it. Thanks for taking my questions.

Operator: Thank you. Our next question is from William Katz of Citigroup. Your line is open.

<Q – Bill Katz – Citigroup Global Markets Inc. (Broker)>: Okay. Thanks for taking the questions. Bill, a question for you just in terms of your comments in terms of, more difficult to put money to work in the United States, is your comment more transitional, in that it's more of a timing issue or more structural as we think about the ability to hit a 20%, 25% IRR?

<A – Bill Conway – The Carlyle Group>: Well, of course, that's a good question Bill. The answer is – if you like the truth, the answer is I don't know. I hope it's transitional. In the United States, the U.S. buyout team is about 70 people, and the smaller business, the Equity Opportunities Fund is about 20 people or so investing on those funds. We'll say it's 100 investment professionals, and they're really trained to go – turn over every rock and try and find deals.

I do think in an interest rate environment where the risk-free rate is zero, by definition it will push all rates of return towards zero, now they won't get to zero, but they will be – they all come down with the risk-free rate being so low. I do believe that this is a temporary phenomenon, and it will change over time, and of course the Fed has said that they expect it to change.

I'll give you an example of the kind of deal that I really would like to try to do today maybe, and this is today, and I'm talking August of 2013, and could change. These rates of return and risk return curves are moving all the time. A good example would be the deal we did last September or so in Genesee & Wyoming. Genesee & Wyoming, a company by the name of RailAmerica came up for sale. Genesee & Wyoming, the largest short-line railroad operator in the United States was one of the buyers. It was a big deal for them. Instead of us trying to buy RailAmerica, we approached Genesee & Wyoming. And we structured a pretty creative deal in which we invested $350 million in a preferred stock of the 5% preferred of Genesee & Wyoming at a conversion premium of 10% or 15%.

And I think the conversion price worked out to be somewhere about the high 50%s I think. When we did that deal, I actually thought that was going to be a relatively lower return deal. Genesee & Wyoming is a great company, very well managed, making an acquisition in an industry it knew really well. We were getting a security that paid us a dividend that was as soon as it was converted, it was immediately saleable by us. So the transaction was relatively close to liquidity, and we can see kind of a path to the exit, smoother than a lot of times going to these deals and you may think you're going to sell to a strategic or sell to another PE firm or take it public.

But, of course, you don't know. In that situation we had a good idea and a path to liquidity right up front. So there we're willing to do at a lower IRR than typical IRRs. Now the company did great, stock market that really performed well, stocks moved to somewhere between $85 and $90 a share or something like that. So it turned out to be a great deal for our investors. But at the time we did it, it was I thought a lower risk, lower return kind of a transaction. In terms of some of the other deals, at the end of last year, we had a real burst in the United States of deals that we did. I think some people were thinking we overpaid, we didn't think so, we did the Hamilton Sundstrand deal from United Technologies, we bought the auto paint business from DuPont, we bought Landmark, big piece of Getty Images. We were very, very busy in what we did at the end of last year. So it can – sometimes it can come in a burst, in August of 2013 I feel like we're having a tough time even with these big deep teams knowing what they're doing trying to find deals that can do 20% to 25%. But as I said that could change quickly and as I talked – when I talked about emerging markets, I made the point that a little bit of turmoil frankly creates a lot of opportunity.

<Q – Bill Katz – Citigroup Global Markets Inc. (Broker)>: Okay. That's helpful color. And then just maybe one more question. As you think about that dynamic in terms of where the better opportunities are and the sort of relative size of portfolios, against maybe David's comment about I won't rest until everyone around the world has a Carlyle fund, is there any [ph] thoughts of tactically (1:07:30) dial back the sort of new business initiatives to better balance the risk of dry powder deployment versus bringing new dry powder on?

<A – David Rubenstein – The Carlyle Group LP>: Well, obviously we're not willy-nilly just building new businesses for the sake of building them. We obviously think that they will add to the value of the firm. And we have gone about it judiciously and the acquisitions we made just to show you how I think judicious they have been, every single one of them is performing quite well, maybe better than we thought, the three hedge funds we bought AlpInvest, NGP, all those investments have turned out to be very good. So we're not snake bitten by anything we bought, and we do think that we're pretty good at looking at things that are opportunities for us to buy and also some new initiates like the International Energy Fund is off to a strong start and other things we started recently we're quite happy with like our Africa fund.

But, we are – we do recognize that we are in a business to continue to grow and we will probably have other strategic initiatives, but we don't try to do one a month or anything like that, a couple a year perhaps and we have a team of people that work on them, but I wouldn't say, we think that they are obsessing us about having to keep doing more and more new strategic initiatives at the expense of quality or high rate of return. In the end, we always worry about the rate of return on the investments and that's our highest priority, and we aren't going to put anything in the field to go to investors if we don't think we can get a very good rate of return for them and for us because we're also very often very large investors in those funds.

<Q – Bill Katz – Citigroup Global Markets Inc. (Broker)>: Right. And then just one last one. I was sort of intrigued by your commentary about timing of being a public company versus your distribution policy. What is it in terms of the seasoning of being a public company that would change your mind, if you will, in terms of going to more of a quarterly payout versus your peers. Is it just mapping the cash flows a bit better? I'm just trying to better understand the [ph] logic flow (01:09:52)?

<A – Bill Conway – The Carlyle Group>: This is Bill. I actually don't think we're going to change it anytime soon, but time will tell. We've just started it and we at the very front end of this process did a lot of discussions with potential investors, what is it that they wanted. Well they wanted some yield, they wanted to have some certainty on that what yield was. We looked at our forecast and like and said what's kind of amount of dividend that we can realistically pay for the foreseeable future to everybody and that no matter what, and that led us to kind of say, okay, let's do the $0.16 a share dividend each quarter and then at the end of the year, let's true it up to the 75% to 85%.

By the way, that's also why we made the deduction or change in adding back non-cash equity compensation. It wasn't fair to kind of say for the purposes of defining DE that this non-cash item wasn't cash earnings if you will. So, I think it was our attempt to do that. I guess my own view, as I'd like to try it this way for a while before I said that I have better idea on how to do it. If our investors were clamoring for something different, we listen to them, we work for them, but I think for now we've got this method that seems to be kind of the way we do it and not likely to change it.

<Q – Bill Katz – Citigroup Global Markets Inc. (Broker)>: Okay. Thank you for taking my questions.

<A – Bill Conway – The Carlyle Group>: Sure.

Operator: Thank you. Our next question is from Matt Kelly of Morgan Stanley. Your line is open.

<Q – Matt Kelley – Morgan Stanley & Co. LLC>: Morning, I was actually going to ask one of those last questions a little bit in reverse. So, as you guys – you've laid out pretty compelling themes and obviously the fundraising traction you've had has been tremendous. So, I'd just be curious as you've obviously diversified the fundraising, do you think there are certain areas, I would mention, hedge fund of funds, maybe commercial real estate, you have opportunities in that you're not necessarily big in or exist in right now that would actually help you get more separately managed accounts from large institutions in the future?

<A – David Rubenstein – The Carlyle Group LP>: We're not in every area that all of our peers are in, and so we do look from time to time in other areas that we might grow in, but we aren't going to go into areas unless we really have a very good team, we're very comfortable with their quality and the performance we're likely to get, and make sure that we can oversee it appropriately and actually within our fundraising network help them raise money. So, it's not as easy as one might think that just go out and buy a hedge fund of funds and make sure it works.

So, we've looked at many different things, we don't have anything that we're prepared to talk about today, but we do look from time to time at all the things you would expect us to look at. And it takes a while to get some of these things done, but I can't say that if that investors say to us, we're not going to give you money because you don't have this product or that product. Generally investors listen to what you have and they – if they want something else, they will go to someplace else to get it. But generally, our biggest problem with our fundraising team has not been a lack of things to sell to the investors.

<Q – Matt Kelley – Morgan Stanley & Co. LLC>: Okay. And then my follow-up and then this is probably for Adena, but on the Energy Partners III Fund, obviously you're at 7%-plus net IRR. Just can you give us an indication for – my sense is when you hit an 8% net IRR, there is an automatic catch-up in terms of accruals, but is there a discretion on the realizations part and is there any sort of catch-up factored into your guidance on DE there?

<A – Adena Friedman – The Carlyle Group>: Sure. And which fund are you referring to again Matt?

<Q – Matt Kelley – Morgan Stanley & Co. LLC>: CEP III.

<A – David Rubenstein – The Carlyle Group LP>: Europe, that's Europe III.

<A – Adena Friedman – The Carlyle Group>: Europe. Yeah, it's Europe III. So with regard to the way that we do the accounting versus the decisions we're going to make around – like a fund like Europe III, as soon as that fund crosses into a carry position which means that it's exceeded its preferred return hurdle which is 8% for that fund, any sort of appreciation in that fund beyond that will generate an accrued carry position for the firm. And so we will – it will start to generate accrued carry and it will show up in positive – total unrealized performance fees for the firm.

But until we have an exit for which we can actually generate carry, well obviously it don't have any realized carry. And even when if we had an exit in that fund, the first exit or maybe even the first few exits, we will – we may choose not to take carry, so that we can build up a little bit of a reserve so that we can feel very confident that we're never going to put ourselves in a claw back position on that fund having taken carry too early.

So, absolutely we will have to account for it and we will account for it immediately. But in terms of our decision around taking carry just like we've done with Carlyle Partners V, there is decision around that, and it is a management decision to make around at what point are we going to be comfortable taking carry of the exits on that fund and I don't know Bill if...

<A – Bill Conway – The Carlyle Group>: I would just say, I've been doing this a long time. And the one thing investors really hate is a clawback. And you get to the clawback and they wonder, well, how come you have their money and you haven't given it to them and the IRR. What happens on these funds is the IRR, if it's really just close to the hurdle, it can flip back and forth, in and out of carry on a quarterly basis. And so we don't actually want to take the carry until we are pretty certain that we're not going to move into a clawback position. So for today, for example, we have about $2.6 billion of gross carry, and I think the clawback is about $50 million. So, it's really de minimis compared to the magnitude of the carry we could theoretically take at the next exit on all these various funds. But I think we're – in addition to working for our unitholders, we work for our LPs as well, and we're just very sensitive to the clawback position.

<A – Adena Friedman – The Carlyle Group>: And just on catch-up, that does have a catch-up. I'm not sure, whether it's 50-50 or 80-20, I'm not quite sure, or 100-0. But so it could be that once it crosses into carry, there could be kind of an outsized unrealized performance fee generation that comes from that particular fund but as we catch up through that period.

<Q – Matt Kelley – Morgan Stanley & Co. LLC>: Fully understand. And the last follow-up for me is that – and just – it's following up on that topic as I look through your fund tables, you've got, I think, four funds at 7% net IRRs as of – maybe five, but I'm counting four as of this quarter – the second quarter. So given – And I know this is a general statement, but given a decent market move this quarter in some equity markets, do you guys – does that – and the reason I'm asking is that's in your DE kind of guidance is that, if we have a couple of more quarters of strong moves in those funds and you decide to take carry, could that kind of boost your thinking towards the higher end of your distribution rates, towards 85% instead of 75%? Or how do you think about that?

<A – Adena Friedman – The Carlyle Group>: Well.

<A – David Rubenstein – The Carlyle Group LP>: It's a great question, but we're not going to bite on that one.

<A – Adena Friedman – The Carlyle Group>: Yeah. I'm not going to be able to give any sort of financial guidance around that. But you're right that we do have several funds that are kind of right on that cusp and hovering around 7%. And I think that once they cross over, as Bill said, as long as we can start to see them staying in the right side of that calculus and once they start to have exits, then we will start to see it. But I – throughout the rest of 2013, if a fund were to cross over into an 8% return, we're not going to take carry the first exit we have. So in 2013, I think that's a harder thing. For funds that are already accruing carry to the extent they have exits that we're not currently foreseeing, that could be a benefit to what we've told you. But generally, I think that David's comments on the call, both last quarter and this quarter, related to our performance this year, we continue to feel we're giving you the right outlook.

<A – David Rubenstein – The Carlyle Group LP>: Let me just add that, everybody – well, the industry, as you all know, doesn't have a firm policy on – or there's no industry standard or a standard way of doing distributions. In other words, every firm has its own way of doing it, and they are somewhat opaque perhaps. Our standard, as Bill articulated, is to really make sure we're never in a clawback position, to the extent possible. So I think we've distributed, over the years, about $75 billion back to our investors, something like that. Is that right? Roughly [ph] with (01:18:38) that. And we've had a clawback position of probably less than 0.1% of all the money we've ever given back. So it's a very, very small thing. We take a lot of pride in never having to do a clawback. And so we probably will err on being extremely conservative. Of course, everybody says they're conservative, but we are really, really conservative. And so we are not going to probably do anything that's going to put us in a clawback position, with any realistic chance of there being a clawback, I should say. Bill, add to that?

<A – Bill Conway – The Carlyle Group>: No, well, I do think that you're actually looking at the right things. If you look in the earnings release on pages like 23 and 24, you see the biggest funds there. They don't all have exactly the same kind of catch-ups and hurdle rates. But which one to be looking at is funds like CAP II, CAP III, CEP III, [ph] COP I (01:19:25) in the Corporate Private Equity business, and then there are others in the Real Assets business. Those businesses that are either – that have upsized and are close to being at that kind of 8% net internal rate of return, those are the funds that can really make our business hum.

<Q – Matt Kelley – Morgan Stanley & Co. LLC>: Great. Thanks for taking the question.

Operator: Thank you. Our next question is from Brennan Hawken of UBS. Your line is open.

<Q – Brennan Hawken – UBS Securities LLC>: So if you guys view investment opportunities in the U.S. as pretty weak and not necessarily compelling, why not ramp up realizations at this point?

<A – Bill Conway – The Carlyle Group>: Well, first of all, as I said, things change every day. But I also think we have ramped up realizations. If you look at last quarter, for example, we did $1.3 billion of investments and we returned to our investors, $3.9 billion. So we've – I would say we have ramped up the realizations. It's easier to exit now. When I went through what our investment professionals were doing in terms of growing value and exiting, I think they're doing a great job there. And of course, they're looking for all those deals to do. I wouldn't say the investment environment is weak. I would just say it's tough to find deals that are going to meet our standards right now.

<Q – Brennan Hawken – UBS Securities LLC>: Sure. And then sort of following up on that, you had said – I think you referenced that some buyers were getting more aggressive in the U.S. Are you seeing an increase in M&A discussions and chatter here more recently on the back of some of that more aggressive posturing?

<A – Bill Conway – The Carlyle Group>: Yes. I think that there've been a lot of stories about tracking the M&A transactions, and that they're roughly flat between this year and last year. And I would say I accept the data because it's – I'm kind of a data-driven person. But in terms of anecdotal information, what we see, I'd say we are seeing more interest by [ph] Strategix (01:21:11). Frankly, I've been surprised it hasn't been even a lot more than it is. [ph] Strategix (01:21:15) is having a tough time growing their top line. One way to do that is through M&A. If they can finance those acquisitions, really, at an interest cost of almost zero, a lot of them have got cash on their balance sheet, but they're investing at zero, any deal they do, even paying a much higher price than we would pay, is going to be accretive. So, I've been surprised there's not been more strategic activity than there is. Financial sponsors, there have been a few big deals announced just recently. And I think you'll see more of that. So anecdotally, I am seeing more strategic interest. We recently bid on a deal that's kind of in the news, a West Coast health care business, where we are significantly outbid by a public strategic company. And so I think they're playing a force as well.

<Q – Brennan Hawken – UBS Securities LLC>: That's helpful color. Thanks. And then last one on optimism around putting money to work in Europe. Have you seen indications that banks, at this point now, are finally starting to sell assets and maybe you start to clean up balance sheets a little bit and that's helping opportunities? Or is that shoe not yet dropped?

<A – Bill Conway – The Carlyle Group>: Okay, let me answer, first of all, a question you didn't answer – ask, but I admit it that I'm answering a question you didn't ask, and that is the credit availability in Europe for deals we do, do. And I would say that has gotten marginally better in Europe over the last year or so. We – in the United States, if you want to raise $1 billion, there are 5 or 10 different people who will stand up, raise their hand and say, I'll take the whole thing. And they'll underwrite it, even in today's markets, and they will sell it down themselves. They'll bring in some partners. They'll take the lion share of the fees for themselves.

In Europe, still when we do a deal, even if it's several hundred million dollars, we will typically be putting the syndicate together ourselves, and we might have six to eight banks in that syndicate. It's a little tougher to do. It requires more work, but the loans can be arranged. Pricing, sometimes it's lower, sometimes higher than in the United States, it depends. If it's a kind of a real local deal, sometimes you can get a cheaper price. And sometimes if it's not, you're actually paying a little more in Europe. For example, our CLOs in Europe in terms of the costs of some of the AAA facilities can be a little higher in Europe than it is in the United States. Now in terms of the other question you asked. I think that – or I don't know – I would be. Anything you'd say, David, on...

<A – David Rubenstein – The Carlyle Group LP>: I think many people anticipated that the European banks would do what the American banks did, which is to sell off a lot of this debt, just sell it off at discount prices. And a lot of funds were raised to take advantage of that, but it didn't really happen. I call it – have called it Waiting for Godot because it never showed up. What's happened now is the banks are somewhat stronger and the governments now have forced the banks to really put in more equity, and as a result, the banks can now afford to sell some things. Initially, they had something [ph] 100 cents to $1 (01:24:26), they marked at $0.80, it was probably really worth $0.50 if they sold it. They didn't sell it because they would get $0.50 and have to take a big markdown. Now, the thing that was marked down to $0.80 maybe it's really worth $0.75 now, and they can afford to sell it because they have stronger balance sheets. So you will see more debt coming out, but not in the droves that people anticipated a couple of years ago.

<A – Bill Conway – The Carlyle Group>: Yeah, in fact, I think the deals, it's interesting, the – you're waiting to say, I'm going to go to so and so French bank and buy €1 billion worth of loans for [ph] $0.70 (01:25:22) and make a huge profit someday. That is not happening. What is happening is, for example, we bought Trust Company of the West from Société Générale, a big part of it anyway. We bought NGP from Barclays. And so what they're doing is that there's some assets that they have on their balance sheet, businesses or parts of businesses, we've been successful trying to buy those from some of the European banks. But in terms of a real flood of them selling loan portfolios, we haven't seen that, other than, I might say, through the European CLOs. Europe – a year ago, there was no European CLO market. The mathematics didn't work. You couldn't raise the AAA. The spreads were too high. The equity raised was very difficult, and even if you raise that side of the balance sheet, finding the right assets was tough. Today, those European CLOs can be done. And when they're done, they are buying assets from the European banks. They're not – of course, they're not buying troubled assets. They're buying, generally, performing assets from those banks.

<Q – Brennan Hawken – UBS Securities LLC>: Great. Thanks for taking the questions.

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

<Q – Patrick Davitt – Autonomous Research US LP>: Hi. Good morning, guys. We heard a lot of chatter about the alternatives benefiting from this bank restructuring story, both in the U.S. and Europe, and you mentioned middle market lending. How far along are we in that process? Do you think it still has lags in terms of growing those kind of direct lending businesses as banks retreat from higher capital charge businesses?

<A – Bill Conway – The Carlyle Group>: The short answer is yes. I think there's a lot of additional opportunity in that business. The – I'll give you an example – specific example that's a little bit off the point, but it would be our Energy Mezzanine business. Our Energy Mezzanine business invests, say, between $25 million and $100 million or lends between $25 million and $100 million, and there is energy transactions in the United States generally. And I would say that they're able to – we call it Energy Mezzanine, but a lot of the loans down there are senior loans, and they're very attractively priced. Sometimes, they have an equity kick or various things going on. It's a business that used to be dominated by the commercial banks. They're gone now.

I would say, in the BDC business, it's a market really – the giant banks, they want to do – finance a big Carlyle investment buyout. They want to lend $1 billion, they want to be big. They're not really wanting to do $20 million and $25 million pieces. In that business, oftentimes, once again, we'll cobble together a syndicate of other people like ourselves and try to arrange financings for these middle market borrowers. I think it's got a long way to go because I think banks around the world are going to delever and they're going to have to delever more and more.

<Q – Patrick Davitt – Autonomous Research US LP>: Great. Thank you. And could you quickly run through what you're seeing from a macro standpoint kind of in your real-time data in the portfolio globally and how that may be have evolved over the last six months or so?

<A – Bill Conway – The Carlyle Group>: Sure. U.S. still continues to chug along. It's got the headwinds from the fiscal situation, the sequestration and the additional tax rates, but growing 1.5% to 2%. Everybody talks about the jobless rate being they're happy or they're disappointed. If you look at like, a moving average of 3 months, 6 months, 12 months, it's about 180,000 jobs a month, and we expect that trend to continue. Europe, we do think, finally has bottomed. We talked a little bit about the credit situation there, still tough on the jobless. Lot of the deals we do in Europe are frankly global companies. And a lot of time, some people are hung up and say this is U.S. deal, a Europe deal or Asia deal, but it's – a lot of these businesses are global businesses.

China is not as strong as it was. They're going through their transition from investment-driven, export-led economy to a consumer economy, and frankly, that is a very tough transition for them to do. If the consumer is 25% or 35% of the Chinese market and somebody thinks that growth is going to offset the drop or the slowing down in the investment side of the economy, it's about – it's very tough mathematically for the consumer to grow fast enough to fill that hole. So China, we think, is slowing, still the envy of the world with a 7%, call it, rate. Emerging markets, as I mentioned before, I think they'll struggle a little bit as United States begins to taper.

<Q – Patrick Davitt – Autonomous Research US LP>: Great, thank you.

<A – David Rubenstein – The Carlyle Group LP>: Ashley, we're going to have to end the call there.

Operator: Yes sir. I'm not showing any further questions. If you have any further remarks, you can go ahead now.

David M. Rubenstein, Co-Chief Executive Officer & Director

Thank you very much. We look forward to speaking with you again on next quarter's call.

Operator: Ladies and gentlemen, thank you for participating in today's conference. This concludes today's program. You all disconnect. Everyone have a great day.