

## **BLACKSTONE Fourth Quarter and Full Year 2016 Earnings Investor Call**

January 26, 2017 at 11:00 a.m. ET

**Weston Tucker:** Good morning and welcome to Blackstone's Fourth Quarter 2016 Conference Call. I am joined today by Steve Schwarzman, Chairman and CEO; Tony James, President and Chief Operating Officer; Michael Chae, our Chief Financial Officer; and Joan Solotar, Head of Multi-Asset Investing as well as External Relations. Earlier this morning, we issued a press release and slide presentation of our results, which are available on our website. We expect to file our 10-K report later next month.

I'd like to remind you that today's call may include forward looking statements which are uncertain and outside of the firm's control and may differ from actual results materially. We do not undertake any duty to update these statements. For a discussion of some of the risks that could affect the firm's results please see the Risk Factor section of our 10-K. We will also refer to non-GAAP measures on this call and you'll find reconciliations in the press release on the Shareholders' page of our website. Also note that nothing on this call constitutes an offer to sell or a solicitation of an offer to purchase and interest in any Blackstone fund. This audio cast is copyrighted material of Blackstone and may not be duplicated without consent.

So a quick recap of our results. We reported GAAP net income of \$770 million for the fourth quarter and \$2.2 billion for the full year, up 95 percent and 38 percent respectively from the prior year comparable periods. Economic Net Income or ENI per unit was \$.68 for the fourth quarter and \$2.00 for the full year, both of which were up materially from the prior year periods due to greater appreciation across the funds. Distributable earnings per unit were \$.55 for the quarter and \$1.78 for the full year. We declared a distribution of \$.47 per common unit to be paid to holders of record as of February 6th and that brings to \$1.52 paid out with respect to 2016.

With that I'll now turn the call over to Steve.

**Steve Schwarzman:** Good morning and thank you for joining our call. Blackstone closed 2016 with strong fourth quarter results as Weston just mentioned and powerful momentum heading into 2017. Fourth quarter revenue and Economic Net Income rose by 79 percent and 86 percent respectively. For the full year revenue reached \$5.1 billion while ENI rose to \$2.4 million – both up 11 percent as compared to only slight earnings growth for the broader market. We generated full year cash earnings of \$2.2 billion and continue to pay very healthy distribution to our unit holders. In fact, over the past 3 years Blackstone has actually distributed over \$8 billion in value to our unit holders which is more than any other public firm in our industry – no one close. And we remain one of the highest yielding equity securities of any large company in the world.

We've delivered these good results during what was really an unprecedented period for markets and active managers in particular. Last year, January marked the worst start to a year for equities in history. Then came the Brexit Referendum and its subsequent violent fallout across many asset classes, and then of course the unexpected US Presidential

election. The fact that the S&P ended up 9.5 percent on the year with positive momentum and surging investment confidence in fact is the highest confidence level in 15 years is really extraordinary. Needless to say many active managers didn't participate in this 9.5 percent gain. Looking beyond markets investors, businesses, governments, and individuals around the world are trying to access the scope and potential impacts of new US policy in many areas including tax reform, a variety of new trade initiatives, immigration issues, deregulation and debottlenecking across the board, healthcare changes, energy policy, infrastructure proposals, and a more pro-growth posture towards our financial institutions.

I've spent a great deal of time recently traveling and meeting with different heads of state and business and political leaders around the world who are looking for insights into the new administration. It's clear there's a good deal of anxiety both inside and outside the country around potential changes in US policy. The major changes that are underway are designed to create significantly higher GDP growth in the United States targeting a rate of growth as high as double the average of the past eight years. Higher growth should drive higher employment and wages as well as greater labor force participation. And we believe this will also extend the business cycle.

And against a better growth backdrop in the United States – the largest market in the world – there should be opportunities for everyone to benefit. The stock market is clearly anticipating a lot of fundamental pro-business reform which I don't think is unreasonable. So we could see a prolonged continuation for current bull market in equities. How does all this impact Blackstone, our investors, and our unit holders? While we don't have all the answers, I'm quite optimistic about our prospects. The largest determinate of our fund returns is our ability to grow the cash flows of our assets which of course benefit in an environment of better economic growth.

And while we've invested much to develop our global capabilities, Blackstone is still today predominately a US-focused company and I expect we will see greater capital inflows and more opportunities to have realizations as international capital is attracted to the United States. By the same token, after the new reform agenda is implemented we could see a divergence between winners and losers in the United States which we're extremely well-positioned to anticipate. Similarly we could see greater opportunities outside the country as values and markets go through an adjustment period.

The benefits of our business model are well-highlighted in this type of environment. We're able to move quickly to deploy capital in scale when opportunities arise and then hold assets through periods of volatility to achieve the optimal outcome. The result over the long term is material outperformance against any relevant measure. Not necessarily every quarter or year, but across business cycles.

Taking the long view at Blackstone has helped us deliver to our investors out performance versus the S&P in private equity of approximately 700 basis points per year after fees, over nearly 30 years. In real estate that outperformance is 900 basis points per year after fees, versus the Real Estate Index over 25 years. Our patient capital and large

dry powder – it's about \$100 billion now – benefits our investors over time. And there are many examples of how this works to ultimately create the great track record I've just described.

For example following the Brexit referendum last June there was a period when markets seized up and transaction activity stalled. We were able to acquire attractively priced assets from sellers needing to fund redemptions, if you'll remember that. In our private equity energy are we were patient and waited on the sidelines through most of the turbulent 2015 for oil prices to settle, selling basically nothing. When pricing looked like it has bottomed early last year we became active purchasers closing or committing to 8 oil and gas investments for a total of close to \$3 billion.

Simultaneously we took advantage of record low interest rates to sell power assets at a significant profit. We also issued a one percent bond – the lowest rate I believe that was obtained in the European financial markets denominated in Euros. Oil prices obviously have risen very sharply since we put out this \$3 billion. And our 2011 and 2015 dedicated private equity energy funds have generated returns from its inception of 13 percent and 36 percent respectively despite the carnage that occurred in the energy markets during this period.

In late 2015, when interest rate returns caused RIET stocks to trade off sharply we moved quickly to acquire both Strategic Hotels and Biomed for a combined \$15 billion as they were suddenly trading below the value of what we thought their high quality underlying real estate was worth. In barely one year, these two investments have already delivered early results that are terrific. We sold most of Strategic's assets at a significant profit and we've sold or have contract to sell non-core assets representing 30 percent of Biomed with sustained healthy fundamentals across the remaining portfolio.

The list of these types of things goes on and on and this is how investing works at Blackstone, driving outperformance. Plus it's a lot of fun to work here. Our track engine provides the growth engine of the firm, combined with a high degree of entrepreneurialism which helps us figure out what new businesses to enter. We're always looking to pioneer innovative new product areas that take advantage of shifts in the market. The outcome of this market of multi-decade record of providing great solutions for our LPs who in turn are happy and want to give us more money, including for new strategies, is a wonderful way to run a business.

We apply a tremendous standard of care when launching new businesses with a strict focus on protecting capital. And that's why our LPs are willing to give us large-scale capital even for new things, like Tactical Opportunities – our new fund of the last few years – which is now up to \$17 billion in assets under management. Our real estate Core-Plus, which in a few years has gotten to \$14 billion. And Strategic Partners, which does our secondaries, is now over \$20 billion, more than double the size of the platform when we acquired it three years ago.

We are fiercely protective of what the Blackstone brand means to our clients and try to only launch products that we think will be truly great. The result is best in class fundraising for basically any period of time you want to look at. We continue to diversify our sources of capital including bringing our institutional quality solutions to the retail high net worth area and family office channels. We built out this effort carefully with the focus on maintaining a terrific experience for the end investor. Besides developing the distribution channel itself we're also designing customized products for these investors.

The early results as Tony mentioned on the earlier call speak for themselves with 15 to 20 percent of Blackstone's total capital raised now coming from retail. And I have great expectations for our ability to continue growing this initiative across each our investment platforms and around the world.

In conclusions, looking forward, I envision excellent prospects for the next several years for our firm and for our limited partners. Our business is flexible and responsive to changing dynamics which is ideal for the period we're entering. For our unit holders we're coming off a period of record fundraising, significant investment activity, and have a powerful, near term earnings trajectory which Michael Chae will describe to you in more detail. Thanks a lot for investing with us and now Michael.

**Michael Chae:** Thanks, Steve and good morning everyone. Our fourth quarter results represented a strong finish to the year with positive trends in revenue, Economic Net Income, distributable earnings and AUM. We achieved positive sequential growth in every one of these metrics each quarter of 2016 with all reaching their best level of the year in the fourth quarter. And that momentum has clearly continued into 2017. Total ENI nearly doubled in the quarter to \$812 million, our best performance in 7 quarters as performance fees and investment income surged in every business. ENI for the full year rose 11 percent to \$2.4 billion as Steve said.

Fee earning AUM rose 13 percent to a record \$277 billion. Total AUM rose 9 percent to \$367 billion with every business up sequentially and year over year. We saw \$17 billion of gross inflows in the quarter and \$70 billion for the year – our second best year ever despite not having our private equity or real estate flagship funds in the market in 2016. That brings us to nearly \$220 billion of gross inflows for the past three years, entirely organic, which is more than the total size of any of our peers.

Fee related earnings for the full year rose 7 percent to exceed \$1 billion despite the spin of our advisory business as well as the 6 month fee holiday for our \$19 billion BCP VII fund. FRE margin expanded nearly 350 basis points to 40 percent, a firm record for an annual period, driven by several factors: the spinoff of the lower margin advisory business, the strong incremental margins on our added AUM, and active management of our cost structure as reflected in our historically low fee comp ratio.

In addition we received a benefit to FRE in the fourth quarter from favorable FX effects in our treasury with the Euro's movement in the quarter being advantageous in relation to our Euro denominated bond liabilities which included what in retrospect was a quite

well-timed September issuance of a one percent Euro bond. Adjusting for that benefit and also the advisory spinoff, our underlying 2016 FRE growth was in the low double digit level. And we expect to remain on this organic growth trajectory moving into 2017. Distributable Earnings were a healthy \$692 million for the quarter and \$2.2 billion for the full year, good annual performance, but down from record 2015 levels as higher FRE were offset by lower realized carry due mostly to the sequencing of realizations in our BCP buy fund that I covered on recent calls.

I'll share a positive update on this in a moment but first I'd like to review some highlights for each business, starting with real estate. Real estate's fourth quarter was a continuation of recent trends of stable operating fundamentals, active deployments totaling \$4 billion, and significant realizations of \$3.5 billion. The carrying value of our opportunistic funds rose nearly 5 percent in the quarter – your best performance of the year – while Core-plus was up 2 percent. For the full year both were up about 11 percent.

As you know the story of this business has been sustained outperformance leading to global expansion and diversification into new areas at scale. Starting with one single global fund 25 years ago we're now on our 5th dedicated Europe fund currently at \$7 billion which launched its investment period in December. We'll likely start raising our second dedicated Asia fund this year on the heels of a successful first Asia fund. Our real estate debt business has evolved from an initiative to acquire oversold loans during the crisis to a \$14 billion platform of mezzanine, liquid CMBS, the commercial mortgage REIT, Blackstone Mortgage Trust, and most recently a new high grade product. And our Core-plus business is up to \$14 billion and should begin contributing realized cash incentive fees in the fourth quarter of this year.

All of this together has driven real estate's and total AUM up 9 percent year over year to a record \$102 billion with an increasing mix of continuously raised permanent or quasi-permanent AUM. We've achieved this growth despite several years in a row of sustained very large scale realizations: \$18 billion in 2016 and \$58 billion over the past three years. And we think the outlook for continued strong realizations is very good. In credit, GSO had a standout year in 2016 with fourth quarter gross returns of 4.7 percent for our performing credit strategies and 6.4 percent for distressed bringing them to 22.6 percent and 17.5 percent respectively for 2016.

Performance was driven by continued appreciation of energy investments as well as a distressed and event driven debt positions across funds. Global demand for GSO's products continues unabated driving the highest inflows of the firm both the quarter and the year. GSO's fourth quarter inflows of over \$8 billion included \$2.9 billion for our mezzanine strategy that positions us with one of the very largest pools of mezzanine capital in the world.

And 5 new CLOs totaling \$2.6 billion bringing us to \$4.8 billion raised this year, and ranks us as the largest global CLO issuer for the fourth year in a row. Total AUM in GSO rose a stunning 18 percent this year to \$93 billion. GSO also had its strongest deployment

quarter in the year with \$1.4 billion invested and another \$1.7 billion of pending deals as of year-end most of which had closed in the first quarter.

In hedge fund solutions BAAM's composite gross return was up 2.3 percent in the quarter, 5.3 percent in the past 6 months, and 6.7 percent for the past 9 months – an excellent recovery since the challenging start to 2016. I'll take a moment to put BAAM's 2016 performance in perspective by providing a breakdown of the key drivers of performance. The performance issue principally resided in one strategy: long/short equities in one quarter – the first quarter – where a perfect storm of factors greatly pressured performance in this area.

Indeed relative to a full year composite gross return of 3.5 percent for BAAM overall our performance outside long/short equities across eight other strategies was 7.5 percent for the full year. Furthermore within long/short equities when pressure was focused in the first quarter with returns of positive 5.2 percent for the last nine months of the year. And on a relative basis BAAM continues to outperform its direct competition. For the year we outperformed various fund-to-funds competitive sets by approximately 250 to 500 basis points.

Following these last three consecutive quarters of positive returns, 78 percent of BAAM's incentive fee eligible AUM was back above the high water mark at year-end up from 67 percent on September 30<sup>th</sup>. In the end 2016 revenues and economic income for BAAM were basically stable with 2015 notwithstanding the turbulence. And similarly our gross inflows of \$10.8 billion marked the third straight year of inflows at or around an \$11 billion level, reflecting continued strong demand for BAAM's products that reinforces our leadership position as the largest allocator in capital in the hedge fund area in the world.

Moving to private equity, our corporate private equity funds appreciated 4.5 percent in the quarter and 11 percent on the year. As with real estate the fourth capped the year of steady sequential improvement in investment returns throughout the year. Total deployment for the private equity segment rose to \$2.5 billion in the fourth quarter, the highest of the year, with an additional \$3.1 billion currently committed but not yet invested. We have never been better positioned with multiple fund platforms and greater firepower in corporate private equities than now with our \$28 million in committed capital across BCP VII, our second energy fund, and our new core private equity vehicle.

Three significant deals to which we have recently committed are great illustrations of the distinctive ways we leverage our unique capabilities across these three different fund platforms to find value in a tricky environment. First, in the energy area we recently partnered with Sanchez Energy in a \$2.3 billion transaction to acquire Anadarko's interest and assets in the Eagle Ford Basin in Texas. This was a highly complex deal involving both our private equity and our credit businesses where collectively we and our partners at Sanchez developed a partnership structure and financing solution that worked for all parties to enable the deal. It's a great illustration of the breadth and synergies

among Blackstone's investment platforms. And we believe no single firm in the market other than us could've made this happen by itself.

Second in the fourth quarter BCP VII agreed to acquire TeamHealth, a leading healthcare services provider which we previously and very successfully owned for eight years in our BCP IV fund. BCP VII's scale and our deep knowledge and experience with the company gave us the unique ability to expeditiously assess and execute a \$6 billion public to private transaction. We expect to close this deal in the first quarter.

Finally, our agreement at year-end to acquire Sesac, a leading music rights company, represents the first investment in our core private equity strategy designed to pursue investments in high quality stable franchises on a very long term hold basis. Our core private equity strategy alongside our real estate core-plus business now together represent nearly \$20 billion of capital for the firm in long duration fund strategies. We view this area as a major recently developed strategic dimension to our product set, an excellent reflection of our ability to innovate at scale, and expect these strategies to drive a large, growing, and sticky stream of recurring long term earnings for unit holders.

Finally on private equity, as discussed on prior calls BCP V sales have for the most part not been converting into distributable earnings for much of 2016 due to an interim shortfall to preferred return on a realized basis produced mainly by the sales of some lower multiple of investment capital – or MOIC – longer hold large positions. To put some numbers around that prior to 2016 our BCP V realizations had an aggregate MOIC up around 2.1 times. In 2016 our BCP V realizations had an aggregate MOIC of 1.3 times. Looking forward our remaining public positions which comprise approximately 75 percent of the remaining BCP V portfolio and are liquidating have MOIC of 2.7 times.

So you could call this something of an air pocket that we hit for a few quarters in 2016 and generating realized carry for a fund that remains overall in a substantial unrealized net carry receivable position. We said previously that we expected this to resolve in early 2017. And I'm pleased to say that in fact based on sales already closed at this point this year we've closed out that shortfall in BCP V and are back into generating realized carry in the fund. That's a good segue to the final topic, the overall outlook for distributable earnings, which is very positive.

As discussed previously we expect continued healthy growth in FRE with key drivers including a full year of full BCP VII management fees in 2017, the onset of full management fees from the fifth Europe fund after its fee holiday ends in April, and the ongoing scaling of other funds that earn fees as invested. With respect to realizations our pipelines are strong. We expect to remain very active and importantly we start the year with great momentum in terms of DE from sales that are effectively locked in. Specifically we currently have \$8.7 billion in realization under contract, or already closed in January, that are expected to drive over \$700 million or over \$.60 per unit in distributable earnings – most of which we expect to close in the first quarter.

These sales include the Hilton Stake sale, transactions involving Change Healthcare, Optiv, Pactera, and our Japan residential portfolio among others, and a number of significant public stock sales that have already been completed just in the first few weeks of the quarter. So from where we sit in January we see a very strong trajectory in terms of DE and cash distributions to our unit holders for the year.

In closing overall we would underscore two themes: momentum and positioning. We finished 2016 and have entered 2017 with a feeling of great momentum across nearly every dimension of our business and from a financial point of view for the firm. And as Steve discussed we believe we are extraordinarily well-positioned to understand the dynamic landscape and external environment and take advantage of the opportunities it will create. With that we thank you for joining the call and would like to open it up now for questions.

**Operator:** Ladies and gentlemen if you'd like to ask an audio question please press star 1 on your phone. If your question has been answered or you'd like to withdraw your question press star 2. Your first question comes from Glenn Schorr from Evercore. Please proceed sir.

**Glenn Schorr:** Hi, thanks very much. First a non-fund question. I'm curious, Steve you chaired the Strategic and Policy Forum for the new administration. I'm just curious on how that differs from your current role and how you chair the firm and where it takes you – how demanding on your time and what types of things you're advising on.

**Steve Schwarzman:** Well actually my wife has asked me the same question, because you know you just pack more stuff in and you sleep less. It's a very interesting type of position to have because you touch a lot of people in the administration. And you know the whole administration is in a startup phase. And as you know most of the cabinet heads aren't even confirmed yet. So there's a startup element of it where in terms of my role which is I'm not a member of the administration. I'm chairing a committee. I'm like a full-time person at Blackstone that's getting sort of sucked into a lot of interesting things that are happening.

Because as I said in my remarks a lot of people around the world are sort of observing all these changes that seem to come out every day and are looking for some type of interpretation of what that means or might mean. And so that's created I think a short term bubble for me to do a lot of stuff. But I don't think that'll continue at the same level for a sustained period of time once they stand up all the cabinet heads. We will have regular meetings with the President and it's supposed to be every month. And so that's a very interesting thing in a rapidly changing environment.

But my full-time job is at Blackstone and I'm shoehorning all this other stuff in. And one other thing – I mean you have to recognize Blackstone is a really terrific place. And I'm just like one person. I happened to lead off this call but that's a little illusionary. And at every place at the firm, led by Tony, it's really an extraordinary place. I'm still reading every memo. I'm doing all that stuff and eventually I'll go back to a more normal life.



**Glenn Schorr:** I appreciate that. I can't wait to see what basketball player you compare the President to. Okay so I heard the fee-related earning guidance. But I'm curious on outlook for fundraising. You mentioned the second best fundraising ever despite having the flagship private equity and real estate funds not in the market. Can we just talk a little bit more on the outlook for fundraising? I know Strategic Partners just closed, new Asia-focused real estate fund but I guess I'm just looking for a little bit more color on how big and which of any of the flagship funds come to market.

**Tony James:** Glenn, it's Tony. I think it's a mistake to focus too much on the flagship funds. We have such a diverse pallet of funds right now all of which are pretty big actually. Plus we have a lot of new initiatives in the pipeline. I think without any new initiatives we'd be slightly less than in 2016 but still a very good year for fundraising. But it doesn't take too many of the new initiatives we're looking at to push this up to be a comparable year.

**Glenn Schorr:** And of the core funds, how do we think about how often they open for new rounds?

**Tony James:** Generally speaking if they're a drawdown fund it's every three to four years. But increasingly we've got funds that are open all the time, taking in money every month.

**Michael Chae:** So when you talk about – Glenn it's Michael – core – in terms of core-plus real estate that is basically always taking in money as Tony said. Core private equity operates a little bit more like a classic drawdown fund in terms of episodic fund raising.

**Glenn Schorr:** The last point I wanted is on core real estate. I think you mentioned in the past that \$100 billion potential market. I mean your growth has been great. Is there anything there you've seen that would dissuade us from thinking the size of the market isn't as you've described in the past.

**Tony James:** I think Steve's goals are the same.

**Glenn Schorr:** All right, thanks very much.

**Steve Schwarzman:** I think Tony just spoke for me.

**Weston Tucker:** I just want to remind everybody, we've got a pretty full queue so if we could just on the first round limit it to one question and one follow on just to make sure we get through everybody, that would be great.

**Operator:** Your next question comes from Craig Siegenthaler from Credit Suisse. Please proceed.

**Craig Siegenthaler:** Thanks, good morning. The infrastructure segment could represent a very large profit opportunity for Blackstone and it's you know a logical extension of some of the teams and products you're managing now. I'm just wondering are there any plans to raise funds in the infrastructure space? And you know what are you working on there now?

**Tony James:** Well Craig as you point out it's a logical target and it's something we've been looking at for a while. I'm not going to give you any idea of timing but yes there are plans to add funds in that space.

**Craig Siegenthaler:** Got it. And then just as my follow up on retail can you kind of circle back and remind us what you're doing across retail, how the liquid alt product is doing, any new products you've launched there? Because you know that's actually a big space you guys can tackle. And that would be helpful.

**Joan Solotar:** Sure Craig, I'll take that. So basically the distribution systems that we're targeting have investable assets collectively of over \$10 trillion. So I would say we're very early in penetrating those. Retail, high net worth assets today are about 17 percent of the total. And it's a mix of the liquid, perpetual products, as well as the drawdown. So if you were to segment it through the major wire houses you're really focused on QPs – Qualified Purchasers – who could really buy anything, although we have daily liquidity products on those platforms as well.

We're entering the independent broker dealer channel which is just as large in assets. But there it's really more accredited investors and going down to dollar one. So you'd have a mix that would be less drawdown and more perpetual offerings if you will. And then we also have you know family office, et cetera, which is more of an institutional type sale. So I would say you know the mix partly depends on which funds Blackstone on the drawdown side happens to be offering in that year. But I think you'll see a growing number in the more liquid perpetual fund space as we're entering these new systems and developing more product.

And then just finally I think one of the most interesting things that we do is also weave together different funds that we already have to create bespoke solutions for these different channels. And I think you'll see more of that coming over the next 12 months.

**Steve Schwarzman:** One thing I'd say – this is Steve – at the risk of prolonging this answer is that you know in life you have to have a dream. And one of the dreams is our desire and the market's need to have more access at retail to alternative asset products. As I said in my prepared remarks if you look at those returns, those are really stunning. And at the moment a lot of people are not allowed to put those into retirement vehicles and other types. And one of the interesting issues when you have a new government is whether they want to continue that type of prohibition or not.

Because what it's doing is denying people sort of a better retirement, and if there's a change in that area that becomes a huge opportunity for the firm. We already have lots of

whitespace that Joan was talking about. So we're not defective in terms of things to do every day to increase sort of penetration but there is an ability for something to get changed that could be really, really impactful. And we'll see what happens with that.

**Craig Siegenthaler:** Thank you Steve.

**Westson Tucker:** Operator next question please.

**Operator:** Your next question comes from Devin Ryan from JMP Securities. Please proceed.

**Devin Ryan:** Thanks. Good morning everyone. Maybe just one starting here on taxes. One of your peers had mentioned a 20 percent corporate tax rate and a 33 percent personal tax rate is a level that would make the economics to them essentially a wash for converting to a C corp. I'm just curious if you guys are looking at – I'm sure examining what's happening in DC. Are you thinking about levels where – at least from an economic perspective – it would seem to be a wash, and just how you're kind of more broadly thinking about that topic right now given all the changes occurring.

**Michael Chae:** Hey Devin this is Michael. Look I'd say obviously no proposal has been on the table around taxes. We're studying it and I think have a good positioning to understand how it will unfold. And we're going to watch what happens. We'll be open-minded. We're not religious about a structure. We want to basically pursue a structure and have a structure that's in the best interests, and maximizes value for our shareholders. So we go into this as students of what will happen. And we'll see.

**Devin Ryan:** Got it, okay. That's helpful. I figured I'd ask. And then with respect to the CLO business and five new CLOs in the quarter – some nice growth there – I'm just curious what's driving that and the outlook. That just seemed a little bit elevated to me.

**Michael Chae:** Well actually for GSO you know as I mentioned they've been the leader for almost half a decade. And that volume of I think nine issuances throughout the year and it picked up in the fourth quarter I think just reinforces their leadership position both in the US and Europe. And so you know we certainly see – we've had a long term success record – like 20 years almost, our team in the CLO area. The returns have been terrific and performance has been terrific. And it's actually we think been a good market moment and opportunity for the economics of those vehicles. So I think it's really a reinforcement of momentum and that business for us that's continued for a long time.

**Devin Ryan:** Great, okay thanks guys.

**Operator:** Your next question comes from Michael Cypress from Morgan Stanley. Please proceed.

**Michael Cypress:** Hi, good morning. Thanks for taking the question. I'm just curious if you could talk a little bit about where you're underwriting new investments today across

your business, just in terms of return expectations, exit multiples, exit cap rates, and just how that's evolved over the past few months as the market has gotten a little bit more optimistic on growth and resting rates.

**Tony James:** Okay well we don't try to – we don't try to take current short term markets, overweight those in our exit multiples. So we tend to look in all of our business what's a normalized kind of exit multiple for a cap rate environment and financing environment for when we exit. You know we're in the illiquid business so we make an investment now. We're having to guess what the conditions will be five years from now. And obviously there's always reversion to the mean. So frankly it doesn't change much with the quarter's good markets. And in terms of our base of returns as I said before they haven't changed much either.

We have capital that we invest for the cycle. We won't sort of lower our returns because interest rates are down typically. We might get less active if there's not much to do and get more active when there's a lot to do. But we try to keep our returns pretty stable and deliver to our LPs results consistent with what we've delivered to them in the past across all the funds.

**Michael Cypress:** Okay then let me ask a little follow up there just to talk on that point. In terms of exit multiples or exit cap rates, are you baking in any sort of expansion of cap rates or multiples on the back end upon exit? How are you thinking about that as you're underwriting today?

**Tony James:** Well so you know with respect to cap rates in real estate, we've always baked in and continue to higher cap rates. And in this world with respect to multiples we're baking in lower multiples on the private equity side – as we have been.

**Michael Cypress:** Got it, so no change there.

**Tony James:** Right.

**Michael Cypress:** Super, thanks.

**Operator:** Your next question comes from Alex Blostein from Goldman Sachs. Please proceed.

**Alex Blostein:** Hey everybody, good morning. A question around – back to the tax situation. So lots of questions around interest expense deductibility. I'm wondering if you guys could either – as you think about the change here, how would you peg the probability of this making its way to the final sort of proposal? And I guess broader I understand there are a lot of moving pieces, but how do you guys think about that impacting the IRRs and the private equity and real estate businesses for you if that were to happen?

**Steve Schwarzman:** I think – and Tony did a really good job with this on our earlier media call. These proposals really can't be unbundled because the way they're being looked at in the Congress is an integrated approach whether it's the order adjustable tax and the lack of ability to deduct interest. But you get 100 percent write-off immediately on capital assets. And you also get a much lower tax rate. So if you bake all these things together net-net it's a neutral to positive for the way we look at what we've heard would be considered. On the other hand this is such a monumental set of changes from a tax perspective and the way we look at, you know, the system. This would be the biggest tax reform in certainly 75 years – maybe 100.

So it all fits together and it's meant to fit together, not to just take one piece out and say well this is unfavorable. You have to look at it all which is the way the people who are putting the law together are looking at it. On the other hand you have to get a law passed. And this is not the easiest lift with all these new concepts. You know my guess is that you'll get it out of the House because it's got enormous momentum in the House. But then you have to go through the Senate which is not nearly as up-to-date on what's going to be coming at them. And then you have to go to conference and make it work.

So you know it's a lot on the table, a lot that has to happen. But if the package as people describe it – even though it hasn't been introduced, so it's basically backstage whispering – gets through, then this stuff all really balances out for a firm like ours and maybe a net positive depending upon where the tax rate – the corporate tax rate finishes.

**Tony James:** Yeah I might just add a couple of color things for you think about. With a typical private equity deal, often we get an asset step up which gives us a higher tax basis which we depreciate which allows us actually to have tax shelter anyway away from the interest for a while – number one. Number two, debt is still cheaper than equity. You know we're looking at equity returns pre-tax sort of 20 percent-ish growth. Debt's a lot cheaper than that so there will still be ability to use your debt to capture that arbitrage. And number three, if some of the things going on are enacted into law you could argue that other things being equal interest rates should come down.

If you come down corporations will issue less debt and yet there will still be the demand on the part of investors for yield securities. And you could also argue that corporate debt will now be taxable at a much lower rate. So it will be more appealing as an investment class. So there are a lot of things playing through here that are hard to predict. But as Steve said the way we look at the package of things that are being put on the table collectively is it's probably net beneficial for our portfolio to some degree.

**Alex Blostein:** Got it. Thanks for that answer. And quick follow up for Michael around core-plus real estate. I think you mentioned that some of that money becomes eligible for carry in Q4 of '17. Can you just remind us based on – I think you said \$14 billion in total AUM you have in that product now – kind of how the stack works over the next couple of years – how much becomes eligible for carry? And I think the carry feels almost like recurring because then it gets based on like the absolute yield level in the portfolio.

**Michael Chae:** Yeah Alex, so the basic thing to keep in mind is that the carry feature begins on the third anniversary of when the capital was taken in from the investor. So in the fourth quarter of this year that's when that first group of investors from what will then have been three years ago are sort of eligible for that. And so what will follow is sort of rolling thing where as the money has been raised over the last few years it will become eligible for that feature. And it will smooth out over time. But as we've talked about in the past that is a very powerful feature of that fund for us.

**Tony James:** Yeah but I want to note it is very much recurring. A, we don't have to sell the asset. It's done on a mark basis. So it's not as lumpy as the other kinds of DE you think about. It's just based on the mark. And B, since it's investor by investor and since we're taking investors in each quarter you'll be getting this every quarter. And as the business matures and as it accumulates it'll become smoother and smoother and smoother. And so you'll expect – you know, we view this as very much recurring income. And it'll be reflected in our recurring income.

**Alex Blostein:** Yep, makes sense. Thanks very much.

**Operator:** Your next question comes from William Katz from Citigroup. Please proceed.

**Jack Keeler:** Hi, thanks for taking the question. This is Jack Keeler filling in for Bill. Just a quick question on hedge fund solutions, obviously you've seen strong growth and better returns than peers in this space. But many – whether it's funds of funds or hedge funds themselves have seen fee pressure as well as outflows. Can you just kind of comment on why you think that you're more resilient than they've been and how that might project going forward both for you and the industry at large?

**Tony James:** Yeah, okay Jack. Well first of all we're using our scale to actually lower the fees that we pay to the underlying managers as much as we possibly can. I think we've been actually one of the leaders in that. You know our goal and ideally what I'd love to do is have our volume discount – because we're so much larger than anyone else in terms of allocating to hedge funds – sufficient to offset all of our fees. And you know maybe we'll get there. We're getting pretty close actually. I think that you know this is an asset class where there's been a lot of press about. Michael talked about you've really got to break it down into different strategies.

We're seeing no diminution whatsoever in investor appetites. As Michael said we're still raising the same amount of money we have in the last few years. And it's an asset class that will underperform in bull markets because it's hedged. And what investors get is they get less volatility. Less volatility means of course protection on the downside. But it also means you don't fully participate on the upside. So you'd expect this product to lag in the kind of bull market certainly we've had in the last few months. But a lot of investors look at the markets today and say they're pretty fully valued. And how do they play equities through the cycle with less risk? How do they protect against the downside that may be embedded with sort of the market prices where they are? This looks pretty good to them.

**Joan Solotar:** And if I could just add, in terms of BAAM-specific positioning you know if you're looking to have a hedge fund piece in your portfolio their performance relative to peers is really quite strong. And as investors have looked to reduce the number of managers not just in hedge funds but frankly in a lot of asset classes we continue to be a beneficiary of that. And so they've continued to gain quite a lot of market share.

**Jack Keeler:** Great, thanks for taking my question.

**Operator:** Your next question comes from Mike Carrier from Bank of America. Please proceed.

**Mike Carrier:** Alright thanks a lot. Michael, maybe a first question just on the DE outlook you guys have said in the past that over time you kind of expect a range of maybe \$1.00 to \$3.00 on the distribution side or the DE side. It seems like you gave some guidance on 1Q and things that have closed. FRE looks – it's set to continue to have some momentum even after the FX benefit this quarter. And I guess when you think about the net accrued or the seasoned capital the outlook there particularly at the capital markets are favorable. I just wanted to get a sense of where are we maybe in this range that \$1.00 to \$3.00 – if the trends continue in your favor?

**Michael Chae:** Thanks Mike. There's a lot in that question. I can't quite talk you through our whole model as part of this answer but look I think first of all the \$1.00 to \$3.00 range that you mentioned – we should put a fine point on that. The low end of that range is basically anchored on sort of – what's the FRE? – which is under contract for a long, long time. And it's not really I would say a real world low end of what we think our DE will be in the absence of some period of time which is really, really unusual. So let me just anchor on that. That \$1.00 is meant to be a really positive thing about one component of our DE that really is a great foundation for everything else that comes from it from realizations.

I think in terms of how to think about the trajectory outlook I talked about how you know if you look at the last few years of DE what was obviously notable about 2016 was while we've had pretty good growth realizations – actually even close to line with 2015 – the conversion particularly in the corporate private equity or because of the BCP V issue I mentioned was lower. And I talked about why we think just mathematically in terms of structure of funds this is the year we'll come out of that. And that's a good thing. And then in terms of that realization pipeline we feel good about it but we'll see what the year brings.

There is good momentum. There are a lot of things you can look at about focusing on our sort of invested capital base and how it's seasoning. Our invested capital base on our drawdown funds has basically tripled in the last six years. And that's obviously – that's are the seeds and the crops for future harvests. Another thing to think about is we're sort of – even though some of these older funds like BCP V and BREP VI have been the gift that keeps on giving and there's still more to go. There are for example the 2011 vintage funds – BCP VI, BREP VII, BEP I – which are really I think coming into their own as

well. I think there is something like \$33 billion of unrealized value in those funds. I think the average ownership period for that capital was like three years in terms of the unrealized amount. And you know how our business works. Three year old investments on average are just coming into their own in terms of potential monetization events, IPOs which will set up subsequent years of harvest, et cetera. So all those things come together and we feel very good about the outlook.

**Mike Carrier:** That's helpful. And just as a follow up you guys mentioned a lot on the policy change whether it's taxes, you know improving economic growth and what that means for the portfolio companies. Just in terms of maybe fundraising opportunities with potential changes – does anything stick out? Tony you've spent a ton of time on the retirement space and what potentially could change or what the opportunity could be for you guys or for others in the industry.

**Tony James:** Well I think Steve hit on it in his comments. The really big, vast, vast untapped territory is the \$27 trillion that's in 401Ks that we as an industry don't sell anything into. And I would say that severely penalizes 401K savers because they earn typically 2 to 3 percent on their money. There isn't a pension fund in America that hasn't earned more than 6 and their targets today are about 7 on average going forward. So you can see the cost if you will of forcing investors into short term, daily mark to market, daily liquidity, liquid stuff. And if we could open up those pools of capital to our kind of investing I can assure you that retiring Americans will be vastly better off both short term and long term.

**Mike Carrier:** Okay, thanks a lot.

**Operator:** Your next question comes from Brian Bedell from Deutsche Bank. Please proceed.

**Brian Bedell:** Great, thanks very much. Maybe just to piggy back on that last question. It makes a lot of sense to be able to have longer illiquid in 401Ks if restrictions were such that you wouldn't sell them. And how do you think you would go about influencing that policy? I mean I guess do you think there's a chance that you can do that with the new administration?

**Tony James:** Well you know this has been a bit of a crusade for me over the last 18 months. And you know we have a plan, that all the details of which may not survive. But one of the core premises of that is that people's retirement savings have to work harder for them. And the beauty of that is you're enhancing peoples' retirement security without taxing anyone higher, without creating new government welfare programs, and that capital – which is now available to be invested in the economy and longer lived assets like infrastructure – will be good for economic growth as well.

So we've obviously spent a lot – I've spent a lot of time with both Republicans and Democrats on this. And I've got an awful lot of favorable reactions from both sides of the aisle. So I'm hopeful that we can make some progress on this with the new



administration. And one of the things that Speaker Ryan has highlighted in his A Better Way is that we need to come up with something – a plan – to help Americans' retirement security. As you might know Speaker Ryan's A Better Way is a very detailed policy proscription. But on this issue he's highlighted the need without the policy. So we're hopeful that we can get in front of him and give him some thoughts that will help address the issue. And certainly investing better is the easiest, cheapest, most painless way to get that done.

**Brian Bedell:** Okay, that makes sense. And maybe just while we're on the topic of the new administration maybe Steve and/or Tony your view – you have been very patient in the energy arena. With some of the changes that are beginning to happen in the new administration, how does this impact your view on energy deployment? And then I guess while we're at it deployment the US and maybe the context of global trade.

**Tony James:** Well okay it's obviously a more favorable environment in the US for energy exploration and transportation. That should pull costs down in the United States– and barriers down – and encourage development. So I think the way think of this playing out is you'll have more production although more production probably puts a lid on prices in the United States. And you probably saw yesterday a spokesman for BP came out and said that we're never going to see \$100 oil again because there's a lot more oil out in the world than we thought and more of it is being produced both from technology advances, regulatory reform like in the United States, but also big countries in the Middle East being able to produce and get on the global markets again.

And their view is that over time demand tapers down. Over a long time demand tapers down due to renewables and whatnot and changes in transportation technology. So that they think that that demand will mean that we don't have the kind of \$100 oil that we had before. I'm not so sure about that myself. I know they're kind of – they've been saying that before. They're kind of a little bit out there on that. And most industry observers wouldn't actually agree with them. But one thing that we do know is there's a lot of oil in unstable parts of the world and any geopolitical risk can cause a spike at any time. But I think the effects on energy of the new administration are net good for the US energy industry.

**Brian Bedell:** And on the deployment opportunities outside the US with the viewpoint of the new administration?

**Tony James:** Well we've been deploying capital outside of the United States around the world. I don't think we're looking at a terribly different picture there frankly.

**Steve Schwarzman:** Well it depends what happens with all these changes. You know if the dollar gets a lot stronger and you know trade changes a bit it could put pressure on individual companies outside the United States and also on individual countries you know that particularly have dollar borrowings. So there may be interesting valuation changes which can provide opportunities for our firm to buy businesses at different prices which you know may end up going through an adjustment period where if you're in at the

right time that could be very interesting. So you have to look at US and then also non-US as a function of some of these really big macro trends.

**Brian Bedell:** You would, say, be a little more patient say in the near to intermediate terms to see how this shakes out?

**Steve Schwarzman:** I don't have an answer for that today.

**Brian Bedell:** Okay, no worries. Thanks so much for all the color.

**Operator:** Your next question comes from the lines of **Jerry O'Hara**. Please proceed.

**Jerry O'Hara:** Great, just a quick one on BCP V as it sort of transitions into carry or both the preferred thresholds. How should we think about the potential for catch up management fees or performance fees I suppose going forward and the runway around that – I guess for Michael?

**Michael Chae:** Yeah I mean it's sort of – back into cash carry. We sort of think about it as stepping back into the shoes of the sort of catch up position we've been in for a while now. And so I think last quarter you know we were – that stat we used being 64 percent through the catch up this quarter. We're something like 69 percent. You know we talked about half of the LPs being in full carry and about half not. So that basic situation stays the same. There's not a structural change in there.

**Jerry Ohara:** Okay thank you. And could you just remind us the size of Europe V that's coming online I guess April 1st? I'm just trying to get a sense about what kind of sizing base management fees now that BCP VII is off holiday and Europe V I guess will be also coming off in 2017.

**Westson Tucker:** Yeah Jerry we've raised about \$7 billion US for the fifth Europe fund and about \$5.5 billion or \$6 billion of that will be under fee holiday until April.

**Jerry Ohara:** Okay great. Thanks for taking my questions.

**Operator:** Your next question comes from Chris Shutler from William Blair. Please proceed.

**Chris Shutler:** Hey guys, good afternoon. Just one quick one on the topic of new initiatives; you already talked about infrastructure which I know you're not putting a timeline on but what other business segments should we expect to see some innovation from in the near term? And is fair to think that the things you're considering are more FRE centric? Thanks.

**Tony James:** Oh boy, I'd have to inventory that but I would say – let's define this by A, investment category, B, target market, and C, structure. In target market you'll see more from retail investors in some of the new segments that Joan talked about. And many of

those will have more permanent capital structures. Some of them are always open. But some of them will also be things where we actually don't really redeem. There are other ways investors can get exit. BDC for example is a good example of that where people put in and then ultimately it's floated as a public entity and it keeps its AUM indefinitely. With respect to new categories one of the other areas we're looking at is more growth oriented investing, earlier stage stuff. I think we have some interesting ideas on that. We're not ready to come public with those yet but that's an area that we've been also studying for a couple of years now and playing around.

And then you know just even businesses like our strategic products investment we started off with one private equity secondaries business. It now has real estate secondaries, there's infrastructure secondaries. It's got a primaries business. It'll be looking at emerging managers and some other things. So in every one of our businesses you'll see that kind of innovation and new categories growing. Although from your sort of financial model of the firm standpoint it'll be a while before they get big enough where you're talking about \$7 billion to \$10 billion to where you need to start changing your models.

**Chris Shutler:** Okay, thanks Tony.

**Operator:** I would now like to turn it over to Weston Tucker for closing remarks.

**Weston Tucker:** Okay, great. Thanks everyone for your time today and we look forward to following up after the call.