The Carlyle Group

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Roger Freeman: Alright. We're going to go ahead and get started just for the sake of keeping on time. So, a couple folks may still beater in. So, first up this morning -- and welcome to the conference, but first up this morning we're pleased to have Adena Friedman, who is the Managing Director and CFO of Carlyle Group. They are a leading alternative asset management firm, having gone public earlier this year. With nearly $160 billion in an array of alternative strategy, Carlyle is very well positioned to take advantage of asset flow trends that we think are favorable for the industry.

So, without further ado, I'll turn it over to Adena. Thanks for coming.

Adena Friedman: Great. Thanks, Roger. And welcome and thank you very much for joining this morning.

Carlyle was launched about 25 years ago and, really, it quickly differentiated itself among its peers which, frankly, 25 years ago there were far fewer peers than there are today. But, very early on in its life, Carlyle chose to be different. First, it was the first -- one of the first firms to actually have multiple funds simultaneously in the market. Secondly, it also is one of the first firms to branch out from the United States and go into Europe and Asia. And since then, Carlyle continues to position itself as unique within the industry and, today, we have a multi-fund global platform. We have exceptional fundraising capabilities. We have 25 years of investing excellence, an operating model that delivers cash returns, both to our LPs and ultimately to our unit holders, and a fully-scaled global platform positioned for growth. And I'll be going through each of these elements of our business in this presentation.

Today we stand at $156 billion of assets under management and we have 99 active funds, of which 52 are carry funds. And of the 52 carry funds we have today, 29 of them are actually generating accrued carry within the second quarter of 2012. We have over 200 portfolio companies in -- among -- within the funds, as well as 250 active real estate investments. So, we have a very, very full and global platform for investments. And we have 1,300 employees, of which 600 are investment professionals in 32 offices around the world. So, it's a very global business. Almost all of our professionals outside of the United States are local to their domestic market and, therefore, they have a much better ability to source deals and execute deals with the connections and the network that they have within their own countries.

Carlyle has four key segments of its business. The flagship business is the corporate private equity business. We have 29 funds and $53 billion of assets under management. We have had a very good track record of performance, with 31% IRRs for realized and partially realized investments. And it continues to be our platform of strength, stability, and also of growth and I'll go through that a little bit later.

We also have our real assets segment, which is -- includes our real estate, infrastructure and energy businesses. We have 17 funds in that business with $30 billion of assets under management. And again, it has had very good performance over the life of Carlyle, with 28% realized and partially realized IRRs.

The third segment is our global market strategy segment, which has been one of our fastest growing segments in recent years. The global market strategy segment actually has three components to it. It's really made up of our credit business and our liquids business; but, within the credit business, we have CLOs, as well as some carry funds in the distressed and mezzanine debt markets. And we also then have our liquids strategies, which are some hedge funds that we have both in the credit and equity markets. Particularly, we have a long/short hedge fund for bonds and credits and we also have a long/short hedge fund for emerging markets.

And then lastly, our fourth segment is our newest segment, which is the fund of funds business, which is really the fund of private equity funds. And we launched this segment with the acquisition of Alpinvest about a year ago and they had $45 billion of assets under management and it's one of the largest private equity funds in the world.

So, if we think about the four activities that really drive the success of Carlyle, the first, of course, is fundraising, our ability to bring in money. And if we think about the carry funds, our carry funds are essentially 10-year funds. So, when an investor is choosing to invest in a Carlyle fund, they're choosing to make a 10-year -- establish a 10-year relationship with Carlyle for that particular fund.

And one of the things that we think that Carlyle is unique at is our ability to raise money. We have over 1,400 investors around the world. Over 50% of our investors are outside the United States. And as you can see in this slide here, we have a very diverse set of commitments from a diverse investor base. We have public pensions, sovereign wealth, corporate pensions, high net worth, fund of funds, etc. So, it's a very, very eclectic investor group.

And one of the things that I think is most important in the private equity space, because they are making long-term commitments to, is that in the midst of them having a commitment into a fund, that they are also making choices to commit to the next fund or a fund in another part of our business. And one of the things that we have that's very unique is the loyalty of our investors. 60% of the capital committed is from investors in six or more funds and 10% of the capital committed is from investors in 20 or more funds. So, we have an investor base that has been loyal to Carlyle, that has chosen to either re-up or branch out and invest in other funds in the spectrum of Carlyle.

One of the trends that we're seeing is a continued need for alternatives within the investor base. And certainly, in the public pension world, the funding gap continues to grow and, therefore, the need for alternatives also continues to grow. The performance of the alternative market has far, far outpaced the performance of the public markets, as well as certainly the treasury markets. So, over the span of time, I think they realize that the need for alternatives is very, very -- is a growing need within their platform and we continue to see the allocation base starting to look at increasing their allocations across the alternatives.

So, that certainly is a strong trend for us and we do believe it's a trend generally for the industry. But, why do they choose Carlyle? Carlyle -- they choose Carlyle because of the investment performance of our funds. We have very consistent and successful performance across the sectors that we invest in, as well as across the geographies that we invest in. These represent the partially -- the realized and partially realized IRRs and MOICs across our fund groups, both across the platform, as well as across the world.

And when we look at what we do to drive value into our portfolio, we do focus on growing earnings. It is no question that, particularly in the US market, that the ability to leverage to help finance the transactions and ultimately to drive some level of value into the transactions is important. But, even in the United States, 74% of the value that we create within our portfolio comes from EBITDA growth as opposed to debt paydown. And outside of the United States, it's actually more important because the access to leverage is different in each part of the region -- each part of the world. And in fact, in Asia, most of the deals we don't use leverage or very little leverage at all.

So, we believe that it is critical that we buy good companies, but those that we can help grow and that we can make better. We can make them better either by globalizing their business if they were a regional player. We can make them better by becoming more efficient, looking at changes; in some cases changes in management or changes in direction. We do spend a lot of time managing the portfolio and working with the leadership. We believe very strongly in letting the leadership of the companies manage those companies, but we are there as key advisors to them.

And in recent -- just since the end of 2000 -- I mean, sorry, just since the end of the second quarter, we continue to be very active in making investments across our portfolio. Since the end of June, these are the deals that we've been able to -- we've announced publicly. Not all of them are yet closed but -- in fact, most of them are not yet closed, but they have been announced. And we have been very active in -- across both our US funds, as well as in South America, China and in Europe. So, we do find that -- we have found a lot of interesting and we expect successful investments that will drive the business forward in the next few years.

But, at the end of the day, what's really important is that we are able to get cash back to our fund investors. And when we're able to complete that investment cycle and realize our investments, distribute that cash back to the LPs, we also have the -- provide the benefit of generating cash earnings for Carlyle and our unit holders. So, one of the things that we focus on is how eclectic is our investment base in terms of the maturity of our investments. Currently, 55% of the fair value of our investments in the ground are from investments that were made in 2008 or earlier. And 27% of our portfolio within the carry funds are in publicly-traded stocks; so essentially, our publicly-traded equities. So basically, we have some mature investments and of which several of them are now public because we've taken 20 companies public over the last two years. And we have the ability over time to stage our exits in the public markets.

In total, we have 72 -- almost $72 billion of assets in the ground, fair value of assets in the ground, of which $9 billion are in the hedge funds and $62 billion are in our carry funds and we believe that we have the ability to generate realization events in the near term for our investors. In fact, since the end of the second quarter, these are the announced transactions that we've announced publicly in terms of either partial exits in terms of public equity follow-on sales or full exits in terms of the completed sales or announced sales of companies in our portfolio. And we also -- then also Booz Allen also did a special dividend that generated some distributions to our LPs as well. So, just in the last several weeks we've been able to complete several exit events that will continue to drive earnings for our LPs, but also for Carlyle and the unit holders.

So, when we complete the investment --when we complete our entire business and we find that our engine is running successfully, we are able to raise money, invest that money, add value and ultimately exit. This is our business and we believe that -- we call this the Carlyle Engine and right now, the engine is doing quite well in terms of the entire cycle. We've raised $6 billion so far this year. We've completed many equity investments. As of the end of the second quarter, we have invested about $3 billion but, since the end of the second quarter, as I showed you, our investment pace has increased dramatically.

We've had about 8% growth in our -- in the value of our assets. And ultimately, we've distributed, as of the end of the second quarter, almost $7 billion back to our LPs. And then, since then, the distribution events that I showed you are in addition to what we've done since -- through the second quarter. So, in general, we've been able to generate almost $300 million in distributable earnings so far this year. And I do think that that's very important because that is a proxy for cash earnings and that leads me to talk about the distribution policy that we're going to have for our unit holders.

Our distribution policy is that we will have a $0.16 distribution in the first three quarter -- full quarters of every year and then a true-up distribution at year end that basically balances our results, our cash earnings results against any sort of needs for -- from cash needs. But for the most part, our goal is to provide you with approximately 75% to 85% of our distributable -- our post actual distributable earnings to be available for distribution, absent any sort of debt paydown or strategic acquisitions that would create a priority for us.

In the second quarter, one of the things that I do want to make sure that we make you aware of is that we have broken out our distributable earnings for the pre-IPO period and the post-IPO period. And post-IPO, we generated $0.28 of distributable earnings in the second quarter and we had a partial distribution in the second quarter, since we were public for only a part of that quarter. So, we had an $0.11 distribution against $0.28 of post-IPO distributable earnings.

So, in terms of -- that really goes through looking at the business as it stands today. But, one of things we do want to make sure that you understand is that we are also positioned for growth. We have a truly global platform. We have funds in every region of the world, but we don't have a fully scaled platform in every region of the world. So, we are able to look at -- for instance, in Latin America and some of the emerging markets, we have a very successful buyout fund, but we have not yet reached -- branched into real estate, so we have the ability to look at other asset classes within the region. I think also is the case in other parts of the emerging markets, where we have -- we've put a flagship business into that region, but we then have the ability to grow out that platform and branch out into other assets classes. And we believe that that will continue to position us for growth in addition to the fact that we continue to have successor funds that, in many cases, particularly in the emerging markets, we expect to be larger than the predecessor funds. So, we do think that we have the ability to grow substantially over the next several years.

And one of the areas of strength for Carlyle is in the emerging markets. We have $12 billion in carry fund assets in the emerging markets and we have 14 carry funds across those markets. We believe that the emerging markets are going -- are positioned for growth. They are less mature than the rest of the world in terms of the private equity industry generally and the penetration of private equity within the economies. And of course, as everyone knows, several of the emerging markets are positioned to grow faster from a GDP perspective. So, we think that we're well positioned there and that will be a key area of growth for us going forward.

So, just to sum it up before I take questions, we have a very strong foundation. We have $112 billion of C-earning AUMs and that's three times what we had five years ago. We have 600 investment professionals across the world making investment decisions every day, making sure that we are always looking for those opportunities to both invest, add value and, ultimately, exit our investments successfully.

We have a very strong and healthy fundraising team that is globally situated to make sure that we're able to touch our investors on a regular basis, find new investors and make sure that we're successful in our fundraising capabilities.

And then, ultimately, we have $72 billion of fair value of assets in the ground today. And as I mentioned before, that's a very -- it's a very eclectic set of investments, with 55% of those investments made in 2008 or earlier. So, it gives us the ability to look at realization events in the coming years that we think will be very successful for us, for our LPs and ultimately for our unit holders.

And so, with that, I thought I'd stop there and see if there are any questions.

Roger Freeman: We've got 15 to 20 minutes. Maybe while folks are thinking, just looking across your businesses, obviously a lot of people know you as a -- obviously as a large and successful private equity firm. In the global markets business, clearly there's a lot of funds there but it's a growing effort for you and I'm just wondering if you can kind of piece that sort of diversification effort inside of the whole firm. And one of the points you mentioned, and you may not have this on the top of your head, but sort of thinking of the number of sort of first generation funds, there may be a number in there, but those tend to be multiples of size a second time through and I'm just kind of thinking about that ramp rate.

Adena Friedman: Sure. So, if we talk about GMS for a second, so the global market strategies business, as a reminder, is one of our segments that focuses on credit, as well as on our hedge funds and it's been a very active part of our business over the last few years. A number -- the first thing is we've launched several CLOs recently and we've also bought the management contract for several existing CLOs. One of the great things about the CLO market, first of all, it has -- it seems like the demand for it, as well as the success of it, has really had a real resurgence and we are very -- we feel very good about the CLO activity in the market right now.

But, generally speaking, I think that we're able to leverage a 20-person team to be able to manage those investments that we make within -- in the assets that are in the CLOs. And so, it makes it so that we can add another CLO without adding additional headcount so it's a very scalable part of our business. And we are the second largest CLO player in the world today. And I think that's based on a very active pursuit of increasing and improving the CLO business. So, that's one part of our business. Generally, fee generating; a fee generating part of our business.

We also have the carry funds, the credit funds within the GMS. And one area that we're branching out -- so, we've got the distressed funds, the mezzanine funds, and now we've actually launched an energy mezzanine fund. And that has been very successful, both in terms of fundraising because there's a lot of demand for that, as well as in terms of investments because a lot of the traditional investors in energy mez have really stepped away. A lot of the European banks are not making the same commitments into energy companies. And we're finding that we're able to position ourselves as a provider of capital in the energy space that we feel very comfortable with. And that has been a very, very successful new business for us. So, that's a first generation fund.

And then, looking at the hedge funds, we have acquired a majority position in two hedge funds, Claren Road and ESG, and that is -- we've done that over the last year and a half. When we acquired them, collectively they had approximately $6 billion -- $6.5 billion of assets under management. They now have $9.6 billion of assets under management. So, we've been able to -- they've certainly been successful in their investments and that drives the AUM up, but also we've been very successful in working with them and partnering with them to raise new funds into their fund. So, I think leveraging our fundraising capabilities and giving them a platform for growth is what attracted them to us. And frankly, their return profile, as well as the uniqueness of their strategies, is what attracted us to them. So, that's been a very successful part of our business as well. And GMS continues to be what we believe is one of the higher growth areas of our business and we will continue to make investments in that to grow it further.

In terms of first generation funds, top of my head I can't think of the exact number, Roger, but we do have a first generation fund in Latin America, energy mezzanine, Africa and probably a couple other areas that I'm just not -- it's not right on the top of my head. But basically, I would agree with you that the second generation is expected to be larger than the first. That's something that -- assuming you're successful and we do believe that those funds have been very successful thus far. Africa's just raising its fund today. But Latin America we've had for several years and the investments they've made and the returns they've generated have been very healthy. So, we feel very good about the ability to hopefully get bigger as -- in that marketplace going forward, and the same with energy mez.

Sure.

Unidentified Participant: (Inaudible) some color as to outlook going forward. Over the previous five, six years we've had a lot of earnings growth related to sales and margin expansion, but there's been a deceleration in the rate of sales growth and more and more is related to margin expansion going forward. At this point in the cycle, as you look to investing assets, what is your outlook specifically as it relates to the ability to have top-line growth versus margin expansion?

Adena Friedman: So, you're -- and you're talking about within Carlyle or across the portfolio?

Unidentified Participant: Across the portfolio.

Adena Friedman: I would say that we are -- our portfolio is very eclectic, so we have over 200 investments. They're all over the world. I think that our view -- as we look at investments today and we make a case for investments, we look at investments that can generate north of a 20% IRR for our LPs and we continue to use that as a discipline for us.

In terms of looking at it as top-line growth versus bottom-line growth, every single investment piece is unique. There are certain businesses where we feel that we can globalize the business, and so that's pure top line. So, if there's a business that's very strong in its home market, but we think that we can take into other markets, which actually is one of the key reasons why companies like for us to become their partner, we -- that's obviously a top-line growth.

We don't tend to do turnarounds, so we don't tend to look at kind of really, really getting into the mix and completely turning around the company. But, we do help them also become more efficient and that would then drive more bottom-line growth as opposed to top-line growth. So, frankly, it really depends on each of the investments that we're looking at. And I wouldn't say that there's any generic trend that I can describe.

Roger Freeman: Let me ask you a few questions. You mentioned that you have $112 billion in fee-earning assets. What's the gap between that and the $156 billion in total AUM?

Adena Friedman: Sure. Well, there's a different basis of what the earning assets is based on; committed capital and during the investment period and investment capital at cost after the investment period. And when you look at a generic private equity fund, usually the first five years the fund is in the investment period and so that assets under management are based on committed capital and the last five years are based on invested capital at cost. And so, that is the basis for fee-earning assets under management, whereas total assets under management includes market appreciation in the portfolio for those funds that are outside their investment period. So, that's a big gap. Also, I think that there's also some level of commitments that Carlyle Partners make into the funds as well. And they would not be counted as part of the fee-earning assets under management, but they would be counted as part of total assets under management.

Roger Freeman: And are you seeing any changes in the fee structures, the level of preferred returns, anything as the industry gets -- it sounds like incrementally more competitive? Do things look any different, the structures today than they might have five years ago?

Adena Friedman: Well, I think there are three components that we look at in terms of either explicit or implicit fees. So, one is the management fee; the second is the preferred return, which I call kind of an implicit fee; and the third is the carry percentage. The carry percentage, at 20%, really does not -- has -- is really not up for discussion. We don't find that that's an area that people focus on in terms of -- or that clients focus on in terms of discussion around fees.

The preferred return, if anything, 8% has been the preferred return for many, many years and it continues to be the preferred return, regardless of the fact that generally yields have come down substantially. So, in essence, the implicit fee structure has gone down for the clients and up for us because we still have to manage to an 8% preferred return. But, that is not -- again, that's not really under discussion.

And then, the management fees, I would say, are always under discussion but, for a well-established player like us, with a very strong track record, it's an easier conversation because they can kind of see what we've been able to deliver in the past. They can see what we're going to be able to deliver in the future and, therefore, the conversation is much more around the margins as opposed to the core of what the management fees are.

One thing we have done with our latest funds, vintage funds, so in particular, our next -- the US buyout fund that we're currently raising, is we've created a tiered pricing structure where we have -- the largest investors have -- get a lower fee and the smallest investors get a larger -- pay a larger fee. And that's actually new within the private equity industry but, obviously, not new within the general market. So, we do find that that's going to help us maintain a general fee rate, assuming that we have the range of investors that we expect into that fund. So, we don't expect fee compression resulting from that tiering structure.

Roger Freeman: Okay. And I know you've only been public for, I don't know whether it's been five or six months or something, but -- and so maybe it's too early to answer this accurately. But, I feel like I've seen some anecdotes lately about larger institutional investors, big, public pensions who are resistant to -- more resistant to invest with publically traded alternative managers, maybe feeling that the focus is less on the LPs and their returns than it was before they were public companies. And can you speak to any anecdotes that you see in that realm, or do you see any impact or have you gotten any feedback from perspective investors that they could care less whether you're public or not?

Adena Friedman: I would say that we have not seen any impact from being a public company. We've been very clear. It's in our S1 and it's in our public filings that we care for our LPs first. I mean, they come first. They're our clients. They're why we're in business. We have to work for them. And that is really key to the success of our business. And so, long as we continue to make sure that we exercise that focus, I believe that the investors -- our fund investors will not see any sort of material change as a result of being a public company. We had not -- certainly not seen any fund investors say I'm going to invest in you because you're now a public company. That's not been any part of the dialogue so far and we don't expect it to be so long as we remain -- keep our focus on the LPs.

Any other questions?

Roger Freeman: We've got a couple minutes. Just conversely, though, I mean, is -- has it been a positive at all to be public? Because the firms in the past that have gone public have thought that the being public and publically listed would make them more sort of legitimate and sort of established in the face of some of the other fundraising opportunities. Do you find that at all?

Adena Friedman: Yeah. I mean, I think that there were several reasons why we chose to go public and one of them is the fact that going public does, in a way, drive a company to become more institutionalized in its approach and I think that that is actually appreciated.

So I, as CFO, do diligence sessions with LPs as they're looking at making an investment in Carlyle. And I do talk about the -- what we've done as -- to go public. They actually have seen continued improvement in a lot of our processes and our controls within the firm as a result of that process to go public and they see that as a positive. So, the control environment that we created, the risk management environment, the evaluation process has all been viewed as moving in the right direction in terms of quality and speed in terms of delivering transparency to the LPs.

So, personally, I think that's been a real positive and that is one of the drivers of going public. I think the other is to be able to attract and retain talent. And so, as more of our peers are public, we want to make sure that we continue to have the right mechanism for us to attract and retain talent into our firm. And then also, of course, to have capital for making investments, both in our funds, but also on strategic investments over time. So, we think that there are a lot of real positives to being a public company that help our LPs in addition to helping our unit holders.

Any other questions?

Roger Freeman: There's one in the back.

Unidentified Participant: Hi. I apologize if you've already hit this. I just arrived. But, if you could talk a little bit on what you might see public policy related and anything -- any challenges or potential opportunities that emanate from Dodd-Frank or any other sort of public policy initiatives would be very helpful. Thank you.

Adena Friedman: Sure. Well, Dodd-Frank has been an interesting -- it's kind of been what I would call the never ending policy process, because I think that -- everyone does. And we don't all know exactly what's going to come out of it yet, even though it's kind of still been in the works. But generally speaking, to the extent that the banks are precluded from being able to do things in proprietary manner that they used to be able to do in terms of making investments, that obviously accrues to the benefit of a pure investor. So, Carlyle will get to take advantage of some of that. In terms of also having to shed assets and then making those assets available for a process or for an acquisition, that also is kind of an interesting opportunity for us. It was in our portfolio. But generally, Dodd-Frank doesn't really have a huge impact on our business and has not -- there's nothing that has a direct impact on our business, other than I would say on the margins very small things.

Any other questions?

Roger Freeman: Anything else?

Adena Friedman: Okay.

Roger Freeman: Okay. Well --.

Adena Friedman: Well, thank you very much.

Roger Freeman: Thank you. The breakout will be in the Riverside Suite, I guess, actually in about 15 minutes or so.

Adena Friedman: Okay.

Roger Freeman: Unless --.

Adena Friedman: Yeah. I mean, we can just go ahead now if -- I mean, is there any reason --?

Roger Freeman: Yeah. Okay.