13-Feb-2018

The Carlyle Group LP (CG)

Credit Suisse Financial Services Forum

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CORPORATE PARTICIPANTS

David M. Rubenstein
Co-Founder & Co-Executive Chairman, The Carlyle Group LP

MANAGEMENT DISCUSSION SECTION

Unverified Participant

Hello, everyone. Our next speaker needs no introduction. David Rubenstein is the Co-Executive Chairman and Founder of The Carlyle Group, which he founded in 1987 with his partners. Unlike many of his private equity colleagues, David worked in government before starting Carlyle with Bill Conway. This included the President Carter Administration in the late-1970s and early-1980s.

Last year, David and Bill passed the Co-CEO titles to Kewsong Lee and Glenn Youngkin, but far from hanging out the golf course, David is still highly active with the firm and also hosts a TV show on Bloomberg called Peer-to-Peer Conversation. Given all the investing in new digital technologies in the industry, maybe next year, we could have a hologram of robot interview David of himself.

With that, let me hand the presentation over to David. David, thank you very much.

David M. Rubenstein

Co-Founder & Co-Executive Chairman, The Carlyle Group LP

Thank you very much. So how many people here actually are investors in private equity stocks, anybody? Okay. How many people have never invested in private equity stocks? Okay. How many people want to invest more in private equity stocks? Okay. How many people think that private equity firms should convert to C-corps? How many people think they shouldn't? Okay. How many people here actually think I should be playing golf? Actually, I don't play golf. And this is the reason. If you have a meeting with somebody and you think that they're going to think you're intelligent and confident, if I went out on the golf course, I would destroy the illusion of confidence. So I decided to just stick to miniature golf where I'm actually pretty good, but -.

Okay. So let me try to do this. I'm going to try to go through two things before we have questions. First is, where the industry is generally, private equity industry and private alternatives industry, and then where Carlyle is. So let me try to cover these subjects in about 20 minutes or so, and then we have time for questions, okay?

So this chart in the end is probably the most important chart even though it's the first chart, usually it builds up to the crescendo, but this is the most important chart about private equity. In the end, private equity is a business that more or less started, let's say, in the late-1960s and now continuing, and it's flourishing quite nicely now. Why is that? It's obviously not because of the charm and good looks of the founders of these private equity firms. It's really because in the end if you take a look at the rates of return that private equity firms have generated for their investors, they have been only average, depending – you can play many different games with the numbers, but on average roughly 600 basis points higher than public market equities.

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So, if you were to think about this, over the last 10 years, 20 years, 30 years or so, 35 years, if you were to be on an average private equity fund, you would outperform an average public equity fund by roughly 600 basis points. Now, everybody doesn't want to be in an average private equity fund, everybody want to be in a top quartile fund. And the top quartile funds, it outperformed by anywhere from 1,500 basis points to 2,000 basis points or sometimes 2,500 basis points. But if you're in an average fund, you're going to outperform, and these are the 20-year numbers, but the 10-year numbers, 5-year numbers are roughly the same. And that's why the industry has grown. The outperformance is just consistently better than public equities.

And you can see this is reflected in the amount of assets under management here. This is the aggregate amount of capital that's been raised in private equity each year. And you can see, it's been fairly steady and today you've got several trillion dollars in private equity dollars under management and in terms of money in the ground and money that's dry powder. This is fairly consistent. When I started Carlyle in [ph] late (00:04:12) 1987, there were probably $2 billion or $3 billion at all in private equity around the world. Now, you can see, these are the numbers being raised each year.

And you can see that general partners are raising bigger and bigger funds than their expectations. So look at this chart and this might be hard to figure out, but essentially what it's saying is that about half the funds being raised by private equity people now are being raised at above the numbers on their cover, so the amount that they were expected to raise. You can say the cover numbers were a little bit low, but the truth is, you put numbers on a cover that you hope you'd be able to reach, but you're not sure you can do it. But more than half the funds, more or less now that are being raised are being raised at numbers in excess of the cover number, which shows you there's lot of interest in private equity.

And this is a chart – it shows you the expectations of what investors were getting out of their private equity fund. So what this shows you on the right-hand side is, roughly 95% of investors are satisfied with or their expectations exceeded what they thought would happen. In other words, if you look at – and you asked the investors are you happy with, satisfied with or did the returns exceed what you thought, 95% of those investors in private equity funds are saying it exceeded or it equaled what they thought. And obviously, that's not the same in public equities. So, people are pretty happy with the performance.

Realizations have continued to drive fundraising. There's been an incredible sale of assets through the large private equity funds and all private equity funds over the last couple of years. And you can see, while the numbers are getting close to evening out, in 2017, the amount of money that's been realized has been quite staggering. So you can take a look at 2015, $427 billion, it was exited in the year 2016 roughly $340 billion, last year $348 billion. So, these are very significant numbers. And you can see a fair amount of money has been deployed. Up until last four, five years or so, more money has actually been exited, returned to investors than actually invested. I just expect there'll be a crossover at some point, maybe this year, where more money will actually be invested than will be exited.

Now, where's those money coming from? Well, we'll talk about that in a moment. But U.S. pension funds are particularly eager for the high rates of return. Why is that? Well, U.S. public pension funds are great things for people that are beneficiaries of them. But honestly, most of these funds, with very few exceptions, are underfunded and underfunded by dramatic amounts. And you can see here that the underfunding is quite significant. So, we take a look at state and local funds, they are underfunded by roughly a third. In other words, the average state and local pension fund has roughly two-thirds of the money needed to honor its commitments.

Now, you can change this by several ways. You can cut the benefits [ph] the beneficiary is (00:07:06) going to get, well, that's not that popular, you can increase the contributions, that's not that popular. So, what do politicians

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do? Well, they say to the pension fund managers, get higher rates of return. And what do they do? Well, the highest rate of return is going to come from private equity generally. So people have dramatically been increasing their private equity rate, private equity allocations, and I expect that trend will continue.

So where will all those money be put to work? Well, private capital is still much smaller than public equity. Public equities is much bigger, but private equity is gaining in size, was not going to overtake public equities anytime soon. But you can see that the amount of increase in allocations is fairly significant. So, this is based on a survey of where people expect to put their money. And you can see that the people who want to increase their allocations to private equity is fairly significant, private debt even more significant. But how many people want to increase their commitments to public equities? Generally, it's not so high. These are the categories where you can see people are really interested in probably mostly increasing their allocations.

Private credit is booming. Now, everybody knows what private equity is. I assume everybody knows what private credit is, but let me explain for those who may not be that familiar. Private equity is a phrase that we use in the United States that is – really the way I like to use it is, it subsumes venture capital buyouts, other types of private investments, though outside the United States the word private equity is synonymous with buyouts. But let's suppose – I'll use it for this case, private equity is synonymous with all private investments where you've got some kind of equity participation. Private credit is a relatively new business. Private equity has been around for 40 years or so.

Private credit really didn't develop in any significant way until after the last recession. And in the Great Recession, people went and bought a lot of debt at discounts and it yielded high returns, enormously high returns, spectacular returns, sometimes higher than private equity returns. And therefore, people began to say, well, this is probably not a bad business, we're getting a fixed income return, we're getting a better part of the capital structure and we're getting some equity upside appreciation. So, the business began to boom and you can see now that by the year 2000, this number was probably just a few billion, relatively speaking. Now you can see it, in 2017, roughly about $600 billion has been committed to private equity – private credit, and that I suspect will continue. Private credit will probably continue to be growing at a much faster rate than private equity, only because private equity is relatively big and private credit is still a fraction of the size of private equity.

Now, private capital is doing different things than it used to do, and one of the reasons is this. It used to be the case that you had roughly 7,322, in this case, of companies that were publicly traded, 7,000 publicly traded companies in NASDAQ or New York Stock Exchange in the United States. Today, you have roughly half that. So you have half as many companies that are public, therefore, there's half as many companies that are available for people who want to buy public equities. That is a big difference between what we saw when I started Carlyle when public equities was a much bigger part of the capital structure than it is today.

One of the reasons is that you don't need to really go public any more to get capital. And this lesson was learned in many different ways. But I think Facebook was a good example of it. When Facebook was privately owned, you may recall that people were buying and selling shares in Facebook before it went public, and people actually went out and bought shares in Facebook from existing holders, typically employees or some of the early investors at a $50 billion valuation. The last time I think they did a private round was at $50 billion. Now, nobody had ever thought that you could buy private equity at a private company wasn't yet public at a $50 billion valuation, but people who did that made staggering sums of the money because it's now worth so much more.

So the lesson that was taken away is that you can buy stakes in private companies, you can trade them, you can make good returns on them and you don't need to take the company public. And so many of the managers of

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these companies have been reluctant to take these companies public and [indiscernible] (00:11:24) the public company, so people have been delaying going public for quite some time.

And you can see here – well, it used to be the case that, that a company that went public was basically eight years old. Today, the companies that are going public are older, 11.5 years. And some of the best known companies in the United States are privately traded and are not clear when they're going to go public, some of these so-called unicorns in Silicon Valley among other places. The number of companies though continues to grow. I said there are roughly half as many companies that are publicly traded as there were, let's say, in 1997. 20 years ago, there were roughly half as – twice as many publicly traded companies as today.

But there are more companies than there were 20 years ago. You can see here, we now have in the United States companies with 20 or more employees roughly 600,000. So that means that we're growing the number of companies, we're just not growing them as publicly traded companies. And you can see on the right-hand side here that roughly 7,000 companies in the United States have private equity dollars invested in them.

So, what does that mean? That means that there is more opportunities to invest private equity dollars because there aren't as many publicly traded companies to compete with. Also, more and more companies are willing to take private equity dollars and therefore you now have something unheard of -let's say, when in 1987 when I started Carlyle, 7,000 companies are now getting private equity dollars in one form or another.

So, what this really means is that private equity is not a mature business, it's still growing in my view, and I think the view people [ph] who have (00:12:49) studied it. Why will it grow? These are the reasons why I think private equity issue will continue to grow. Investors are more interested in this than ever before. One, because they need the higher rates of return in the case of public pension fund, that is true of individual and high net worth investors, they want the higher rates of return.

Private equity firms are different than they used to be. It used to be the case in, let's say, the 1980s that private equity firms would lever up a company, they would borrow 95% of the purchase price, they put in only 5% equity, they would depend on U.S. GDP growth to be 4%, they'd be buying things with 5 times cash flow, while you can sit on the beach and make a fair amount of money with that kind of leverage and that kind of macroeconomic growth and that kind of purchase prices.

Today, prices are much higher, now leverage is much less, and so for private equity firms to earn the kind of money they want to earn for their investors and themselves, they really need to add value. So, all these large private equity firms and the medium size ones have added enormous amount of operating talent that really add value. So, people don't hire as much investment bankers as they used to, they hire operating people, and a lot of these people in Carlyle is a good example. We have large numbers of people who have operating experience, CEO experience, and these people are really adding a lot of the value for what we do when we buy a company.

Private credit investments will continue to grow. I think at some point they will equal the amount of private equity investments. Right now, private credit is probably one-sixth the size of private equity overall, but it will ultimately grow to a point where it's equal to the size of private equity in my view and I think that's in part because private credit has a higher position of the capital structure, gives you current yield, and there is some equity appreciation, and people who want current yield find private credit to be much more attractive than traditional fixed income.

Emerging market opportunities, think about this, 83% of all the private equity dollars invested every year, roughly 83% go to the so-called developed markets, which is Western Europe, United States, Canada, Australia, and Japan, more or less New Zealand as well, that's therefore 83%. So only 17% is going to the emerging markets,

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China, India, Brazil, they're only getting 17% of the private equity dollars, only 1% of private equity dollars goes to Africa, a continent with 800 million people only has 1% of private equity dollars, that fairly is going to change. Right now, the emerging markets, if you measure by purchase price parity, have 55% of the world's GDP yet they're only getting 17% of the private equity dollars. So there is more opportunities in emerging markets, and you'll see over the next couple of years, more and more private equity dollars going there.

Well, what happened there? Number five skipped. I missed it, pushed the wrong button, I don't know. It was edited out. All right. Number six – number five, if somebody can guess what number five is? So private equity is widely accepted as an asset class today. When Carlyle was started, when Blackstone was started, when KKR was started, people did not really think that private equity was part – was mainstream, they kind of thought these are people [ph] off those site (00:15:53). They were really not doing the kind of things you might expect, they might be shipping jobs offshore or maybe they weren't paying attention to environmental concerns or other ESG concerns. That's all changed and private equity is accepted as an asset class today and is in a way that wasn't before. So nobody is afraid to say that they're an associate of private equity. You see major CEOs retiring from major companies. Now they're joining private equity firms. It's not the case – it wasn't the case 20 years ago, 25 years ago. People who are current CEOs are not embarrassed to say, I'm selling an asset to a private equity firm. That might have been the case 20 or 30 years ago. Today, private equity is accepted as an asset class, and I think it's probably still called an alternative, it's really mainstream today.

Number five, okay. Longer term funds, now private equity historically is a business where you might hold on to an asset four years to six years. Sometimes if you were long term, you might hold on seven years or eight years, but very often it'll be held on for seven years or eight years because you couldn't exit earlier. Today, people like longer term funds and they intentionally want people to hold on these funds for longer period of time. Why is that? Well, if you're a large sovereign wealth fund and you have enormous amounts of money deployed, if I give you – I am a sovereign wealth fund, I give a private equity fund money, they have to – and they return to me in four years, I have to figure out what to do with that money in next year or two before I can redeploy it. And so you just can't immediately redeploy the money in another private equity fund, and so therefore you have a drag.

Now one of the brilliant things of private equity, this is the secret of private equity to some extent, one of the brilliant things that private equity founders did, not me, but other people is this, we measure the internal rate of return from the day that money is invested, not when it's committed, from the day it's invested, not when it's committed. So – but some groups when you see IRR numbers, they're basically the time the money was invested, not committed, but some large pension funds, large investors, say, well, I understand that's how you conventionally measure these things, but if I have $1 billion and I give you $1 billion and I get back $2 billion and I don't get to redeploy it for a long time, I have a lower rate of return than you're telling me. Or stated another way, if you tell me you've got a 30% rate of return on my $1 billion, that's great, but every time you give me money back, I have to deploy it in cash or keep it in cash and that overall balance does not give me 30%, I have a lot in cash while I'm waiting for you to call the money down. When you give me the money back, I'm waiting for it to redeploy and I'm actually getting a lower rate of return.

So there are some investors who say, what I really want is a long-dated fund where I can have money invested for 10 years or so, and by doing that I don't have to worry about putting money back in cash. So, you can see more of that occurring.

Investors are continuing to deploy capital through the asset class, much with the higher expected rates of return. This just shows you that investors in a survey think that private equity is going to have much higher rates of return than any other asset class going forward, the lower rates of return than we've historically done, but still higher than anything else.

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Sovereign wealth funds are growing their allocation to private equity. You can see that in the year 2020, it's expected that sovereign wealth funds will have roughly $10 trillion. Now that number, $10 trillion, is sovereign wealth funds, it's not national pension funds. National pension funds are – you add to that number, it would be even far bigger, probably almost twice as big, because some of the sovereign wealth funds – some of the national pension funds invest like sovereign wealth funds, but they're not technically sovereign wealth funds or national pension funds. So, these are enormous numbers, and these people are – these funds are allocating you can see increasingly higher amounts of money to private equity.

And then even so, some of the large sovereign wealth funds and national pension funds have not yet put in that much money in the private equity. So, for example, famously the Norwegian fund has not really put anything of any consequence in private equity, the 2.5%, I think, it's in real estate actually. So I think in the end you're going to see some of these gigantic pension funds like this – like the National Pension Fund of Japan has just said they're going to put 5% into private equity. They haven't yet done it. But there is staggering amount of money that'll ultimately come into private equity. So you're seeing more and more money coming in from these sovereign wealth funds and national pension funds.

The beneficiaries of a lot of this are the large private equity firms that are publicly traded, typically the large private equity firms. It sounds self-serving, but you can see this. If you take the large – the largest 20 private equity funds some of which are publicly traded, some of which are not, they're getting roughly 40-some-percent, a little bit more than 40% of all the private equity dollars. And why is that? Well, if you're a sovereign wealth fund or you're a large pension fund, it might be nice to find three guys in a garage in Palo Alto who can get a quadruple on their $25 million that they might invest in some venture deal, but if you have to deploy billions of dollars, assuming that a couple of guys in a garage in Palo Alto isn't going to help you very much. [ph] You need people who (00:20:33) can deploy billions and billions of dollars and typically these larger firms can do it. So you're seeing more and more of the money invested as a percentage going into these larger firms.

So why is Carlyle well-positioned to take advantage of all these phenomenon? Well, for those who haven't obsessed over who Carlyle is or what Carlyle is, it's a firm that was started in 1987. I was one of the founders of the firm. Today, this is a firm that now manages about $195 billion in assets, you can see here in four different asset groups and the different sizes of AUM. So we basically manage each of these in a coordinated way but they're separate teams with 650 investment professionals managing this money.

Last year, we had – we realized proceeds for our investors in our funds, about $26 billion. We raised $43 billion, which was a record annual raise for us. We invested $22 billion and our carry funds appreciated, these are the main buyout private equity kind of funds, real estate funds. The carry funds appreciated at 20%. So those are four good indicators of how the firm is in pretty good shape. I'll go through each of these in a moment, but these are the main points I'd just like to convey and let me just do it separately this way.

The strong investment performance is driving acceleration in accrued carry. Our accrued carry is growing and it's growing because we are – we have very good appreciation in our funds. You can see, we had 20% appreciation in our overall funds last year, 32% in corporate private equity. And as those who aren't familiar with this, when your funds appreciate and they're doing well, that doesn't necessarily mean you exit. You have more accrued carry and at a certain point of time when the fund is mature enough, you will take that carry and realize it, but our carry is – our accrued carry is increasing and I think it will continue to increase dramatically.

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Each of our funds has been performing well. These are main fund categories. I won't go through all the numbers, these charts are available to you. But, you can see that all of our big funds are performing well and because of that we're likely to get more and more accrued carry and opening more net performance fees.

Carlyle is growing to fund sizes. So every – we have a lot of our big funds in the market now, our U.S. buyout fund, our Asian buyout fund, our European buyout fund. Each of these funds is going to be roughly 40% larger than their predecessor fund. So when we have these larger funds, we're probably going to deploy more capital and probably earn more fees, ultimately have more accrued carry. And I suspect the next generation on top of the one we're now raising will be above this one by another 30%. So Carlyle's business is one where people are increasingly giving us more money, we're investing it reasonably well and the result is more and more accrued carry and more and more net performance fees.

Our ability to deploy the capital, I think, is important, and we – as I say, we deployed $22 billion last year, we have 650 investment professionals doing it. There may be more [ph] investment factors of some (00:23:24) comparable firm, I'm not sure of it. We have an enormous number of people. Because we really think to get these high rates of return, it takes a lot of talent, and we're pretty pleased with the talent we have. And we suspect we'll be able to deploy this increased capital that we're getting relatively well, because we have a very large investment team already.

Some of you may know that we announced a while ago that we wanted to raise $100 billion over a four year period of time. We're very much on track to do that. We've already – last year, we raised $43 billion. So we've raised $57 billion of that projected $100 billion and are very, very comfortable that we'll get to a $100 billion and may exceed it.

Where is this money coming from? Well, you can see the geographic areas we're getting. Probably about half our money is coming from the Americas, half from Europe and the Middle East – I'm sorry, quarter from the Europe and the Middle East, and quarter from Asia-Pacific.

The bottom left is an interesting chart, 62% of our capital comes from investors who are in 10 or more of our funds. So cross-selling is sometimes a word that is used to exaggeration, maybe people can cross some, maybe they can't. But we've found that, when you like one Carlyle fund, you tend to like another one, you tend to like another. So again, 62% of our money, more than half comes from people in 10 or more of our funds.

And you can see here, the public source – the main source of our capital like comparable firms or sovereign wealth funds, public pension funds, and now increasingly high net worth individuals. Carlyle has not been the leader in fee-related earnings. When we built the firm, we built it to focus on distribution to our investors. We increasingly recognize that people that buy publicly traded shares of private equity firms want more and more fee-related earnings for a lot of reasons, and so Carlyle is working much harder to do that. We expect it'll be, by the end of this quarter – end of this year at a run rate of $300 million of fee-related earnings a year.

In other words, we'll probably have about $75 million of fee-related earnings in the fourth quarter, and we think that will give us a run rate of roughly $300 million, which well exceeds what we did in 2017. So we will see a much higher fee-related earnings in a very consistent basis in our view.

Our global credit business is very important to us. We have about $33 billion of AUM now but it's in our view much smaller than our private equity and much smaller than it can be. So, we brought in a man named Mark Jenkins, who ran the credit business for Canadian Pension Plan previously at Goldman. He has done a spectacular job of thinking what we have and building on it. And we expect to see a lot more funds raised in this area. And areas

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we're not currently in, we have a lot of white space in the credit area and we expect to fill out that white space in the coming years.

So to conclude, Carlyle is in pretty good shape. The firm has very good momentum in fund raising, very good track record in investing, very good ability to see a capital appreciation in the funds that we have, and very good accrued carry performance. So for all these reasons, I think, the firm is in excellent shape and we're very excited about our prospects for 2018.

With that, let me sit down and take some questions.

QUESTION AND ANSWER SECTION

Q

And guys I'll start with the first one, but if you have any questions, please feel free to raise your hand after we're done. So first on initiatives. You mentioned on the earnings call that there is a lot of whitespace in the global credit that you're exploring. What other areas would Carlyle like to have a presence in that you're not in today?

David M. Rubenstein
Co-Founder & Co-Executive Chairman, The Carlyle Group LP

A

Well, the credit areas that we're in, we're in direct lending but at a relatively modest size compared to where we want to be. So we do have two BDC vehicles. We expect we'll expand our direct credit business. We are in the process of expanding our opportunistic credit business; we're raising a fund for that. We'll probably expand in the real estate credit, infrastructure credit where we're not in currently. So those are number of areas. We don't have as many different vehicles there as we do in private equity, so we have a lot of different areas we can fill out. But, I would say, real estate credit, infrastructure credit, more direct lending, bigger opportunistic credit vehicles are probably what we'll see the most in that area.

Q

Got it. I'm going to throw out a second one here on the transition. I think it's comforting to the markets to gain new visibility into your succession plan with a decision to appoint both Kew and Glenn as co-CEOs, what factors led you to select both of these individuals and what do you think makes them good long-term managers for the business?

David M. Rubenstein
Co-Founder & Co-Executive Chairman, The Carlyle Group LP

A

Okay. For those who aren't familiar with this transition, the two co-CEOs, Bill Conway and I, who are two of the co-founders of [ph] Dave Rubenstein and Dan D'Aniello (00:27:55), we transitioned as of January 1. Dan D'Aniello was the Chairman of the firm, he's now the Chairman Emeritus still. Conway and I were the co-CEOs, we're now the co-executive Chairs. And Bill retains the title co-CIO. So we picked three individuals really to help us with the transition. One is Glenn Youngkin, he has been with the firm for about 23 years, He had been in our European buyout business, he'd been our President and COO for many years. He knows the firm inside out, he's a culture carrier, he will spend a lot of time on our energy business, on our real assets business, and on our solutions business, and also dealing with unitholders and with investors.

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Kewsong Lee has been with us for about four-and-a-half years, five years, he's been 23 years at Warburg Pincus, has an incredible track record as an investor, was the deputy to Bill as CIO for the five years he was at Carlyle. He has more of an investment focus in private equity, he'll oversee private equity business and our private credit business as well. So the two of them work together quite well, they have complementary skills, and we think that it will be a very strong combination, they're younger than Bill and I.

Bill and I are now 68 years old, which I used to think was old. Now, I think it's more of a younger age than I thought many years ago. When I worked in the White House for Jimmy Carter, we wanted to run against Ronald Reagan, who was then 69 years old, and I said, how can anybody 69 years old run for President, he's probably ready for a nursing home. Today at 68, 69 seems younger. But, we do recognize that when you have a six behind your age category, people look at you differently, Kew and Glenn are late 40s, early 50s and I think they've got a much longer runway ahead of them. And so we thought it was appropriate to do the transition.

God obviously looks favorably upon the private equity founders because they don't get killed off early. So there is a tendency private equity founders maybe stay a little bit longer in some cases maybe than they should or maybe than they really want to. In our case, we didn't want to stay any longer than we thought was appropriate and we thought it was appropriate to step back now. But we're still involved, we're still doing some things to help the firm in many ways and we're the largest shareholder. But the day to day operations of firm are now transitioned to a younger generation.

Q

Got it. Any questions from the audience? Mark?

Q

[indiscernible] (00:30:05-00:30:20)

David M. Rubenstein
Co-Founder & Co-Executive Chairman, The Carlyle Group LP

A

The hurdles in private and emerging markets...

Q

Yeah.

David M. Rubenstein
Co-Founder & Co-Executive Chairman, The Carlyle Group LP

A

Well, there are several hurdles in emerging market private equity. If you go back over the last 10 years, 15 years and 20 years and look at emerging market private equity rates of return, they're roughly identical to developed market rates of return. So if their returns are roughly identical why take the risk and why deal with all the aggravation factors. So you have to get over the hurdle that's not worth the time and the effort. And I think it will change as the emerging markets continue to grow but they become more sophisticated about private equity. So you get higher growth rates in these countries but you – and probably still lower prices, but probably some of the problems of the emerging market investing may go away, the principal problems are there are very few managers

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relative to what you have in the developed markets; two, it's harder to get debt when you need debt for a leverage deal; three, there is much more accounting problems let's say, there is much more corruption let's say. And I'd say the ability to exit when you want to exit is not as great as in the developed markets.

So I think there is some challenges in the emerging markets. But again that's where the greatest growth is in the world. The greatest population in the world is in emerging markets, greatest growth rates in the world is really in the emerging market. So if you're not going to be in the emerging markets, I think your ability to grow as a firm is going to be very reduced.

Q

[indiscernible] (00:31:32-00:31:47)

David M. Rubenstein
Co-Founder & Co-Executive Chairman, The Carlyle Group LP
A

I am sorry. The question was? [ph] Tom (00:31:50), can you repeat it?

Q

[indiscernible] (00:31:51)

David M. Rubenstein
Co-Founder & Co-Executive Chairman, The Carlyle Group LP
A

Right.

Q

[indiscernible] (00:31:55)

David M. Rubenstein
Co-Founder & Co-Executive Chairman, The Carlyle Group LP
A

By the industry or by us?

Q

The industry.

David M. Rubenstein
Co-Founder & Co-Executive Chairman, The Carlyle Group LP
A

Okay.

Q

[indiscernible] (00:32:01)

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David M. Rubenstein
Co-Founder & Co-Executive Chairman, The Carlyle Group LP

A

I don't think so, and this is the reason. In Carlyle's case, and we're maybe typical, roughly 95% of the money we've raised in carry funds over the years we've actually invested. I think investors want you to invest the money but they want you to invest it in reasonably good time. So right now a lot of money is being invested and committed to these funds, but people recognize that the money is probably going to be deployed when we have some economic slowdown and prices come down, and that's probably when the best rates of return are going to occur.

In addition, you typically have five years to invest the money but you can get extensions if necessary. So I think most of the money typically that is committed to private equity funds is invested. I think in our case, as I say, 95%, so I'm not that worried about it and never. We've had very good economic growth for the last six, seven, eight years. At some point, I don't know when, there will be a slowdown. And when there is a slowdown, it could be two or three years, I'm not predicting when it will be, but when it does occur, I think prices will come down and you'll see a lot of the capital that's on the sideline coming in and buying things at discounted rates.

Q

[indiscernible] (00:33:10)

Q

[Question Inaudible] (00:33:14)

David M. Rubenstein
Co-Founder & Co-Executive Chairman, The Carlyle Group LP

A

Well, why don't you come to the mic, sorry. Here we got a mic, one.

Q

Hi, yeah. Why are more companies choosing to stay private? You said that the number was up at 7,000 and it's twice...

[indiscernible] (00:33:22)

David M. Rubenstein
Co-Founder & Co-Executive Chairman, The Carlyle Group LP

A

Yeah. Why did they choose to stay private?

Q

Yeah. Why? Is it cost – is it cost or is it really to do with regulatory issues and when does the pendulum swing again?

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David M. Rubenstein
Co-Founder & Co-Executive Chairman, The Carlyle Group LP

A

Well, I'd say, there are a couple of reasons. One, dealing with analysts who care about quarterly earnings is not as pleasurable as people in this room might think. Two, there is a focus on short termism versus long termism. There is a focus on current earnings versus growing the business. And there are very few CEOs who have the courage to do what Jeff Bezos did, which is to ignore all the analysts who told him, hey, your company is going nowhere, and you're not making any money, you don't know what you're doing. Well, who had the last laugh? So, I think very few CEOs have that kind of courage. So, I think there's a concern about quarterly earnings and short termism.

Secondly, the regulatory burden is considerable. If you go public, you're going to have to add an enormous number of additional people for compliance-related reasons and other kinds of concerns. Third, there's no need to go public in many cases because you can get the capital and stay private. In other words, I was trying to illustrate earlier the Facebook example, it used to be you needed to go public to get capital to grow the firm and to give the existing shareholders and the employees some – really the – get liquidity, you don't need to do that anymore. You can get – you can sell your private shares to private equity firms or other people. The managers typically can sell theirs as well if they want. The early investors can sell theirs. And there's no theory or there's no need really to go public to get the liquidity that you really once needed. And also, you often don't need capital, often people went public to get capital, but now you don't need to do it. So, I don't think the pendulum will swing right away. I think it might swing in a couple of years if the regulatory burden goes down, and there's less concern about short-term earnings, but I think it's only years away.

Q

Any last questions, we have time for one more.

David M. Rubenstein
Co-Founder & Co-Executive Chairman, The Carlyle Group LP

A

There's one more here. Front row.

Q

Yes, I'm [ph] Tom Burgeon with OPM listed private equity and mutual fund (00:35:33). Could you give us some comments about increasing interest rates? People seem to be a bit nervous when the interest rates go up. And maybe also you can add some comments about your financing costs. The margins are higher even though the rates are lower.

David M. Rubenstein
Co-Founder & Co-Executive Chairman, The Carlyle Group LP

A

Well, I wish I could tell you for sure I knew where interest rates are going to go. Years ago I hired a young man, very talented guy, named Jay Powell. He worked at Carlyle for a number of years, and I never thought he would be Chairman of the Federal Reserve Board, but obviously a very talented person. I have no special insights on what he's going to do, and he is – probably I'm kind of the last person he's going to talk to because he worked at our firm for a number of years.

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But I suspect that he will probably increase interest rates a few times this year, but not probably as many – as were predicted four months ago. I think four months ago, five months ago, people thought you'd see four 25 basis point increases this year, I suspect you'll see less than four this year. And I don't – but I don't really have any special insights. I do think interest rates are still much lower than they were when I was in government. And I still think that the ability to get credit is very good. It used to be you can get credit only from banks, now the banks are not the most significant source of credit. Hedge funds, other private vehicles, private equity firms, other people can give you credit. And therefore, I don't think that the cost of credit is that high because there is so much competition, and I just don't see any credit crunch coming anytime soon.

Any questions?

Q

Yes. One more. I was hoping for a comment that private equity can still make money even though the interest rates go up a bit.

David M. Rubenstein
Co-Founder & Co-Executive Chairman, The Carlyle Group LP

A

So, it was a leading question or a – okay, a rhetorical question. All right. Private equity firms may – people shouldn't worry about private equity firms didn't know how to make money. The people that are in these private equity firms, they're aligned with the investors. They generally have figured out how to make money when interest rates are high and when interest rates are low. Remember, there were – when interest rates were high, private equity firms were doing extremely well also. When interest rates are high, two things happen: one, you tend to use less leverage; and I might remind everybody, that the leverage is less important to private equity than it used to be. In the early days of private equity, people borrowed 95% of the purchase price it they didn't borrow 99%. Today, you might be borrowing 50%. So you're using it less than before and therefore it's not as important. And a large percentage of deals today have no leverage at all. They're minority stake transaction. Most of the deals done in emerging markets are a minority stake transaction, increasing their larger percentage in the United States are minority stake transaction were no leverage at all.

But if you are using leverage to buy a company and you're competing against people that are using leverage, basically you're going to wind up paying a lower price. So I think if leverage costs go up, people are just going to pay a lower price to get the return they want. So I don't think it's a big problem. Now, if all of a sudden there was no credit available and you couldn't borrow anything at all, a lot of these deals couldn't get done perhaps they're leverage buyout deals, but I don't see that happening right now. There's so much credit out there, I can't see it drying up any time soon. [ph] Steve (00:38:47)?

Q

[Question Inaudible] (00:38:48)

David M. Rubenstein
Co-Founder & Co-Executive Chairman, The Carlyle Group LP

A

Yes. Well, I lost the bet. I thought I wouldn't get asked that question. Okay. I think all of the private equity firms are spending a lot of time and money trying to figure out what the right thing to do is. In our case, we have said in our last quarterly earnings call that we studied it and at the current times we don't have a current plan to convert.

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However, things can change, markets can change, lot of other factors can change. I suspect that as long as the tax laws are where they are today on carried interest and so forth – and the law just changed a little bit, but it still maintains carried interest taxation – I think that conversion is a more challenging thing then if carried interest went away completely.

If carried interest taxation, as we know it today, went away, then I think it would be easier. But assuming this law change stays where it is today, I suspect that some people will convert and some will not. And it really gets down to whether people buy your stock are going to be happy that they're going to have more money taxed away than given to them for them to figure out how to deal with taxes. And I just don't think anybody knows. If you told me the stock market was going to say the private equity firms are converted, the stock will go up 100% because of that because you got a much bigger investor base, I suspect they will all convert. But nobody knows whether [ph] you're going to go by (00:40:14) 100%, 50%, 20% or no percent. So I think you'll see this mode unfold very gradually one at a time and people will see how the first one goes. And then the first one goes well and then a second one might fail, but I don't think you're going to see anybody – all the private equity firms doing it at the same time or anytime very, very soon.

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With that, I think we're out of time and out of question.

David M. Rubenstein

Co-Founder & Co-Executive Chairman, The Carlyle Group LP

All right. Thank you all very much.

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