The Carlyle Group(@Nasdaq 41st UK Investor Conf)

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Corporate Speakers:

- Bob McCooey; Nasdaq; Company Representative
- Curtis Buser; Carlyle Group; Chief Financial Officer

Participants:

- Unidentified Participant; Unknown Company; Analyst
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PRESENTATION

Bob McCooey^ We're so delighted to be able to have the Carlyle Group, presented by CFO Curt Buser for this next session. I'd also like for you to both use the Vivox App for any questions you might have for Curt.

What we're going to do is, Curt's going to do a presentation, then he and I are going to conclude with the fireside chat, and allow for some questions through the app. If you do have a question from the audience, please wait for the microphone to come to you as this session will be webcast. So with that, Curt Buser.

Curtis Buser^ Good morning and thanks Bob. I really appreciate being a part of this conference, and want to thank Nasdaq and Morgan Stanley for having us on, and being here. I want to thank each of you for choosing to attend.

So there's three main topics I'm going to talk about today, first, the great momentum that just in the alternative asset sector. It's really no longer alternative, it's really mainstream. Second, the momentum that Carlyle has, and third, the implications of our announced C corp conversion, which will occur on January 1st of this coming year.

With that, I'm going to start with a little bit of background on the firm, obviously important information. We were formed in 1987 with about 1,700, almost 1,800 employees. We operate around the globe, 33 offices. More than half of our investment professionals are outside of the US. It’s really a hallmark of the firm is our global reach. We're clearly a leader in our sector, in our space; we're well known, and we're growing quickly.

We manage about $222 billion of assets across our four main businesses, I'll touch on each of those in a minute, but the point here is about 98% of that capital is in long-dated structures, not subject to redemptions. We earn 685 million in distributable earnings in the last 12 months, or about $1.80 per common unit after tax.

Just to step back and think about how we actually earn money, we earned what we call fee-related earnings, that's earnings on our management fees after all operating expenses, compensation, et cetera.

We earn money on our funds through carried interest, or a performance fee; so we often refer to that as a net realized performance fee, to which the cash portion of that is retained by the firm.

We earn money on the investments that we make off of our balance sheet, investment income, that portion that's cash is realized investment income, and then there's obviously net interest expense based on the balance sheet. So, when you add all that up, that's distributable earnings on a pre-tax basis, essentially a surrogate work cash earnings.

We announced our intention to be a C Corp on January 1, 2020, and we've done that in a way that we think is unique and different from our peers, but really, we're going to be a regular corporation like most other public companies.

As I said before, we're a leader in private investing, $222 billion of assets under management, about $73 billion of dry powder, or available capital.

We operate through four segments, corporate private equity is our largest business, $84 billion of AUM, that's often what you typically think about when you think about Carlyle, it's the buy-out business. Remember here, while it's set as one business, there's a diversity of funds in each of these segments, so in CPE we operate the US buyout fund, a Europe buyout fund, an Asia buyout fund, a Japan buyout fund, a Fig fund, et cetera, et cetera you get the point.

Real assets, the same kind of structure, that's our real estate business and our energy business, and our infrastructure business. Global credit, a $48 billion business, that's up from about 25 billion just a couple years ago. We've grown revenues in this business to about $320 million on an annualized basis as of September 30, compared to about $240 million just a year ago. So, tremendous growth in this business.

We've always had a very large CLO business, number one, number two player, and in addition to a direct lending distressed credit opportunistic funds, and recently we've added Carlyle Aviation partners, our -- beginning into asset back-lending.

Investment solutions, which is our fund-to-funds business, in addition to our secondaries business, and our co-investment business, and in total, that's really how Carlyle comes to market. Some of the financial metrics to think about when looking at what we do, and really what drives the business, first, obviously raising capital.

We raised $135 billion over the last five years. We've often been talking about our big fundraising campaign, that was $100 billion just from 2016 through 2019, which we've already exceeded.

We realized the proceeds for investors of $132 billion over that time, that's capital return to all of our fund investors, and then we invested $93 billion during that time just in our carry funds, which is corporate private equity real assets, and part of our global credit funds, and then, across the entire platform, across all of the segments and across all the geographies, about an annual 12% appreciation per year.

First major thing, really the growth in this industry has been phenomenal, no longer alternative, it's mainstream. $6 trillion is really what this industry has grown to. It's been a 10% compounded annual growth over the last 10 years. That's really across all asset classes. Why?

It's because of they out performance to which you can get anywhere else. So whether it's in corporate private equity compared to the MYSQ worldwide index, or in real estate, or in private credit, the returns are better than what investors can find otherwise, and so therefore in terms of completing their portfolio, this asset class, be it equity, real estate, credit, or solutions is what's really sought to meet the obligations that they all have.

So, investors, as a result, are saying that they want to either maintain or increase their allocations to this space because of the returns, and they're doing it, you know, if you're pension fund or a sovereign will fund, or an insurance company, you often will have obligations that are growing, so whether it's the teachers or the firemen or the police that are in those pension plans, we work in part to help and to make sure that those pension obligations are met.

This data is Carlyle specific. So really the key to our business is not just being able to invest well, and it's not just financial engineering, but the real key is being able to make the investments we invest in better.

When we think about companies, it's how to make good companies better. It’s about how to add value, which fundamentally means how do you increase sales, and how do you increase earnings?

The chart on the left shows in our corporate private equity business, we've been able to grow sales faster, and we've been able to create incremental margin, which has led to a 720 base points appreciation above what the standard SMP Global market base has yielded. That’s where the returns are. You back test in our performance, 2/3 of the value creation is because we've actually made the companies perform better.

This slide here shows, really, it's US data. Private, equity-backed companies sine 2000 have essentially tripled in number, while public-backed companies in the US have come down by 50%. Public markets are still much larger than private equity, so there's still plenty of room for private equity to run, but the trends are really interesting to see, and you see the power of this sector.

Second major theme that I want to talk about is really the momentum that we have as a firm. First, we've been growing rapidly. Our (fear) in an AUM is now at $159 billion.

(Fear) in an AUM compared to total AUM really reflects what we have invested in the ground at fair value, plus dry powder.

This is the number upon which we actually are able to charge fees, difference really being, simplistically said just the appreciation in the funds is reflected in total AUM with the 222, versus the 159 here.

That number has grown on a core basis, i.e. that stuff which we continue to run and perform in the business has grown at a 10% compounded annual growth rate, and there's an about $7.5 billion which has yet to turn on mostly fees that will turn on as we invest the capital.

Fee related earnings, one of the components of distributable earnings. Fee related earnings is really again that part of the earning stream which comes from management fees. It's easy to project relatively easy. It's a core metric of growth, it's a core driver of valuation. It's now also a core focus for us as a leadership at Carlyle. Back in 2017, on a core basis, $124 million of FRE, about a 10% margin.

Coming into 2019, we said we would generate $400 million of fee related earnings at a 25% margin. We'll do about $450 million this year at a 27%, 28% margin, and we've given guidance that over the next couple of years will grow that to $500 million, and the margin will go up to 30% and plus in the next several years.

We believe we can do that even without another super cycle of fundraising, especially as we continue to grow our global credit business, and as we continue to find efficiencies in the business. Specifically, here are the strategies:

Again, scale in this business matters, raising funds that are big, continuing to scale. This last go round in fund raising, our current generation of funds are 30% to 40% larger than the prior generation. It's obvious in terms of how that helps drive FRE.

Our deployment strategies, often now we're earning the fees as we deploy capital, so you don't always have to have that direct linkage between fundraising and FRE growth. Global credit, that business has been growing fast, as I just said. It's a key element of where we're going.

While we've grown revenues and fear in an AUM significantly in that business, it hasn't dropped yet down to margin, or fee related earnings. Why because we've been investing. Going forward, you're going to see far more of that growth and profitability drop right to the bottom. That’ll be a key driver of our future FRE growth.

We'll also have further growth in our solution business over the next couple of years. That too will help drive FRE in the near term. You probably recently saw the announcement on Fortitude. We in 2018 took a 19.9% stake in Fortitude.

We just made an announcement with -- whereby a Carlyle vehicle, Carlyle fund we contributed our 19.9% to a fund that we have raised. That loan, about 71% T&D, the Japanese insurance company, will own 25%, AIG remains about 3.5% stake, once that yield is closed in the middle of this coming year.

That then essentially allows us to be a manager of potentially greater amounts of assets. We're not looking to be an insurance company; we're looking to manage the assets that they manage. Fortitude currently has about $30 billion to $40 billion of assets, about 10% to 15% of which is appropriate to invest in the types of assets that we manage.

And then, expense management. We continue to be very much focused on efficiencies and driving expense management, and that's obviously a key to driving the earnings. Here, you can kind of see that net realized performance fees are proven at 1.8 billion; you see that in the middle. It's up from where it's historically been at about 1.5 billion.

Our remaining capital in our carry funds is now at $83 billion on the ground, up from an average of about 62 billion. A lot of fresh, new capital is in the ground. In our GAAP accrual basis, you can see the strong performance upon when we expect to realize a significant amount of carry in future years.

However, you'll see in the last 12 months, we've been at a low point in terms of realizing carry. See that increasing in 2020, and further increasing in 2021.

Finally, the C corp conversion. We announced January 1, 2020 we will convert one share one vote. Everyone -- all shareholders will be treated the same. No private units will remain via $1 fixed dividend, which is essentially an amount that we believe we can continue to pay. It's a very stable amount. We’re very focused on not having that decrease. In fact, we anticipate that it will grow over time, as we grow fee related earnings.

Obviously, we've included from an index perspective in a number of industries, this industry has not been included in index, previously. You can see on the right hand side of the chart, that in the current year, huge uptake in volume, and all of the stocks in the industry. K-Car was really a little bit earlier, and so that's why it's not showing the same boost this year.

For us, we'll come in in the indexes here in 2020. We have structured ourself such that we will be eligible for S&P inclusion. Not saying that we'll be included, but right now there is no one from this sector in the S&P 500.

We meet the market cap, a single class of ownership, one share one vote, no longer dual class. So we're uniquely positioned to be eligible to be included. We think all of this combined really sets us up well, and is explained in why you see that shareholder growth.

Again, from a value-creation growth in the platform, we're attractively valued, and the C corp piece adds a clear reason for technical improvement in the stock. No longer a K-1, so people are very much interested in looking at the stock. That's it. Thank you.

QUESTIONS AND ANSWERS

Bob McCooey^ Thanks, Curt. So, let's dig into the last area that you just spoke about, because you have 75 out of 85 in my notes percent increase in your stock this year. Kind of counter intuitive to the fact that you're paying more taxes, you're lowering your after tax income, so why do you think that the market has reacted as well as it has, and how do you really feel -- like, do you feel like you're finally getting fairly valued, or is there a lot more (run to gun)?

Curtis Buser^ I think that the way that the stock has performed is just confirmation of the three themes that I just talked about. So, people recognize the growth in the industry, people see the growth in Carlyle, and people really hated the K-1. It was not -- none of these companies were included indexes, and so as that's been fixed for us and for our peers, that's been fixed.

You see an 80% increase in the value of Carlyle this year, that's roughly similar to what in honesty our peers have also seen, ARON and their stock price as well. We remain valued at a discount to our peers.

We're valued at roughly 12 times A forward in 2020 distributable earnings. Our peers are valued a little bit higher than that, so I think that we're still attractively valued. Actually, we have room to run, to your question, and I think as we continue to be very much focused on growing the business, and that makes it a compelling case as we go forward.

Bob McCooey ^ You and the team have been fairly clear that growing and improving the fee related earnings are a key priority. You certainly went through that in the presentation. Can you just give us a sense of why that's so important, and how you see that growing over the next number of years?

Curtis Buser^ I think fee related earnings in some ways, the easy metric for shareholders to look at, and to see growth. I gave a lot of metrics, AUM, fear in an AUM, invested capital, fundraising, et cetera, but fee related earnings, easy way for people to see growth.

It's not as volatile as part of our other earning streams, and comparable businesses in other sectors right now, a lot of those earning streams are being valued like 20 times. Some of the part multiples are being applied to this sector would also imply very high multiples, and so that's why the clear importance.

We have made it a real driving force in the firm. It was not always viewed as what's key, clearly investment performance is important, but fee related earnings for our public shareholders, and for us, quite frankly, is really important.

Bob McCooey ^ So, the global credit business. You touched on that a couple times during the presentation, and I kind of sensed that that's a business that you're going to focus a lot on. How's it going so far? Is it meeting expectations, and where do you see that fitting into the drivers of earnings and growth, going forward?

Curtis Buser^ We've always had a very successful, large, profitable, structured credit CLO business, but we had not really built out the rest of the global credit platform. Quite frankly a lot of our large public peers were earlier to the game in that sector than we were.

The good news, it's a huge space, and a huge opportunity, and we have a lot of white space to grow in, and we've demonstrated that growth essentially doubling the AUM of that business, and also increasing revenues 25%, 30% over the last year. So, with that, what I'm not happy about is my margins in that business are still low, mid-teens.

That business should be a 30% FRE margin business. I believe we can get there as we continue to grow that business. We won't need to continue to invest in the platform as we've invested in the platform, so that future growth will drop to the bottom. It'll be a key element of future growth in FRE. So, I'm very bullish and very excited on this business.

Bob McCooey ^ I can tell. Yes, totally. Your face was lighting up as you talked about that business during the presentation. You've talked about your focus on FRE, and then more recently, obviously, the conversion to C corp.

Both of these have happened post the founders turning over the reins to the new co-CEOs, Glenn Youngkin and Kewsong Lee, who took over about two years ago. Can you share with us other priorities that they might have, or focuses they might have, so we can understand where they're looking -- what they're looking at?

Curtis Buser^ We're an investment manager at heart, so investment performance is key. Don't ever think that investment performance is not the key initiative in the firm. It will always be. However, there's lots of other things that matter. FRE was an area that we had not focused on in the same way, Glenn and Kewy made that a priority.

Growing global credit, key strategy increasing fee related earning from our solutions business, key strategy, looking for other areas for growth, really, growing the business is a key importance for what we're all focused on, but doing it with scale. So, making sure that what we launch and what we do has the ability to really be big, as opposed to just trying something and not necessarily making money at it.

Bob McCooey ^ So we do have some questions from the audience. First one is, is there any risk that the tax treatment of debt may change as some might argue that it would encourage excessive leverage?

Curtis Buser^ Taxation on interest deductibility, those rules have changed, in particular in the US. We don't believe that it really adversely affects us from a firm perspective. We factored that all into our modeling and how we think about our effective tax rates going forward as a C corp.

From an investing perspective, again, changes in taxation and regulation can occur, but actually driving this through will always be difficult as our teams are always focused on potential changes.

We've made money in all different types of environments. The issue is always kind of knowing how things change, and being able to position your portfolio to be able to take advantage of changes.

Bob McCooey ^ There's a couple more questions here, but are there any question in the audience? Gentleman there.

Unidentified Participant^ Short question, in terms of M&A, what is the key KPI, what drives the evaluation of a company?

Curtis Buser^ Obviously, our core business is acquisitions at the fund, but I think your question is really about us at the firm level. And as we look at potential acquisitions, it's really can we grow faster, more effectively, and in an appropriately risk perspective by doing the specific tuck in acquisitions.

Carlyle aviation is a good way to get into asset-backed lending, through an aviation business. The metrics very much tied to fee-related earnings, and fee-related earnings growth, so I like that deal, still early stages. It's really done well, it's integrated well. And the Fortitude transaction again another way for us to kind of grow the platform, and we'll look for similar kinds of things, but it won't be the exclusive way in which we grow.

Bob McCooey ^ Was there another question here? There you go. Microphone.

Unidentified Participant^ Thank you. Some public companies now are saying that they've been competed out of deals by basically private-backed companies paying too much, and also that the debt to EBITDA levels are rising inexorably among private use. Could you maybe comment on what's happening in your business in both these respect?

Curtis Buser^ Valuations are high, and we're also in a global world where growth rates are lower, or flat. So, it makes investing challenging. And over-leveraging a company in any cycle, bad move, and – but valuations have been high for a long time.

As long as interest rates remain low, my guess is valuations will remain high. And so, the issue really gets down to as one is investing is how do you bring a value strategy to grow revenues and grow earnings of the asset that you’re buying, because you need to be -- as part of the underwriting case, at least at our firm, is making that case very clear, because you cannot depend upon GDP growth, and you cannot depend upon financial engineering, or buying low and selling high, to make the deal work. You need to really be able to model it and underwrite it based on your ability to deliver a plan that will really drive value creation.

Unidentified Speaker^ So, we'll finish with this question, which I'll help you answer, but the question is, are the question marks over the IPO market likely to make exit strategies more problematic in the future, which I think continues on with what you were just talking about, right?

Curtis Buser^ Yes, it – look, I mean, the IPO market comes and goes at times. Right now, I would say it's looking fairly promising.

Bob McCooey ^ We think that too.

Curtis Buser^ I bet you do. From our perspective, we will always choose to exit through a private transaction. I like cash, as opposed to another security that we then have to exit at another point and time, but it's always an avenue for some of our companies, roughly about 10% of our portfolio and our carry funds is publicly listed companies.

Bob McCooey ^ And with that, with 22 seconds left, I think we're going to close out this session, and thank Curt Buser CFO of Carlyle for being with us here at the London Conference. Thanks Curt.

Curtis Buser^ Thank you, Bob, really appreciate it. Thanks for having me.