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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by and welcome to The Carlyle Group Third Quarter 2019 Earnings Call. At this time, all participants lines are in a listen-only mode. After the speakers' presentation there will be a question-and-answer session [Operator Instructions]

I'd now like to hand the conference over to your speaker today Daniel Harris, Head of Investor Relations. Thank you, please go ahead.

Daniel F. Harris  
Managing Director & Head—Public Investor Relations, The Carlyle Group LP

Thank you, Jimmy. Good morning and welcome to Carlyle's third quarter 2019 earnings call. With me on the call today are our Co-Chief Executive Officers, Kewsong Lee and Glenn Youngkin; 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 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 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 with our third quarter results which is also available on our Investor Relations website. For the third quarter, we generated $109 million in fee related earnings and $161 million in distributable earnings, with DE per common unit of $0.41. Our distribution will be $0.31 per common unit.

Our previously announced conversion to a full C corporation will be effective on January 1, 2020. After that date quarterly distributions to shareholders will be in the form of dividend and as such the distributions for the third quarter of 2019 to be paid in November will be the last unitholder distribution. Upon conversion, shareholders will receive regular 1099 tax forms with K1 reporting requirements only relating to unitholders through year end 2019. Glenn and Kew are each going to provide some brief comments and Curt will go through our metrics and financial results for the quarter. To ensure participation by all those on the call please limit yourself to one question and then return to the queue for any additional follow ups.

With that, let me turn the call over to our Co-Chief Executive Officer, Glenn Youngkin.

Glenn A. Youngkin
Co-Chief Executive Officer & Director, The Carlyle Group LP

Thank you, Dan, and good morning everyone. Thanks for joining the call. With Carlyle’s global headquarters being in Washington DC for nearly 33 years. Let me start by saying what a spectacular Game 7, go Nats.

Now turning to the quarter, in the spirit of getting to the point I want to reiterate the consistent themes that you have heard from us all year. We have solid momentum across the business and we are delivering on the priorities that we established at the beginning of the year. Our corporate financial results especially FRE continue to improve. We are on track to exceed our fee related earnings guidance for 2019 and are positioned well to grow FRE further in 2020 and in subsequent years.

We are on track to achieve our fundraising target for 2019 building on our success over the past few years including the recent final closing of our fifth European private equity fund at €6.4 billion or just over $7 billion.

Our growth initiatives are more broadly at global credit, but also more specifically in insurance and aviation finance are performing in line with if not a little head of expectations. And finally, while appreciation was relatively low for the quarter, aggregate fund performance continues to generally track in line with predecessor funds giving us confidence that our substantial accrued performance fees which total $1.8 billion will become realized performance revenues over time. This momentum underpins our expectations for continued earnings growth and margin expansion over the coming years. And we believe that our announced corporate conversion will help to further unlock shareholder value.

With that, I’ll turn the call over to Kew.

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

Thanks, Glenn. Let me provide some more thoughts on our corporate conversion. Since our announcement last quarter, we have spent significant time with existing and new potential shareholders. The reception has been positive and I want to share a few observations. First, there is a much broader pool of investors that want to
engage with us, including many that have not previously been able to invest in Carlyle due to our current partnership form.

Second, the simplicity, transparency and alignment of our structure. One class of common shares, $1 fixed dividend per share for all shareholders, and a one share/one vote governance construct is viewed as distinctive by many investors.

Third, investors appreciate the substantial recent progress we have made in improving and expanding our business. And finally, even though we remain two months away from our conversion, we've already seen a meaningful pickup in our trading liquidity, and there is broad recognition that our structure maximizes the potential for index and benchmark inclusion. We are encouraged by this early feedback.

Clearly, however, operating performance will drive our valuation over the long term and we remain focused on improving our financial results and producing attractive investment performance, which is the second topic I'd like to touch on. The focus on investment performance is paramount given the complexities of the current environment. Slowing global growth, high valuations and the uncertainties from trade tensions and geopolitics makes investing more challenging now than ever before. But this environment is also creating significant opportunities. As corporations sell non-core subsidiaries, companies seek private capital solutions and entrepreneurs from around the world seek to partner with us to help them grow and build their businesses for the long term.

We believe our investment approach in global platform positions us well to drive value at our existing portfolio companies while also finding interesting new opportunities across multiple asset classes in every major region of the world. Our track record of success and ability to generate attractive performance is an important reason why our fund investors have entrusted Carlyle with significant amounts of capital, and we remain focused and disciplined as we drive our investing activity forward.

Let me now turn the call over to our Chief Financial Officer, Curt Buser.

Curtis L. Buser
Chief Financial Officer, The Carlyle Group LP

Thank you Kew. This quarter we generated $161 million in distributable earnings, of which two-thirds came from fee related earnings. Fee related earnings totaled $109 million in the quarter, 22% higher than the year ago level. Year-to-date we have produced $345 million of fee related earnings and we expect to end 2019 with approximately $450 million in FRE, exceeding our prior guidance of at least $400 million. We ended 2018 with a quarterly FRE run rate of below $100 million and are now routinely generating a run rate FRE in the $105 million to $110 million range, which we expect to further grow in 2020.

We expect annual FRE will reach approximately $500 million over the next couple of years. The fee-related earnings margin was 27% in the third quarter and 28% year to date up, from 17% year to date in 2018. We expect FRE margins to expand into the 30% plus range over the next several years as we continue to focus on growing FRE and improving margins. FRE growth during 2019 has been supported by more than $16 billion in year-to-date fundraising activity, driving an 8% year-over-year increase in fee-earning AUM to $159 billion.

Fund management fees were $385 million in the quarter, an increase of $30 million over the year-ago quarter and generally flat with the second quarter of this year after adjusting for catch-up management fees. Cash compensation expense was $194 million for the quarter, an increase of 4% over the past year. Third quarter equity-based compensation expense of $39 million was down 25% from the year-ago quarter and we expect
equity-based compensation expenses to continue to decline in future periods. G&A and other indirect expenses were generally in line with the year-ago period and depreciation and amortization expense increased $3 million over the third quarter of 2018 primarily due to the accelerated depreciation of certain leasehold improvements.

Realized proceeds from carry-funds were $5.7 billion in the quarter, higher than the trend in the first half of 2019, but we remain below the levels of recent years. The increase in realized proceeds helped drive an uptick in net realized performance revenues compared to the first half of the year totaling $58 million in the third quarter. Strong exits in our real estate business drove most of the realized performance revenue this quarter while corporate private equity realizations continue at levels below a year ago. Our carry fund portfolio was up 2% in the quarter primarily reflecting the strong appreciation in the solutions portfolio offset by headwinds in energy. This compares to a 1% decline in the MSCI All Country World Index over the same period.

Net accrued performance revenue of $1.8 billion was down slightly from $1.9 billion last quarter. During the quarter we optimized certain parts of our balance sheet taking advantage of low interest rates. In early September we issued $425 million in new 10 year notes with a 3.5% coupon, in the first week of October we completed the redemption of our 5.875% preferred equity securities. This refinancing is projected to improve after tax distributable earnings by more than $12 million annually.

In closing, let me reiterate that we will complete our corporate conversion on January 1, 2020. Meanwhile, investor interest in our sector and in Carlyle is rapidly building. We remain excited about our future and with that we are ready to take your questions.

**QUESTION AND ANSWER SECTION**

**Operator:** [Operator Instructions] Our first question comes from Craig Siegenthaler with Credit Suisse. Your line is now open.

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

Thanks. Good morning, everyone.

**Kewsong Lee**  
Co-Chief Executive Officer & Director, The Carlyle Group LP

Good morning.

**Glenn A. Youngkin**  
Co-Chief Executive Officer & Director, The Carlyle Group LP

Good morning.

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

With the credit business continuing to expand here, can you talk about the fundraising outlook really outside of the CLO business, including direct lending, aviation and some of your carry funds?
Okay. Hey, Craig. How are you? In general, it's not appropriate for me to talk about funds that are in market, so let me just give you a little bit more color. We are very pleased with the progress that our global credit business is making. Revenues are up, AUM is up, and the momentum is quite strong. As you correctly pointed out, our CLO business is doing very well and continues to be a market leader in that business.

Away from that, let me just pick on some of the items you raised. Our aviation finance business, as Glenn mentioned, is actually doing a little bit better than we expected. We are accelerating our plans there to raise funds, and the platform is exceptionally well-positioned in the current environment and has a lot of tailwinds. With respect to our distressed business, it's still in its investment phase but we are trying to think through in light of the current market when we can actually bring the next-generation of that fund to market. You should know that we're already in our fourth fund in the distressed business. It's a top performing fund and we have every expectation that our investors will greet that fund warmly when we do go to market with the 5th version of that fund.

And then finally, direct lending. Direct lending, no doubt, is among the most competitive sectors in the credit space. We did have a very successful fundraise with a private BDC over the course of the past 18 months. We are preparing to think about when we want to go back to market with respect to more fundraising. It is a core and important element of our strategy and we feel pretty confident in our ability to continue to grow our direct lending business in the general credit space.

Mike, thanks for the question. So look, I think the CRSP, MSCI, Dow Jones, Russell indices are all expected to be added in the first half of 2020. And we think that that will be a nice pickup for volume as that occurs. We have reached out to the S&P. I think that's a more difficult discussion. I like the fact that we are appropriately structured and believe that we have positioned ourselves very well for consideration in those indexes. But as you know that's a more subjective test and so we'll see how that that process goes. But we remain optimistic in terms of everything we're seeing. In terms of discussions with investors, I mean they have been really pleasing. Just as we commented in our opening remarks, that process is going very well and you can really see the uptick in the activity of the stock.
Hi. Good morning guys. Thank you. My question is on the credit mark negative 2% which looks about the same as 4Q 2018 when there was a much worse kind of a credit spread environment. Could you maybe give a little bit more color on any idiosyncratic positions that might have driven that or groups or funds that drove that?

Patrick, it's Curt. So just remember that this chart just shows carry funds. And so it's not really reflective of the entire credit business. An entire structured credit business is outside of this. A lot of the direct lending business is outside of this. So it's only the carry funds and the big carry funds that impact here were energy mezzanine funds, and you all know what's happened with energy prices and a lot of the comparable energy indices are down like 18%, et cetera, in the quarter. So that had an impact here on us in the quarter, it's really energy. Everything else is actually tracking quite nicely.

Perfect. Thanks.

Okay. Thank you very much. So I appreciate sort of the fresh look on the FRE outlook for the fourth quarter as you look out over the next couple of years. So as you continue to study your franchise, how you think about benchmarking versus your peers where FRE margins are rather high? I appreciate some of them may as idiosyncratic drivers, but even if you strip that out your margins are still running rather low to that. So as you think longer term, where do you think margins would get to maybe beyond this 30% plus range?

Bill, thanks for the question. So look we are fundamentally built differently. We have a very global platform, many dedicated teams. And I think that that's really proven true in our historical ability to generate a lot of great carry and fully expect that to be our future again.

With respect to margins, just think about where we've come from. We've come from a low teens margin. We gave you guidance entering this year that we're going to seek to kind of around 25%. We're already year to date at 28%, 27% here in the quarter, really trying to push this forward to get to 30% plus. We think we can achieve that
once we get to there. Look we're not going to stop. We're going to continue to push on beyond that. But we've got to get to the 30% first and once we do that then I'll reset your guidance.

William Raymond Katz
Analyst, Citigroup Global Markets, Inc.

Thank you.

Operator: Thank you. Our next question comes from Glenn Schorr with Evercore. Your line is now open.

Glenn Schorr
Analyst, Evercore ISI

Thanks very much. SEC talking about finding ways to make private investments available to individuals on a broader basis makes tons of sense obviously. Can you talk about what you think the right vehicles are and what you're doing to make sure that you're there on scale if and when that happens? Thanks.

Glenn A. Youngkin
Co-Chief Executive Officer & Director, The Carlyle Group LP

Yeah. Glenn, hi. It's Glenn Youngkin. I think that this topic has been discussed for many years and it continues to be a tough one. I think we have a very, very robust demand equation out of the high net worth channels and we continue to see that demand in our own fundraising. But broader access to particularly very illiquid private investments by the broad based mass retail. I think we'll continue to provide challenges on how to structure it and how to provide the same kinds of registered vehicles and liquidity offerings that exist in the comparable registered '40 Act funds. And so I think this will continue to be an area that we all spend a lot of time thinking about, but I don't expect this to be something that is crapped correct in the near future.

Glenn Schorr
Analyst, Evercore ISI

How come not as simple as putting something inside the 401(k) platform just with different liquidity constraints? I guess easier said than done.

Glenn A. Youngkin
Co-Chief Executive Officer & Director, The Carlyle Group LP

I think you answered your own question. It is easier said than done.

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

Hi. Morning. This is Jenny filling for Ken Worthington. So just a quick question on realization cycle going to next year, so we continue to see a somewhat recurring environment for you and peers in term of realization and especially in private equity, could you maybe review the lighter activity this year especially in private equity and update us on the outlook of more active realizations looking forward?

Curtis L. Buser
Chief Financial Officer, The Carlyle Group LP
Jenny, it’s Curt. Thanks for the question. And you’re right, activity has been live but here in the current quarter $5.5 billion or so of realized proceeds. That's been tracking relatively well although granted this year is lighter than it has been. As we look at how that translates to carry, our model is helpful given the multitude of funds and platforms that we have. This year we've seen a lot out of our real estate business and it's done really well. I expect that to continue.

I do think that 2020 is going to be an uptick over 2019, so I expect an increase next year over these levels, but predicting carry in this market and the expected market with the macro risks, very difficult, very challenging and so I would be careful in terms of how much of a rebound to expect in 2020. I do think it will be up, but I'd be careful with that. 2021 I think it goes up even further and underpinning all of this is $1.8 billion of accrued carry which I feel real strongly about and feel that that is just a question of timing and underpinning that is $83 billion remaining fair value in our carry funds. So really see a recovery in our realized carry over time. Exact timing, always hard to predict.

Thank you.

Operator: Thank you. And our next question comes from Michael Cyprys with Morgan Stanley. Your line is now open.

Michael J. Cyprys
Analyst, Morgan Stanley & Co. LLC

Hey, good morning. Thanks for taking the question. Just hoping you could give a little bit of an update on some of the trends within your portfolio companies around revenue and EBITDA growth. Any additional color there you're able to provide around the pace of realizations. I know you mentioned in an answer to the prior question being all a little bit lighter year on year. But I guess why is that the case, and if this current market backdrop continues, can we still expect to pick up next year.

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

Hey Michael, it’s Kew. Yeah. Thanks for the question. First of all, just generally speaking, we're observing what all of you are seeing which is in general global growth is slowing down. It's positive but it's lower this year than it was last year. We all know the reasons why that's the case. In particular I would just comment the industrial sector seems to be more weak than it was last year at this point in time. And obviously the consumer sector seems to still be strong. Certain parts of Europe are a bit weaker at this point in time than we saw last year.

So with that with a general economic backdrop, our portfolio in general shows much of the similar trends. Having said that, on a run rate basis right now generally speaking on our private equity portfolio, our companies are growing at about 8% in terms of EBITDA year-over-year on a run rate basis. That's trend. So I would say that our portfolio is, while experiencing the same type of macro conditions, is in terms of slowing down and growth is challenged and margins are challenged, in general, on a fundamental basis we think we're in okay shape.

With respect to your realizations questions, I mean the deal environment is tough. There's a lot more uncertainty. It's harder getting things done. Accessing the markets is harder than it was last year at this point in time. And confidence is something that’s – and trust is something that’s required to get deals consummated. And I think it's fair to say everyone recognizes that this is an environment where there's a little bit more uncertainty. And having
said that, this is probably, as Curt mentioned, the low watermark in terms of realizations. We fully expect realizations to start picking up next year and with the $1.8 billion of accrued carry that we have in the ground and with the fundamental performance of our portfolios all tracking in line with what predecessor funds have been doing, we're pretty darn confident that realizations will pick up in the future. It's just that the visibility of the exact timing is a little harder to predict.

Michael J. Cyprys
Analyst, Morgan Stanley & Co. LLC

Great. Thank you.

Operator: Thank you. And our next question comes from Alex Blostein with Goldman Sachs. Your line is now open.

Daniel Jacoby
Analyst, Goldman Sachs & Co. LLC

Hi. Good morning guys. Thanks for taking the question. This is actually Daniel Jacoby filling in for Alex. I appreciate the FRE guidance. Can you just help us think about the timeframe, help us zone in on that timeframe a little bit? I think you mentioned next few years for hitting $500 million in FRE and 30% margins. If you could just provide a little bit more color as to kind of what next few years entails and help us think about that timeframe. Thanks.

Curtis L. Buser
Chief Financial Officer, The Carlyle Group LP

Sure. So, as I said on the call, $450 million or approximately that here in 2019, $500 million of FRE in just a couple of years, but before our big buyout funds come back to market.

Daniel Jacoby
Analyst, Goldman Sachs & Co. LLC

Got it. Okay. Thank you.

Curtis L. Buser
Chief Financial Officer, The Carlyle Group LP

Thank you.

Operator: Thank you. [Operator Instructions] Our next question comes from Chris Kotowski with Oppenheimer. Your line is now open.

Chris Kotowski
Analyst, Oppenheimer & Co., Inc.

Yeah. Good morning. I was looking at the carried interest receivable and there was a 7% drawdown during the quarter and wondering if you can give some color on that. I mean I understand there's trouble in energy, but it just seems like kind of a big drawdown for just given the overall market environment?

Curtis L. Buser
Chief Financial Officer, The Carlyle Group LP
Sure, Alex (sic) [Chris]. I mean, this is Curt. So, $1.8 billion this quarter, $1.9 billion last quarter. If you were to just mark the differences between the components, you'll see it's primarily in our natural resources funds where it's — we now have net accrued performance revenues of $134 million versus $212 million of net accrued carry last quarter. That's largely in as it related to upstream production as opposed to investments in portfolios that are currently producing and also we have new stakes that we're looking to do in renewables. So, obviously that's not really been affected there. But just the — we have both a good downward movement, 11% over the last 12 months in natural resources. But it all comes back to kind of where various things are in their respective carry waterfalls you can get kind of outsized returns. But that's for the math is.

Chris Kotowski
Analyst, Oppenheimer & Co., Inc.

Okay. All right. Thank you. That's it for me.

Operator: Thank you. And I am showing no further questions in the queue at this time. So I'd like to turn the call back to Daniel Harris for any closing remarks.

Daniel F. Harris
Managing Director & Head-Public Investor Relations, The Carlyle Group LP

Thank you for your time and attention this morning. If you do have any follow up questions feel free to call Investor Relations after the call. We look forward to talking to you next quarter.

Operator: Ladies and gentlemen this concludes today's conference call. Thank you for participating. You may now disconnect.