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The Carlyle Group, Inc. (CG)

Credit Suisse Financial Services Forum

CORPORATE PARTICIPANTS

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

OTHER PARTICIPANTS

Craig Siegenthaler
Analyst, Credit Suisse Securities (USA) LLC

MANAGEMENT DISCUSSION SECTION

Craig Siegenthaler
Analyst, Credit Suisse Securities (USA) LLC

Hi. Good morning, everyone. Let's get started. This is Craig Siegenthaler from Credit Suisse and it's my pleasure to introduce Kewsong Lee from The Carlyle Group.

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

Thanks for having me here, Craig.

Craig Siegenthaler
Analyst, Credit Suisse Securities (USA) LLC

Kew is the firm's Co-CEO and also chairs Carlyle's executive committee. He joined Carlyle back in 2013 as Deputy CIO, and in 2016 he was promoted to lead Carlyle's credit business. Carlyle was one of the largest alternative asset managers in the world with $224 billion in assets under management. And while many know the firm from its very strong reputation in private equity, Carlyle has been focused on building out its credit business, its real assets business and its investment solutions business. So Kew, thank you again for coming.

QUESTION AND ANSWER SECTION

Craig Siegenthaler
Analyst, Credit Suisse Securities (USA) LLC

Q

So maybe starting now with what many down here think is the elephant in the room, the coronavirus. Maybe you can discuss for a moment what you think the impact on your business will be?

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

A

Sure. Okay. Well, obviously, this is the topic of the day and I suspect will continue to be for a while. First and foremost, there is a real human element to this and so I've got to as a CEO take good care of our people. And so we are very focused every day, multiple times with folks looking at the right policies and protocols to make sure that our people, the families and really broadly speaking our portfolio companies are taken care of and we're trying to do the best that we can. So we're doing that.

Short term, first, I'll say, environmentally, but then I'll get to the different layers involved in your question. There's definitely going to be a short-term financial hit. You can't have half of the world's second largest economy be dormant and not have an impact the global economy. You can't have 55% of the global manufacturing output go through China in some shape or form without there being a short-term hit. And I think people underestimate the disruption to the supply chain. We've got estimates of close to 60,000 containers that are in the wrong places, wrong ports, wrong railway stations, because everything is disrupted. To get that all moving and going and sequence in the right way is going to take a long time.

So monitoring our portfolio at the ground level without a doubt lack of travel, retail traffic down, people not making decisions, it's going to have a short-term financial impact on our portfolio. We're on top of it. We've got plenty of capital. We've got great financial partners and we're going to work our way through it. It's just too early to tell to understand the magnitude of some of this, because the situation is evolving. But if you take a bigger step back, I think we're built to deal with crises and issues like this. We're a well-diversified company, multiple asset classes and there are parts of our business like our credit business where volatility in the world starts to present financing opportunities for them, because the banks may be more risk off. We're seeing, with our $70 billion of dry power, inability that over time as the investment environment shakes out that we feel well-positioned to navigate through the environment.

But the first and foremost issue's got to be for us to focus on our people, then to focus on our portfolio companies, and then to take a step back and say how will this play out and how are we positioned in this environment. It's too early to tell, Craig, and I don't think there are any experts who really can predict what's going to happen here as to the severity and the duration of this, but I feel like we're well-positioned to push through this and navigate it as the circumstances evolve.

Craig Siegenthaler
Analyst, Credit Suisse Securities (USA) LLC

Q

Kew, the topic we've talked about with each executive of your peers this week has been the secular migration to private markets, private capital. Do you think the industry can continue to grow at this pace?

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

A

The short answer is yes. I mean, it's a $6.7 trillion, close to $7 trillion of assets growing at about 10% and it's growing across all asset classes, not just private equity, but private credit, real estate, infrastructure, et cetera. I just came back from SuperReturns in Berlin, which is the industry's largest conference and I can tell you, despite the environment and some of the market correction that is happening, there is no shortage of appetite to continue to invest and to seek allocations into this asset class. In fact, I keep making the comment, it's really not alternative anymore, it's more mainstream. It's such a main part of every single institution's investment portfolio to help drive return.

You didn't ask, but I'm going to go right there, which is there's a Bain Company report, which pointed out that, hey, over a 10-year period of time, public markets have outperformed private equity, at least that's the assertion. Yet, when you look at it, I think the report does a better job of framing the really important question, which is public markets delivered 15%, which is an outperformance of 2x over their historical levels of return, do we really think public markets can keep continuing to outperform in that way or do you suspect a reversion to the mean, whereas private capital has been consistently generating the types of returns that are being published.

And so to me, the question is how do you drive these types of returns moving forward. And it's interesting that in that report, 60% multiple expansion occurred to get the public returns to deliver what they did, whereas if you take a look at what Carlyle does, two-thirds of our returns are driven by operating earnings and growth and fundamental changes that we're putting into the business with less than 20% based on multiple expansion.

So I guess, where I'm going with all this is, is I think our asset class is performing. It's going to get harder and harder to perform, but we have the platform builds to continue to drive change, create value to deliver that type of performance. If that continues, I suspect you're going to continue to see secular tailwinds to support continued growth in our asset class, because quite frankly it is the best performing asset class that all of our customers have to help them meet their investment objectives. So I think this is going to keep continuing for a bit longer.

Craig Siegenthaler
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. Maybe coming to investing for a second, especially given the coronavirus issue and large inflows you've experienced over the last few years, how do you think about prudently deploying capital and could the coronavirus actually provide an opportunity to invest across asset classes at lower valuation?

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

A

Sure. Well, look, it's not appropriate for me to say that we're going to be opportunistic about something which has got such human consequences, right. So again, we're carefully trying to manage this to make sure our people are well taken care of. I can tell you deal flow right now is about as high as it's ever been and people talk about all this money, all this dry powder, but you can't talk about dry powder without talking about the other side of the equation, which is the opportunity set for deals. And in every single asset class, you're just seeing the demand for private capital expand significantly to soak up that dry powder.

You're seeing companies wanting to stay private for longer. The number of private companies versus public companies, private companies exceed public companies by a factor of 2x. Banks are retreating from certain types of loans and you're seeing private capital go in and make direct loans. In every single asset class, you see regions opening up like Japan. So the opportunity set is growing. And I think that's what will absorb all this dry powder that is being raised.

And you have to keep in mind, it's not necessarily the lack of an ability to put the money to work, because there is plenty of way to put the money to work. The real question is, are you putting the money to work in good deals. Valuations are high, no doubt. And so the key is how do you drive returns. And I like our model, because we drive returns with a long-term perspective based on creating this fundamental operational improvement and changes to a company's profile that improves earnings. And if you have that mindset, I feel very good about our ability to continue to consistently deliver the types of returns that what we've always done to properly deploy that dry powder that you're referring to.

Craig Siegenthaler
Analyst, Credit Suisse Securities (USA) LLC

Q

Yeah. Maybe just starting right there. If I look at the historic return in some of your larger funds, I'm taking Carlyle Partners IV, V, VI, very solid double-digit zone, what is your confidence that future funds could actually generate [ph] more funds (00:09:49)?

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

A

Sure. So what I can comment on is the following. The current funds, the big flagship funds that we're deploying on a multiple of invested capital basis, they are tracking more or less in line with exactly those predecessor funds that you're mentioning. So, my crystal ball is – can get a little bit cloudy. But as of right here, right now, despite the challenging environment, despite the facts that you're talking about, our current large funds are more or less tracking in line with what our historical predecessor funds have been able to do. So, if that were to continue, I feel very confident that we'll be able to drive performance revenues and the level of earnings that we have been able to do in the past.

Craig Siegenthaler
Analyst, Credit Suisse Securities (USA) LLC

Q

Got it. Coming to one of my favorite topics, C-corp conversion. You had a differentiated C-corp conversion that was actually completed almost two months ago, January 1, how do you think your shareholder base will change, when I look at both the active side and the passive side?

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

A

Okay. Great question. So, yeah, we did do a C-corp change. It was a true C-corp change, as folks know, we went. It's best-in-class. It's one share of a – one class of common stock. It's one share, one vote. It's the best governance, the simplest, the most transparent. And we feel very good about it and it opens us up to the maximum possible amount of index inclusion vis-à-vis our peers.

If you take a step back and look at what is likely to happen, and for some indices it's formulaic and for others there's some judgment. But starting in March, in the mid-spring and throughout the year, you will see Carlyle be added to a bunch of indices, and that for sure will drive a technical demand or a need for our stock, as we get included in a lot of these passive indices. S&P 500 or the S&P is something that we are also eligible for. Obviously, there is a committee there that has a judgment as to whether or not we should be included. But best to our knowledge and based on conversations, we fulfill all the criteria, so it's just a matter of do they want us in that index or not. But we are from an index inclusion perspective, probably the best positioned across our peers, given the simplicity, transparency and the ultimate structure of how we converted. And as a result, I suspect you're going to see that type of technical demand for our stock starting in the not-too-distant future and that should continue to go throughout the year and into next.

Craig Siegenthaler
Analyst, Credit Suisse Securities (USA) LLC

Q

Great. And this topic kind of linked to that topic, but valuation. Despite the really nice run you've had over the last 12 months, The Carlyle stock still remains at a lower multiple than peers.

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

A

Right.

Craig Siegenthaler
Analyst, Credit Suisse Securities (USA) LLC

Q

So, how do you think about that discount and how do you think you can close that?

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

A

Yeah. Thank you for pointing this out. It is something that we look at all the time and it's either annoying or an intellectual curiosity as to why this is the case. I can appreciate some of it. If you go back to the very first question you asked about the virus and the impact, I was – we're missing not mentioning, our capital is locked in, 98%, let's call it, virtually 100% of our capital is locked in for many, many, many years and as a result, our fee base is in essence locked in.

So, I feel really good about our ability to continue to drive on FRE and the ability to continue to scale that up as our CFO talked about on the last earnings call. That gives us a level of solidity and a base, which regardless of the volatility in the world and regardless of events in the short term, gives us huge confidence in our ability to provide that base level of earnings. And that's a huge focus of the firm that we went into a few years ago to say, we will establish a solid base of FRE and continue to grow it. By the way, as that happens, it would be our intent to move our dividend up in line, maybe lagging, but in line with that type of FRE base.

Off of that, you then have are our carry income, which is much harder to predict. But as I just told you, our funds are more or less performing in line. And you also have to keep in mind, five, six, seven years ago, we were investing at a pace of about $10 billion, $11 billion a year, which when we look at it through a cycle created about on a normalized basis $600 million of performance fees.

Over the past three, four years, we've been investing at over $20 billion a year, okay. So I just want folks to appreciate the back-of-the-envelope math. We've doubled the ability to have money in the ground. Our performance right now is more or less on track with historical. Yes, we have product mix. Yes, you have events like coronavirus. Yes, you have events like Phase 1 US-China tension. Yes, does that mean that exits could get pushed out, et cetera, of course. But the pace has been doubled.

So, if our performance is anywhere near to what it used to be, you guys can do the math to say, well, where should the $600 million go up to. You add that to the FRE baseline that we feel very comfortable is – last year it was 450-ish. This year our CFO guided you all to about $475 million and a number with a [ph] 5 (00:16:10) on it and call it a 10% type of growth rate over the cycle. You can kind of start the back of the envelope to say, wow, the earnings power of what we build is pretty good. It's visible. We can see it, we can see how we get there. Maybe I can't predict it by this quarter or that quarter, but you can start seeing the building blocks for kind of a back-of-the-envelope model that kind of makes sense.

Now people out there have to decide what multiple they want to put on that. Should we be at the highest level of multiple, should we be at a slight discount because of the fact that our growth profile is X or product mix is Y. Those are judgments that the market can make. Do we deserve the level of discounts that we have now based on what I just described, I would say, maybe not. But that's my opinion, the market's got to make their own judgments, but that's the way I look at it.

Now, in terms of what could drive future growth, people have to appreciate, we have a powerful private equity business and it ain't getting less powerful. And I hope that we can – our last $100 billion fundraising program, the PE portion of that, the biggest funds grew 20%, 30%, 40% over previous funds. I would hope that, that type of step-up is what we have in line on the PE side.

Credit has basically gone from, on an apples-to-apples basis, $25 billion to well over $50 billion currently, and it is on a track to grow even more, and I would be disappointed if we weren't growing well above the 10% rate that the industry is growing at and is starting to already add significantly to our FRE on a contribution basis. We have a very strong real estate business, a really strong energy business. You add all of this up, you're seeing a more diversified business model where we have real growth happening out of credit, you see sustained organic growth coming out of PE. And then our solutions business for the first time is starting to move the needle if we can get a couple of funds raised.

So you're starting to see all the elements in place that we're going to deliver growth on an organic basis. You're seeing a real concentration of getting that FRE up, and you're seeing the earnings power of the carry that I just back of the envelope for you.

And then finally, you add to that, we made some strong strategic moves on a very selected basis with acquisitions and things like Fortitude and our aviation finance business, both of which are on plan, if not doing better than we thought, which is external. So wrap that all in, and you have to make the judgment, well, can this management team execute? And that's what I ask at investment committee meetings all the time. On the PE side, when you're doing a deal, can this management team execute? Are they delivering credibility and earning the credibility of the market to be able to earn higher and higher valuation and multiple, because of your belief that we can actually get this done and deliver. I'd humbly submit over the past two, three years, we've done a pretty darn good job. We'll see where that goes in the future, as we keep navigating through some of the tough environment. But my really long-winded answer to your very simple question of, do you think we're undervalued and do you think we can grow to command a higher valuation, you can tell from my answer, I believe so and I'm pretty confident we can get there.

Craig Siegenthaler
Analyst, Credit Suisse Securities (USA) LLC

Q

Excellent. One topic you don't get to cover much in the quarterly earnings calls and we're talking about margin...

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

A

Sure.

Craig Siegenthaler
Analyst, Credit Suisse Securities (USA) LLC

Q

...for a fundraising is really the One Carlyle philosophy, and the firm culture, which arguably can help you find better investment opportunities across the business, also maybe help you attract better talent. So, maybe just talk about those two elements and how they benefit the firm?

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

A

Sure. Well, look, the most important thing we pride ourselves on being a global investment firm, we have to have a strong culture that unites us and brings us all together. And it starts first and foremost with our sense of values, the teamwork, the collegiality. But really our ability around the world across all the industry sectors to pitch in to get really complicated deals done, and it's – the One Carlyle platform has in it human capital assessment, procurement, digital – using digital and data more effectively at portfolio companies, our capital markets functions, senior operating executives, consultants [ph] on (00:21:31) proprietary to us. You add up all of this, plus more, all of this gets brought to our investment processes to help find value and do better deals, and it's just a huge resource that we have that many firms don't that makes us distinctive.

But the thing about Carlyle that I think is really important is our focus on total impact to drive performance at our companies. Everything we do is looked at through the lens of how do we make companies better. And I think that is something that is going be increasingly important moving forward, because it's not just driving revenue or managing margin, it's about how do we improve the governance at the board of our portfolio companies, how do we drive diversity, how do we make sure that employees are more engaged and practices are more sustainable. When you have that type of an approach, it leads to better performance and it leads to building better companies, which drives better investment performance.

Final thing I'd have to say about Carlyle and our culture is, we're in the judgment business. It's just about how do you make better decisions. You cannot do that if you don't have a culture, which celebrates and wants a diversity of experience and insight and background [ph] at the firm (00:22:57). We can only make the best decisions if we have the best views around the table and a culture, which is inclusive of that, so that we can put the best minds to help us make these important judgment calls. And so I'm exceptionally proud of the fact that about half the AUM at Carlyle managed by women. 50% of all hires last year were women. So we're in the lead on this, but we still have a lot of work to do. But I think that is a glimpse of kind of what Carlyle is like. But most importantly it shows you that our culture and the way we think about things is supportive of the most important thing we do, which is to make important decisions on behalf of our clients to drive investment performance.

Craig Siegenthaler
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. I have one more question up here, and I thought maybe we could see if there is any question from the audience. But my last one is, you've been Co-CEO now – is it two or three years?

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

A

It feels like 20. I think it's the start of the third year, maybe.

Craig Siegenthaler
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. So you came up more through the investing side of the business for a few years...

Kewsong Lee

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

A

Sure.

Craig Siegenthaler

Analyst, Credit Suisse Securities (USA) LLC

Q

...and then you moved over, and you have more of a leadership hat today. You deal more with public investors...

Kewsong Lee

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

A

Right.

Craig Siegenthaler

Analyst, Credit Suisse Securities (USA) LLC

Q

...be it Curt and Dan here. What really surprised you about this world, the leadership role and also dealing with public equity investors?

Kewsong Lee

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

A

I dealt with public equity investors through our portfolio companies, because some of them are public and I've been on a ton of public boards and meet directors on public board. So I understand the public markets pretty darn well. I think the more frustrating element of it is, we are in the long-term business and all of our decisions and judgments are driven with that lens, whereas – and you know this better than anyone. And unfortunately, a lot of the questions and a lot of the pressures we are under are much more short term in nature. And so I think it's just a constant balance.

There is a definite need to make sure we're reporting and we're saying and we have all the right transparency, and I also understand why the short-term matters, because if you can't get the short term right, how do you get to the long term right. But on the other hand, my mindset continually needs to be to drive the company with that longer term perspective in mind, not worry about the quarter-to-quarter bumps along the way. But guide with a sense of real strategic prioritization about what will build and drive the firm over the longer term.

So, I'm not as uncomfortable with the whole public side of the equation, because I'm going to say what I think is important to say and be less worried about the shorter term impact. I'm much more focused on how do we build this company the right way for the long term.

Craig Siegenthaler

Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. With that, I think we have a mic in the back. Please raise your hand if you have any question. We have one in the front. And just please wait till we have the mic.

Q

Thank you so much for being here. What are your thoughts on using M&A to help accelerate the growth [ph] other than your (00:26:31) business is in credit and real assets, especially after your acquisition of Carlyle Aviation Partners?

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

Sure. It's a great question. We very open to it, but it's not our base case plan. Our base case and kind of what we think about when we come in day-to-day has got to be build the business the old fashioned way organically, drive performance to go raise funds and manage the business as well and think about that. But as was shown in the Aviation Partners et cetera, when we see opportunity to extend strategically in an adjacency where it's additive to the business, where it'll fit in with our culture, where it can also give back, because it's got knowledge or capabilities that we don't have and so it's reciprocal and obviously it's got to be accretive to value, we will use our balance sheet to make those acquisitions. But I would say, it's much more rifle shot and with real strategic purpose as opposed to plan right now to say we've got X hundred millions of dollars that we're just going to deploy to go buy stuff. So, there isn't that type of a mentality. The mentality is much more focused on our business, do it the old fashioned way. And yes, if you see an adjacency or you see something strategically interesting, be opportunistic about acquiring.

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

Great. One question here.

Q

Yeah. Just presenting right – next to right now is Athene, so just curious if you have any thoughts about that structure and...

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

Sure.

Q

...pertains to the business you guys might do?

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

Sure. Yeah, I won't comment on Athene and the other A company, but we've done it in a different way and I like the way we've done it, which is we have a strategically important minority investment in a company called Fortitude, which we helped to acquire and we now have to deal with a whole bunch of other capital that we help raise in essence to acquire control of all of Fortitude from AIG. It's a broadly diversified portfolio of legacy liabilities, incredibly long tail. And unlike Athene, which is consumer-facing, this is completely, what I call, B2B. It's institutional, it's a different type of regulatory thought process. And it also, and this is really important, enables us to control our growth in a very thoughtful fashion. When you're dealing with a mono-line consumer-facing entity and you need to originate policy and you turn that spigot on to do that, be careful what comes in and how you have to then reinvest the capital. Whereas for us through Fortitude, it's institutional. We can decide when Fortitude acquires other blocks of businesses and how Fortitude grows, which enables us to properly manage our growth.

The reason why I think that's important is, in our business, people always think about and talk about fundraising, but you have to appreciate that the hard part of our business is also deploying in a consistent way to drive appropriate rates of return. And if you can't get that balance right, if you have too much capital coming in that needs to be put to work, at some point in time you upset the applecart and the whole model starts to fall apart on itself because of the size, right. And so, for us, I like the fact of how we did it. We have a preferred investment management agreement with Fortitude such that for every asset and [ph] as worded (00:30:46), to growth, a portion of that asset base, we're entitled to manage on the alternative side. And so, the fact that it's much more diversified, the fact that it's much more institutional, the fact that it is something that on a thoughtful controlled basis, we can manage the growth of Fortitude, it's something that I very much like as it relates to how it fits in with Carlyle's profile.

Craig Siegenthaler

Analyst, Credit Suisse Securities (USA) LLC

And with that, I think it's the perfect time to stop. Thank you. Thank you so much for joining us.

Kewsong Lee

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

Thank you. Appreciate it. Thanks for having us.