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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to Carlyle Group Third Quarter 2020 Earnings Call.

(Operator Instructions) As a reminder, this call is being recorded.

I would now like to turn the call over to your host today, Mr. Daniel Harris. Sir, please go ahead.

Daniel F. Harris - *The Carlyle Group Inc. - MD & Head of Public IR*

Thank you, Ludy. Good morning, and welcome to Carlyle's Third Quarter 2020 Earnings Call.

With me on the call today is our Chief Executive Officer, Kewsong Lee; and our Chief Financial Officer, Curt Buser.

This call is being webcast, and a replay will be available on our website.

We will refer to certain non-GAAP financial measures during today's call. These measures should not be considered in isolation from as -- or as a substitute for measures prepared in accordance with generally accepted accounting principles. We have provided reconciliations of these measures to GAAP in our earnings release.

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

Earlier this morning, we issued a press release and detailed earnings presentation, which is also available on our investor relations website. For the third quarter, we generated $119 million in fee-related earnings and $152 million in distributable earnings, with DE per common share of $0.40. We have declared a quarterly dividend of $0.25 per common share.

(Operator Instructions)

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

Kewsong Lee - *The Carlyle Group Inc. - CEO & Director*

Good morning, everyone, and thank you for joining our call today. We hope you and your families are safe, healthy and doing well.

Carlyle's third quarter results underscore our position of strength as we adapt and perform in the current environment. The hard work and dedication of our people and the resilience of our global platform puts us on track to deliver attractive financial performance this year. Our portfolio continues to create value on behalf of our fund investors, which we believe sets the stage for higher distributable earnings for our shareholders over the next several years. All of this momentum, combined with our senior team's focus on the long-term strategic direction of the firm, positions Carlyle for accelerating growth.

I'd like to touch on 4 important points underpinning our momentum. First, we are focused on growing FRE. We've done this by scaling our largest fund platforms while carefully managing expenses. This has helped drive our FRE margins up more than 300 basis points this year, and margins have increased more than 1,000 basis points over the past 3 years. We intend to continue our focus on FRE and capture the benefits of operating leverage as we scale and drive growth in the years to come. Second, our fundraising continues to be successful despite challenging conditions. Our limited partners continue to entrust us with more capital, and we raised $5.5 billion of new capital in the third quarter. Year-to-date, we have raised $18 billion versus $16 billion for the same period last year despite not having any of our flagship private equity carry funds in the market. Most of our new capital comes from global credit and investment solutions, which are businesses we've been building over the past several years. And it's worth noting that Fortitude, the centerpiece of our insurance strategy, continues to positively impact fundraising. By the end of this year, Fortitude will have rotated or committed to invest approximately $4 billion of capital into Carlyle funds, with more expected in 2021. The funds raised from Fortitude are attractive because of the recurring, permanent-like nature of this capital.

The third point is our investment portfolio is performing well. Our overall carry fund platform appreciated 5% in the third quarter, with our global private equity business leading the way and up 5% as well, with particular strength in our Asia portfolios. Our U.S. Real Estate funds continue to perform extremely well, up 3% in the quarter, due to disciplined portfolio construction, resulting in virtually no direct exposure to the hard-hit office, retail and hotel sectors. And our global credit teams are executing at a very high level, with our CLOs now substantially recovered and collecting all fees as a result of active, thoughtful repositioning and trading within these portfolios. Let me quickly also highlight our exposure to the energy sector, which is facing cyclical pressure as well as secular issues. Our investment exposure to this sector has been purposely structured to be ring-fenced in a few industry sector-focused funds, and as a result, much of our private equity and private credit portfolios have very limited exposure to energy-specific investments. As a result of the strong value creation by our funds this quarter, our net accrued carry balance grew to $2 billion, increasing our confidence for significant earnings growth as realizations increase and performance revenues accelerate. It's worth noting that we turned on carry for our largest fund, Carlyle Partners VI. And while we remain in the early stages of monetizing some of the public and private holdings across all of our maturing funds, we have line of sight to accelerating realization activity over the next several years, environmental conditions permitting.

The fourth and last point I'd like to make is that our activity is picking up as we use our platform to originate new investments. We invested $3.7 billion of new capital in the quarter, and our pipelines are filling up as activity builds throughout our businesses. Our private equity business continues to show resilience. It remains our largest and strongest platform. Growth investments are a key pillar; and we're very pleased with the activity in this area, especially in our strong industry sectors like technology, health care, consumer and financial services. Our global reach also continues to be a competitive differentiator. We have been quite busy in Asia, notably China, India and Korea. And we have closed or announced more than $1.5 billion of new investments in 2020. And while the industry's large, complex buyout volume has been muted, our teams are more active assessing traditionally larger opportunities like take-privates and carve-outs. And this is demonstrated through the announcement this morning that we have agreed to acquire Flender, a global leader in mechanical and electrical drive technology, in a carve-out from Siemens for EUR 2 billion. Lastly, in Global Credit, we're seeing good deal flow in our opportunistic credit funds, as mid-cap private companies have a growing need for transitional capital.

Before handing it over to Curt, a few comments on the environment. The economic recovery continues to be uneven based on region, asset class and industry sector. As the recovery progresses in different ways, dispersion of outcomes is becoming apparent. Some sectors have seen acceleration of growth, while other sectors like energy, retail, travel and leisure continued to struggle. Capital market conditions have been robust and accommodative to new debt and equity issuance, but we expect volatility to persist given the fits-and-starts nature of the recovery. Disruptions from the impact of COVID are changing the way we live and work, accelerating trends and modifying behavior. While no doubt uncertainty exists from the geopolitical policy, health care and regulatory issues of the day, our global platform and deep industry and sector expertise is what sets us apart and will help us navigate through this environment.

We are very well positioned to be selectively aggressive and appropriately circumspect as we manage our existing portfolio; and seek attractive new opportunities across regions, asset classes, investment strategies and industry sectors.

Let me stop and hand the call over to our Chief Financial Officer, Curt Buser, and then I'll come back and offer some final thoughts.

Curtis L. Buser - *The Carlyle Group Inc. - CFO*

Thanks, Kew. And good morning, everyone.

I will begin with a few observations on our expected growth in distributable earnings based on our strong fund performance. Then I will wrap up with a review of our current results.

As Kew mentioned, our fund performance continued to build on the strong momentum from last quarter, with third quarter carry fund appreciation of 5% in Corporate Private Equity, 2% in Real Assets and 4% in Global Credit. Investment Solutions appreciation was 8%, with the standard 1-quarter reporting lag in many of its funds. This strong performance is most visible in the growth of our net accrued performance revenue, which as Kew indicated reached nearly $2 billion at the end of the third quarter, up 14% on a year-to-date basis. The increase this quarter was largely driven by strength in our sixth U.S. buyout fund, which appreciated 4% in the quarter and 28% year-to-date; as well as our fourth Asia buyout fund, which appreciated 17% in the quarter and is also up 28% year-to-date. Both of these funds are fully invested and in a strong accrued carry position. We expect these funds, together with several others, including our U.S. Real Estate funds, will be strong drivers of continued growth in net performance revenues.

With regard to realization of performance revenues, we continue to be confident in a significant ramp over the next few years. In the third quarter, we saw an important step in that direction, with both Carlyle Partners VI and our Ireland fund realizing carry for the first time. We are typically cautious when we first take cash carry as we look to minimize the risk of any future clawback. We look at whether a fund is fully invested, the valuation and time buffer between the fund's fair value and its preferred return hurdle and how much capital has been returned to our limited partners. Our first carry realizations in a fund are also typically at less than our contractual 20% share, which we recapture with higher carry rates on later exits. Once we turn on carry in a fund, we expect that fund to continue to realize carry on future exits, absent some unforeseen turn of events. The decision to initiate realized carry on these 2 funds demonstrates our confidence in their performance and maturity. And they are just 2 of several funds with meaningful accrued performance revenue which could begin to monetize in the near future.

Now let me walk you through our third quarter 2020 and year-to-date financial results and touch on some key business drivers as we look forward.

Fee-related earnings were $119 million, with a 30% margin, for the third quarter of 2020, up from $109 million and a 27% margin in the third quarter of 2019. On a year-to-date basis, fee-related earnings of $375 million and a 32% margin remain ahead of the $345 million in FRE achieved in the prior year-to-date period, though the current year result includes the positive impact of the $30 million of cost recoveries in the first quarter of this year.

I have previously commented on the growth in revenues in our Global Credit business together with our continued investment in that business. It's now appropriate to call out that this effort has culminated in nearly doubling FRE in Global Credit on a year-to-date basis to $65 million, as compared to $34 million a year ago, with FRE margins increasing to 25% from 14% over that same time period. The same story is true in Investment Solutions, where it has also doubled its year-to-date FRE to $34 million from $17 million a year ago, with a similar improvement in its margin. These businesses have each benefited from strong fundraising in the current year, and we intend to continue to build on this success.

Fee revenues for the third quarter were $394 million, roughly in line with the third quarter of last year. Current quarter revenue includes the full recovery of the $8 million of previously deferred CLO subordinated fees, as the repositioning and improvement in the underlying portfolios has supported a much faster-than-expected recovery. To be clear: All subordinated fees in our CLO portfolio are now fully recovered; and we expect to collect all base and subordinated fees going forward, absent a material change lower in credit markets.

We continue to carefully manage our overall compensation structure, which will help us drive higher FRE and margin across the cycle. Cash compensation was $205 million for the third quarter; and $619 million year-to-date, approximately 3% higher than the year-to-date pace in 2019. Equity-based compensation was $87 million year-to-date and is running 25% below the prior year level.

G&A expense was $62 million in the third quarter and continues to track materially lower compared to the $81 million in G&A expense a year ago. Travel and conference expenditures remained low relative to prior periods, and we expect these costs to remain depressed for the next several quarters. Some of these costs will return as activity levels increase post pandemic, but we believe many will prove to be permanent savings as we capitalize on learnings from this current environment.

Looking forward, we expect full year 2020 fee-related earnings to be at or slightly above the high end of our prior guidance range of $475 million for 2020, though I will reiterate that this result includes the aforementioned expense recoveries in the first quarter. We are currently in the process of evaluating our 2021 outlook for FRE, and consistent with past practice, we will share that with you next year.

Net realized performance revenues remained modest in the third quarter at $40 million, bringing us to $159 million year-to-date and approaching the $164 million we generated for all of last year, but as I've said, we are confident in a strong rebound in performance revenue realizations beginning next year and then further increasing in subsequent years. Distributable earnings were $152 million for the third quarter and $525 million year-to-date compared to $475 million in the prior year-to-date period. DE per share was $0.40 for the quarter and $1.41 year-to-date. And we declare our quarterly dividend of $0.25 per share.

In sum, we are pleased with the durability and sustainability of our fee earnings, and we are increasingly optimistic about the opportunity for growing distributable earnings over the coming years.

With that, let me turn it back over to Kew for some final thoughts.

Kewsong Lee - *The Carlyle Group Inc. - CEO & Director*

Thanks, Curt.

The third quarter demonstrates that Carlyle is delivering attractive results. We are focused on adapting and are evolving the way we operate our business to accelerate our growth in what will undoubtedly be a very different environment in the years to come. I'm very proud of our people around the world and want to thank all of them for their dedication, hard work and commitment to all of our stakeholders. Our leadership team is excited about the strategic direction of the firm, and we look forward to discussing this more broadly with all of you in 2021.

With that, we are now ready to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Glenn Schorr from Evercore.

Glenn Paul Schorr - *Evercore ISI Institutional Equities, Research Division - Senior MD & Senior Research Analyst*

So I mean you had some good growth on the fundraising side between sectors versus -- and credit. I'm curious with the biggest buyouts, I think, in the range of 47%, 26% and 25% committed. Can we just talk about if anything has changed on your outlook for the next -- the timing of the next round of fundraising for that big super cycle?

Curtis L. Buser - *The Carlyle Group Inc. - CFO*

Glenn, it's Curt. Thanks for the question. Look, you appropriately pointed out that actually momentum seems to be going really well. We're excited about our pipelines and really the deals that we think that can get done. And with that, I will say that things are coming forward a tad but still too early to tell. We're going to give you our full multiyear kind of analysis, especially around 2021, at the beginning of next year, but let me just tell you now that you're right that some of the big funds are well positioned, but here in the short term we're going to continue to have a variety of products in the market, most importantly investment solutions and global credit. And then we'll see also a few other of our growth funds coming to market as we speak. So we're in good shape at this point, and more to comment as we kick off at the beginning of next year.

Operator

Our next question comes from the line of Ken Worthington from JPMorgan.

Kenneth Brooks Worthington - *JPMorgan Chase & Co, Research Division - MD*

There would seem to be the potential for a higher U.S. corporate tax rate and the potential for a much higher dividend and capital gains tax rate for the wealthy. Does the potential for the higher corporate tax rate play into the way you think about making and harvesting corporate investments here in the U.S.? And would a much higher dividend and capital tax rate for the wealthy influence the way you think about capital allocation between dividends, buybacks and investments back into the business?

Kewsong Lee - *The Carlyle Group Inc. - CEO & Director*

Ken, it's Kew. Look, appreciate all the interests in this topic, but really it's just too early to comment. And it's not worth speculating given the limited details that we do know, but suffice it to say there's a lot of work going on. We're scenario planning, thinking through all the implications, but here is the bottom line. Look, we're long-term investors. We've been around for a long time, working successfully through all types of environments, markets, administration and -- changes and changes in tax policy. I'm confident that the firm will be prepared regardless of whatever the outcomes are.

Now there are maybe 2 other points I'd make, one a little bit broader and the other maybe a little bit more granular. First, the history and track record of our asset class suggests alternative assets generate relative outperformance for LPs regardless of tax environment. So this is important to keep in mind because, at the end of the day, the alpha and relative performance we're generating ought to continue to provide tailwinds and demand for what we do regardless of any potential changes in tax policy. Second and finally, please remember, when we converted to a C corp, the path Carlyle chose was to become a true C corporation, as opposed to an up-C or a hybrid C corporation. As a reminder: Our structure is really very simple. It's one class of shares, one share, one vote. This means that whatever changes the current taxes, the simplicity of our C corp structure makes it much easier to understand and manage through future tax changes. It also means real alignment, as we don't have private shareholders or public shareholder distinctions. All of us are shareholders owning the same shares just like you.

Curtis L. Buser - *The Carlyle Group Inc. - CFO*

Ken, it's Curt. Let me just add onto that one quick comment, Ken, on your dividend question. We implemented a fixed annual dividend of $1.00, $0.25 a quarter; do not see any of the tax proposals as changing that fixed dividend. We're confident with that. The real question is, when do we increase our dividend? And that will come as we continue to grow.

Operator

Our next question comes from the line of Mike Carrier of Bank of America.

Dean M Stephan - *BofA Merrill Lynch, Research Division - Analyst*

This is Dean Stephan on for Mike Carrier. It looks like some investment solution funds moved into accrued carry in 3Q, where Carlyle has a higher performance revenue stake, so wondering if you can update us on the potential financial impact of these funds, Carlyle's performance stake in these funds versus prior funds and maybe how we should think about the potential timing of performance fee generation moving forward.

Curtis L. Buser - *The Carlyle Group Inc. - CFO*

Great observation. Look, I'm really proud of our Investment Solutions team and how they've been performing. The funds were up 8% here in the current quarter, and you're right. Accrued carry came back up. Now that's across the whole portfolio and so there's a blend. So there are some that [we know of] pieces that we're -- our acquisition, in terms of what we're entitled to as small, 10% to 15%; and then at the much higher end at a 40% piece of all of that on a net basis. There's about $100 million net accrued carry. That's going to come over time. These are European-style waterfalls, but what I'm really excited about with Investment Solutions is the FRE ramp. It's doubled versus last year, and their continued strong fundraising is going to enable us to continue to see the ramp in FRE. This is a good FRE business for us, plus it's also just performing really well. So thanks for your question.

Operator

Our next question comes from the line of Gerry O'Hara from Jefferies.

Gerald Edward O'Hara - *Jefferies LLC, Research Division - Equity Analyst*

Great. And perhaps just actually picking up a little bit on that FRE ramp, especially as it relates to Global Credit and Investment Solutions. Appreciate the pickup, I guess, year-to-date and year-over-year, but can you perhaps help us frame where that FRE margin could continue to go, especially within those 2 businesses, if they still are kind of relatively early innings with that growth trajectory?

Curtis L. Buser - *The Carlyle Group Inc. - CFO*

Gerry, thanks. Look, you're right. I mean they've -- I'm really pleased with the progress we've made. We've gone from, call it, mid-teens, so -- mid-20s. We need to continue to grow that, and our credit business should be much greater. So watch for that to continue to grow over the next several years. That's going to be a really good growth driver for FRE and will improve our overall margins. Investment Solutions, same thing. As it kind of continues to perform as to its AUM base and as we've also been adding other products within that sector, I see that also being a bigger driver of FRE. And [there will be] improvement in margin. Credit will have a much better upward trajectory, as you can see from -- just from industry analyses. Investment Solutions will be a good driver of total FRE, as opposed to, say, margin per se.

Operator

And our next question comes from the line of Craig Siegenthaler from Credit Suisse.

Craig William Siegenthaler - *Crédit Suisse AG, Research Division - MD*

So I have another FRE question. And if I can sneak in a 2-parter, I'd really appreciate it, but first one, just given the improving macro backdrop, are we out of the woods with CLO sub fee deferrals? And number two is G&A is down roughly 30% during the first 9 months of 2020. Where could G&A head into '21 and '22 as both T&E normalizes and also there could be some future investments?

Curtis L. Buser - *The Carlyle Group Inc. - CFO*

Great. Thanks. Look, the CLOs, if you think about it broadly, what's really happened here is we've got a big team. They've worked really hard and they've been successful and really taking advantage of it. What we've also seen is rating agency downgrades have really slowed down. We've seen a pickup from new CLO formation. We've issued new CLOs. And then really the question that you're really asking that I think about is really how is the real economy going to perform next year. And if the M&A market comes back and accelerates, our CLO business will do really well. If we see some sort of big downturn in the real economy, which then also comes through into the credit markets, obviously that will be a challenge, but right now our CLOs have done really well and really repositioned. We recaptured all of those subordinated fees, so I'm feeling pretty good about where we are, as I said in my opening remarks.

On your second question, on G&A, you're right. We've had a real benefit in G&A expenses this year. Now some of that in the first quarter is the recovery of the litigation costs, so that portion, you've got to take out of the analysis, but even absent that, it's a very good kind of improvement. And obviously travel, conference costs are down, but also other things and professional fees, litigation costs, et cetera are also down. There's a number of things that we think that we can permanently benefit. We are changing the way we live and work, to quote Kew, and I think a lot of that could be permanent savings. So you're going to see some of this recovery, but I think a lot of it can also be permanent. The exact amounts, we'll tell you in time, but we're working through that and think that we can save a good part of this and really manage our expense lines very well going forward.

Operator

And our next question comes from the line of Michael Cyprys from Morgan Stanley.

Michael J. Cyprys - *Morgan Stanley, Research Division - Executive Director and Senior Research Analyst*

I'd just be curious to hear your latest updated outlook on investment returns on both existing investments you have in the ground today that may see some longer hold periods and then also on the new investments that you're putting to work here. What sort of returns are you underwriting to across your different strategies? And how is that attribution of the return profile maybe evolving a bit in terms of the key drivers of that in terms of leverage and so forth versus operational improvements, versus what you've done in the past?

Kewsong Lee - *The Carlyle Group Inc. - CEO & Director*

Mike, thanks for that question. I mean, look, this is a challenging investment environment, right? You have low yields, a lot of competition. And in the midst of all this, we have dislocation and disruption, as certain industries and certain regions are doing really well and others are, quite frankly, being left behind given the dispersion that we're seeing as it relates to what's happening because of COVID. Having said that, we do see prices still are very high for very-high-growth businesses but with low interest rates and low discount rates. And if these growth rates can truly materialize into real businesses that are built, you can see why those types of prices are justified, but we're also seeing good activity starting to build in what I would say more traditional sectors, industrial sectors, et cetera, like the deal that we announced this morning, which are a little bit more -- have a little bit more of a value aspect to it. But having said that, the main driver of returns moving forward: We're not underwriting to multiple expansion. We're not underwriting to more benefit for financial leverage given that quantum is pretty high right now and cost of capital is pretty low.

So the real driver of an alpha in our asset class is going to be driven by making these businesses better, by improving them, like growing the top line, improving margins, increasing capital efficiency. And this is what our platform is perfectly positioned to help our management partners execute against and do. That's what we're all about. That's why we partner with our teams over the long term. So when you start with this global platform, great industry expertise; and then you add on top of that all of our corporate resources from our capital market expertise to our procurement experts, our digital experts, human capital experts, all helping our teams and our management teams, our portfolio companies grow, you can see why we feel pretty good about our positioning and continue to drive performance. So yes, it's hard. It's competitive, but Mike, it's always been competitive in our industry, so it's all about driving and creating fundamental value with a long-term perspective, working in partnership with our management teams to do the old-fashioned work of growing and making these businesses better.

Curtis L. Buser - *The Carlyle Group Inc. - CFO*

And let me just add onto that, Mike, because you asked also about our current -- our portfolio. So just to remind everybody, Corporate Private Equity, our big business, 5% appreciation this quarter, that's after 13% appreciation in Q2. And that results in an 11% appreciation over the last 12 months. So that business is doing very well from a performance perspective.

Michael J. Cyprys - *Morgan Stanley, Research Division - Executive Director and Senior Research Analyst*

Great. I don't know if you had any specifics in terms of targeted returns, though, that you're willing to share.

Kewsong Lee - *The Carlyle Group Inc. - CEO & Director*

The target returns depends on the thesis and the underlying nature of the deal and the risks, right? The more growth-y and the more risk there is in the business plan and in the deal, the higher rates of return we're going to be underwriting to. Those that are very, very cash flow generative with recurring like fee streams, clearly we're able to push ourselves and stretch a bit more on price. In terms of what we're shooting for, we're still shooting for our funds to generate 2x return on total capital in -- on a MOIC basis in our major private equity funds. And our IRRs are still in the high teens that we underwrite to on average. Now it's really all about portfolio construction. And what you really want to do is assemble a portfolio with a wide variety not only of industry sectors but a wide variety of different theses, different types of return and risk profiles. And when you assemble all that, what you're shooting for is a portfolio that is consistently generating on a gross basis the high-teens type of returns in the private equity business. That's what we're still -- we're striving for that, and we think we're well on our way to continue to accomplish that given what we're seeing today.

Operator

Our next question comes from the line of Adam Beatty from UBS.

Adam Quincy Beatty - *UBS Investment Bank, Research Division - Equity Research Analyst of Financials for Brokers and Asset Managers*

Kind of along the lines of portfolio construction, I just wanted to ask about the credit business given the good flows and the upward trend there. How is the book positioned right now just given some of the uncertainties? You mentioned some of the bifurcation and pandemic impact. Rating actions have probably been muted, so far, but could tick up in future. So just wanted to get your thoughts on the outlook there and maybe the interaction with the insurance channel.

Kewsong Lee - *The Carlyle Group Inc. - CEO & Director*

Great, Adam. I mean it's hard to comment monolithically on "credit" because we have a platform that has a wide range -- a wide array of strategies. I can tell you in our CLO business, given we're one of the leaders in the industry, we have full sector coverage across all industries. And that team is generating -- has generated historically great returns with "lower than industry average" default and loss experience. And so we're very confident that they always are thinking about constructing portfolios carefully. Look, our Direct Lending business, there is a lot of opportunity right now as the private markets continue to grow with respect to being able to provide direct loans, especially, in our view, in the small- to mid-cap segment of the market.

The -- let me jump to the distressed side. I'd say, the distressed side, we are not seeing as many actionable opportunities as we like in light of the fact that liquidity and what the Fed has done has made our jobs harder, as liquidity has and the bridge available has extended the runways for many companies, but having said that, the pipelines of opportunities that we're interested in continue to build. And we're monitoring it day to day. And our suspicion is going to be that there will be more activity on the distressed side of the equation sometime next year. Infrastructure credit, which is a business we've recently launched, is seeing a tremendous amount of opportunity in light of some of the issues in that sector, but also our limited partners are looking for really interesting risk-adjusted yields right now. And that's one area that affords very interesting returns in what is a volatile environment. And let me land on finally credit opportunities, which is really benefiting from volatility and the need of mid-cap companies seeking transitional capital. And the volatility that we're seeing and some of the uncertainty actually is helping that team as more and more companies come to them looking for interesting ways to secure transitional private credit during a time when they're trying to sort through what's happening in the real economy. So broadly speaking, it's really hard to comment generically on credit, but if you break down our different strategies -- I think I've just given you a bit of a snapshot and color on what we're seeing.

Adam Quincy Beatty - *UBS Investment Bank, Research Division - Equity Research Analyst of Financials for Brokers and Asset Managers*

That's very interesting -- sorry. Go ahead.

Curtis L. Buser - *The Carlyle Group Inc. - CFO*

If you were to aggregate it, Adam -- but if you do kind of take this all together, there's really strong momentum in the credit space. If you look at the numbers, AUM $53 billion. That's up 14% year-over-year, and it's more than 40% over the last 2 years. Fee-earning AUM in this business is $42 billion. That's up 12% year-over-year and, similarly, up 40% in the last 2 years. I've already told you about the doubling of FRE. So all of what Kew just said is being recognized in both fundraisings and in the way our AUM is growing.

Operator

Our next question comes from the line of Alex Blostein from Goldman Sachs.

Daniel Jacoby - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

This is Daniel Jacoby filling in for Alex. Just on the $475 million or better of 2020 FRE guidance, if I'm doing my math here correctly, it looks like the implication is you're guiding to something like $100 million or better in the fourth quarter and which obviously I kind of see -- I see that there's some room for upside, but it looks like there is also some room for that to kind of come down versus where we've been in the prior 2 quarters closer to about $120 million a quarter. So can you just help us bridge from kind of the -- where were you kind of running at, at about $120 million per quarter to kind of the range of outcomes that you're projecting for the fourth quarter?

Curtis L. Buser - *The Carlyle Group Inc. - CFO*

Dan, great observation. Let me give you some clarity. Just as you noticed, $375 million year-to-date, that includes the $30 million in the first quarter. The -- and we just did $119 million of fee-related earnings here in Q3. That does include the $8 million of the CLO recapture. So that puts us at $110 million. $110 million and $375 million is going to put you above the $475 million, which is what I was pointing out. So thanks for highlighting that. And if you -- the real question, though, I think that you have is really what's that core run rate. And I will tell you that right now -- and we're expecting to grow this, but right now we're in that $110 million to $120 million range. And so when you back out the $8 million, that puts you back down to the $110 million kind of level, but we have a lot of product coming online. Japan buyout, a $2.5 billion fund, for example, activates its fees here in the fourth quarter on October 1. And so that, coupled together with a lot of the growth in credit and in Investment Solutions and other things that we have kind of in plan, we're going to see top line growth. And that will really contribute to the FRE as well. So hopefully, that gives you some color.

Daniel Jacoby - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

Got it. Yes, that makes sense.

Operator

Next question comes from the line of Robert Lee from KBW.

Robert Andrew Lee - *Keefe, Bruyette, & Woods, Inc., Research Division - MD & Analyst*

Great. I'm just curious if maybe you can update us a little bit, just trying to get a sense of Fortitude Re. Like it's maybe how it's contributing. It's -- I know it's early days, but kind of update us on where that stands, its contributions right now and how we can maybe think about that flowing through in the coming -- next year or so.

Kewsong Lee - *The Carlyle Group Inc. - CEO & Director*

Sure, Robert. It's Kew. Look, we're pleased with our progress with Fortitude. It's now fully carved out of AIG. It's completely standalone and fully operational. It's got a great management team. And Fortitude is an organization and, if you include dedicated employees over at service companies, close to 900 employees, so it's a real platform that's up and running. It's very differentiated from other approaches in our industry. It's got a diversified global book of business in both P&C and life. And in terms of its source growth, it's reinsuring or acquiring legacy liabilities, as you know, as opposed to trying to originate organic growth in a single product like annuities. And the reason I point out those 2 things with respect to differentiation, the diversified book is important because it provides more capital efficiency. And it's recognized as such versus that of a monoline insurer. And then obviously we like our B2B approach, where we are looking to acquire legacy liabilities, as opposed to trying to originate and dealing with the end consumer in terms of originating new policies.

The way Fortitude is contributing to Carlyle really is in 3 ways, and it's been great thus far. First, our balance sheet investment is growing quite nicely. Fortitude is generating right now close to mid-teens types of return on equity, and so we're quite pleased with how our balance sheet investment has gone. Second, as I mentioned in my commentary, we've already rotated over $4 billion of capital, which is pretty sticky in nature, right? So that $4 billion has come over into a wide smattering of Carlyle funds, everything from private equity, real assets and our credit products; and we do expect more to come. And obviously, those funds generate fees for us as well as carry over time. And then finally, to the extent we raise more capital for Fortitude, we have been able to do this by creating vehicles for our limited partners. And as we raise that money, we do earn fee-related revenue from those assets that we are managing. So there are 3 ways that Carlyle benefits from Fortitude. Looking forward, we are quite excited about this platform growing via acquisition. The space is large, trillions and billions of dollars of legacy liabilities that we think are available. And as Fortitude grows, that will benefit Carlyle.

Operator

Our next question comes from the line of Chris Kotowski from Oppenheimer.

Christoph M. Kotowski - *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

Yes. I'm just kind of curious to get your thoughts on the real estate business just in the sense that I guess that's one world that really has been kind of disrupted in a very significant way by COVID. And your current flagship fund is roughly half invested, and so I guess I'm curious. How has COVID impacted the existing fund? And how has it made you think about investing the remaining half? And then -- and I guess I'm also curious about when it becomes time to start raising for the successor fund. Just in real estate, has -- have the discussions and the dynamics changed with the LPs? Are they looking for different things in this new world?

Kewsong Lee - *The Carlyle Group Inc. - CEO & Director*

Okay, there are a lot of questions in that, but let me try to hit the high points. Look, we're investing in our eighth U.S. Real Estate fund. It's $5.5 billion of capital. And I got to tell you we're exceptionally pleased and proud of our team and their performance. We pride ourselves on very disciplined portfolio construction. Their approach is to set up a bunch of subsectors within real estate and, at a very granular level, looking at demographic trends, make investments which they think make sense on a risk-reward basis. And being very disciplined as they were, starting about 2, 3 years ago, they pulled back. And as a result, we currently have virtually no exposure to the office, hotel and retail sectors in CRP VIII and in CP I, which is a huge compliment to our team for having constructed the portfolio this way. That explains why, despite all the disruption you're seeing in the broader real estate market, this fund continues to perform consistently and quite well. Looking forward, they're sticking to their approach, very demographic driven. They are looking at and trying to distinguish between secular and cyclical trends. And based on what they're seeing with consumer end markets and actually industrial end markets and behavior, it informs them on how they're going to be positioning and making investments in their asset-by-asset strategy. So look, I don't want to get into exactly when they're going to start fundraising or exactly where we think this could all go, but suffice it to say we're very pleased with the team. They've done a great job with the portfolio construction. The results speak volumes in terms of their disciplined approach, and we're optimistic about the future behind this platform and team with respect to how they approach the U.S. real estate market.

Operator

And I'm showing no further questions at this time. I will now turn the call over to Mr. Daniel Harris for closing remarks.

Daniel F. Harris - *The Carlyle Group Inc. - MD & Head of Public IR*

Thank you, Ludy. And thank you, everyone, for listening to our call this morning. If you have any additional follow-ups, feel free to reach out to investor relations after the call. And we look forward to speaking with you next quarter.

Operator

And ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect. Have a wonderful day.
