BLACKSTONE First Quarter 2018 Earnings Media Call
April 19, 2018 at 9:30 a.m. ET

Christine Anderson: Good morning. Thanks, Joyce. Thanks, everyone, for joining our 2018 first quarter earnings call for the media. With me today is Tony James, Blackstone's executive vice chairman, Jon Gray, our president and chief operating officer, Michael Chae, chief financial officer, and Joan Solotar, head of private wealth solutions and external relations. This quarter, Jon will step in to help us summarize the highlights from the quarter, and then we'll be happy to take your questions.

Before I hand it over to Jon, I'll remind you that we will refer to non-GAAP measures on this call. For reconciliations, you should refer to the press release, which is available in the shareholders' section of our website. Today's call may also 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. Please see the risk factors section of our 10K for a discussion of risks that may affect our results. As always, there's a shareholder call later today at 11:00 AM. Dial in details are in the press release and on our website. I'd encourage you to listen to that call, and if you have any other questions, please give myself or any member of the team a call. Thanks so much. Jon?

Jon Gray: Thank you, Christine. Good morning, everybody. I'm excited to join my first Blackstone press call. I will try to keep things lively, like Tony, but he is a tough act to follow.

I know many of you. I look forward to getting to know you better. My goal is to be as helpful as possible, providing insights on our business and the environment we face.

Before jumping in, a little background on me and some thoughts on the firm. I have a super boring biography. I've been here for 26 years, straight out of college. I started in our private equity area, and then I joined our fledgling real estate business. I joined the management committee ten years ago, our board six years ago, and I spent the last three years working closely with Steve and Tony, understanding the key issues across the firm. I owe both of them a huge debt of gratitude for their mentorship.

This has been a very smooth, well-telegraphed transition, which we think is critical for a firm like ours. We are long term stewards of capital. We strive to be methodical, both in deploying that capital and managing our most valuable resource, our people.

How's it going six weeks in? Other than hitting the wrong elevator button occasionally, it feels pretty good so far. This is very exciting for me, and it's also humbling. I love this firm. I love our people. I love our mission, which is to deliver great returns to investors, including more than 30 million pensioners globally.

What am I going to do in this role? Well, I start with a Hippocratic oath to do no harm. The firm is in incredible shape. AUM is up fivefold since the IPO in 2007 to $450 billion, and the returns are rock solid across the board. But I do have a few key areas of focus.

First, we want to become even more globally integrated, to harness the power of the firm's relationships, investment insights, and data. How can we capitalize on trends we see in one business unit, or in a geography, elsewhere at the firm? If investing is all about pattern recognition and connecting dots, then we should have a clearer picture than anyone, given our scale and breadth.

Secondly, we want to continue to innovate. There's a huge opportunity for us in two relatively untapped markets, retail and insurance. Retail is a $50 trillion market, insurance $30 trillion. Both have low single digit exposure to alternatives. In contrast, our traditional institutional market – pension funds, sovereign wealth funds – are 25 percent plus in alternatives. The combination of low global yields, increasing longevity, and our consistent outperformance, creates a real window of opportunity in both the retail and insurance spaces.

Thirdly, I'd love to increase the growth orientation in our investing, including doing more in Asia and adding to our capabilities in areas like life sciences and technology. This is critically important, given the rapid pace of disruption across the global economy.

Fourth, we want to continue to focus on maximizing shareholder value. As a reminder, insiders own close to 50 percent of our units. We've paid out $7.00 in distributions to shareholders just in the last three years. In our press release today, we described two additional shareholder friendly elements, paying out a $0.30 dividend over the balance of the year in connection with the end of our Franklin Square joint venture, and our board authorized a $1 billion share buyback.

We're fortunate to have significant financial flexibility, $4.5 billion in cash and liquid assets, no net debt, an A plus rating, and meaningful free cash flow. We anticipate the buyback will be used to offset dilution from future equity awards over the next several years.

Before jumping into specifics on the quarter, a quick summary of why I think our business model is so powerful. It's anchored by a simple virtuous cycle: deliver strong returns and investors entrust us with more capital. We've done this for 30 plus years, and this quarter was no exception.

Economically, we're paid base management fees, which cover our people, our overhead, and produce growing fee-related earnings, approximately $1.00 per share over the last 12 months. Plus, we're paid performance fees, which are tied to realizations, primarily. These are lumpier by definition, given the nature of dispositions. The last three years, we've had a range of approximately $1.00 to $2.00 per share. The timing may be uncertain, but the net accrued carry on our balance sheet is an indication of what's to come.

Our objective overall is clear. Continue to grow fee-related earnings and increase the range of performance fees. Why do we believe we can do this? It's because we have a business model which requires virtually no capital, has 50 plus percent operating margins, is supported by third party capital that's generally locked up for 10 plus years, and we're focused in a rapidly expanding alternative space where we are the clear global leader.

Turning to earnings, we had a solid start to the year, but against tough Q1 comparisons. That was when we sold $6.5 billion of Hilton stock. ENI per share was $0.65, distributable earnings $0.41, investment performance quote strong versus markets. The S&P, as you know, was down 1 percent, global REITs down 8 percent, the high yield index down 1 percent.

When you compare that to the Blackstone performance, it's quite striking. Our PE complex, private equity, tac ops, strategic partners, up five to seven percent. In real estate, opportunistic, core plus, private credit, up three to four percent. In credit strategies, zero to three percent. And in hedge fund solutions, up 1.3 percent.

What drove this outperformance? I'd say two things: high conviction investment themes and significant operational improvements. These elements are increasingly important going forward, as we shift out of this low rate environment and potentially see pressure on multiples.

As examples, in corporate PE, we IPO-ed our Gates Global business this quarter, a leading global manufacturer, resulting in a significant valuation uplift. Much of the credit goes to our Blackstone portfolio ops teams, helping drive a 20 plus percent improvement in margins. Overall, our EBITDA for corporate PE accelerated to low double digits in the quarter, reflecting the impact of these kind of initiatives and a strong global economy.

In energy, we smartly invested $3 billion in 2016, primarily in high quality oil assets, just as prices bottomed.

In real estate, our largest current holdings reflect growth-oriented sectors, more insulated from rising rates: US and Spanish housing, Indian office buildings, global logistics, and life science office buildings. Our private REIT, BREIT, is nearly 50 percent in logistics, versus just 8 percent for the overall public REIT index.

In credit, we've been more active in energy in Europe, where spreads for comparable risks have been higher. And we've had increased exposure to floating rate debt as well.

And in hedge funds, our calls on structured credit, mortgage servicing, and idiosyncratic situations have paid off for our investors.

This strong performance continues to drive remarkable inflows, over $18 billion for the quarter. AUM was up 22 percent on the year, despite $45 billion of realizations. In terms of new businesses, in infrastructure, we've assembled a world class team, and they are pursuing a robust deal pipeline. We expect to have our first close this quarter, and more over the balance of the year.

As you know, we received a long term commitment of up to $20 billion from PIF, to be matched by funds we raise globally. We did not intend to raise all that capital at once. We can't comment on fundraising beyond that, but we are confident in the prospects for this business.

Going to deployments, scale investing continues to be a big competitive advantage for us. We deployed over $10 billion in the quarter, including a UK payments business and a major Spanish NPL investment, along with committing to two large Canadian transactions, Thomson Reuters, and Pure Industrial. Attractive deployments today create the basis for future performance fees.

Realizations were slower due to the volatile quarter, but importantly, net accrued carry grew to $3.6 billion, the highest level in 3 years.

Finally, we see plenty of reasons for optimism, as Blackstone remains the preferred port in the storm for investors in an uncertain world. Blackstone is not about one product or a single fund series. It's about exceptionally talented people with extensive domain expertise, a disciplined investment process, and the confidence of global investors. We will continue to apply this formula in a multitude of places for both our shareholders and investors. And with that, I open it up to questions.

Operator: Our first question comes from the line of Miriam Gottfried. Please proceed.

Miriam Gottfried: Thanks for presenting so much information. I was wondering if you could talk a little bit about the percent of inflows that came from the retail business this quarter, if you're going to be sharing any more details about the contribution from that business.

Jon Gray: You know, I don't know if we broke down the detail. I'm just looking. But I think it's getting up close to 20 percent, I want to say is the number. It's –

Michael Chae: This quarter, it was about $3.5 billion out of the $18 billion of inflows, Miriam, and the mix was –

Miriam Gottlieb: Thank you.

Operator: Our next question comes from the line of Heather Perlberg. Please proceed.

Heather Perlberg: Hi. I was just wondering if you could give us any more insight on what drove growth in the private part of the private equity portfolio, just because public markets are down, as you say.

Jon Gray: You know, a couple of things. We obviously had the IPO of Gates Global, which was helpful, relative to where we were carrying that investment. And then I would tie back to the performance of our investments. EBITDA up above double digits is obviously meaningful, and quite helpful when you look at valuations.

Michael Chae: Yeah, I would just chime in – it's Michael – that as Jon was saying, overall, while Gates was a particularly positive factor, it was a minority of the increase, and the majority was from pretty broad-based strength across the portfolio.

Tony James: You know, we also invest a lot in energy, and it didn't hurt to have energy – oil prices up a lot.

Operator: Your next question comes from the line of Joshua Franklin. Please proceed.

Joshua Franklin: Good morning, and Jon, welcome to the media call. Thanks for taking my question. Just wondering, one of the big events in the quarter was President Trump's decision to impose steel and aluminum tariffs on certain exporters to the US, and obviously, this can't have been something that was in many firms' forecasts when investments were made. I'm just wondering, can you give any color about kind of what Blackstone expects the implications for this to be for your portfolio companies, especially on the manufacturing side, and any supply chain disruption, and if you've taken any action in your companies on this, and – or in response to China's reaction? Thanks.

Jon Gray: Yeah, I'd start with the last question, which is no, we haven't taken any actions. I think you have to step back and look at it as sort of the broader relationship between the two countries. The US is obviously a very mature economy that has a quite open market. China, if you look back 10 or 15 years ago, was very much of an emerging market economy, and like most emerging economies, was more closed.

As their economy has grown and matured, the relationship with the US is likely to change, and that's what we're seeing. So clearly, the headlines can create some volatility, and we saw that in public markets, but our view is that both parties have a lot at stake, and both parties would like to see a constructive outcome. So it doesn't there may not be some to-ing and fro-ing as folks go back and forth, but our expectation is over time, some reasonable outcome that'll be positive for both sides should come about.

Tony James: Jon, if you don't mind, I'll jump in here. I think it's –the whole trades topic has been much more impactful on the market than it is on the economy. You can look at a bunch of studies and say even a ten percent across the board tariff and retaliation by the rest of the world would only have a .2 percent impact on GDP growth. So I think it's a bit overblown in terms of its on the ground impact for our companies. Even before this, many of them were seeing tightness getting supply, and if you look at the deliveries across the board, you can see that the delivery times are up a lot in the manufacturing sector.

But it's important to remember that US manufacturing is only 15 percent of the economy.

Operator: Our next question comes from the line of Evelyn Lee. Please proceed.

Evelyn Lee: Hi. Good morning. I had a question. Jon, you mentioned in your summary earlier, you said you're focusing on certain areas of real estate, like Spanish housing, Indian office. I wonder if you could share any more color on why you find those particular strategies attractive.

Jon Gray: Well, we're clearly heading into what we think should be a rising rate environment as we see global economic strength, and as investors, what that means is you can no longer rely on multiple expansion, and therefore, you need to buy things that will grow faster. So in a real estate context, cap rates are likely to go up. You want to own things where you can see higher earnings growth.

And so where do we see that? You touched on a couple of those. Yes, in Spain, where there's a shortage now of housing, we're seeing a cyclical recovery. We see growth there. In global logistics, where there's a movement from land-based retail to online retail, we've been the major player in the world, having bought more than 500 million square feet in the last 7 or 8 years. We're very focused in tech and creative oriented office markets, those sort of places. Life science office, again, the same thing.

So what's more exposed is if you owned a 20 year leased office building that looked and felt more like a long duration bond. You want to buy things that have growth associated with them, and that's certainly what we've done with our real estate portfolio.

Evelyn Lee: Oh, great. Thanks for the answer to that question. One additional question. I noticed BREP VIII is approximately 50 percent invested. Can you talk about the pace of investing so far for the fund and what your outlook is about deploying the remaining capital, given that we're further along in the real estate cycle than we were three years ago, when the fund launched?

Jon Gray: Yes. If you look over time here, we did deploy a fair amount of BREP VIII relatively quickly. The market has gotten tougher for opportunistic US real estate. I think we've said that on some recent quarterly calls. We're certainly on pace, and there are some larger situations we're looking at. But it has slowed us down.

On the flip side, if you look at our Europe V fund, which is another larger fund, I think $9 billion, there, we're moving much faster, and that speaks to what we see, and I would say really across the board in credit as well, attractive opportunities, still more legacy distress in Europe.

So I'd say overall, BREP global, which is US focused, has been a little slower. BREP Europe has certainly been a bit more active.

Evelyn Lee: All right. Thanks so much, Jon.

Operator: Our next question comes from the line of Heather Perlberg. Please proceed.

Heather Perlberg: Hi again. I just wanted to ask you about the tax plan. Can we expect to see any impact of that reflected in your numbers going forward?

Jon Gray: No, I don't think there's any specific numbers. I think the biggest impact of the tax plan is companies and what it's done I think in terms of increasing confidence, lowering companies' cost of capital, and accelerating growth. It's definitely been a stimulus. So I don't think anything specific to Blackstone and our numbers, but certainly a positive to growth.

Heather Perlberg: Great. Thanks.

Operator: Our next question comes from the line of Devin Banerjee. Please proceed.

Devin Banerjee: Hey, Jon. Good morning, and welcome to the quarterly ritual. I was curious – you guys have spoken about growth efforts around technology and life sciences for maybe a couple of years now. I'm curious if you see those efforts becoming their own teams or even their own business line, or do you just see those efforts incorporated into your real estate investing business and private equity business?

Jon Gray: I think ideally, Devin, we would like to create some dedicated capabilities and dedicated funds. We've been doing more, particularly in private equity and tactical opportunities, software related businesses, cyber security. We've done health care services things with a technology component. And we've done some things in real estate as well.

But I think given the opportunity and the size of those markets, for a firm like ours, at some point, as we build up our capabilities, as we show sort of our investing experience, that would be something we could do, but no fixed timeline at this point.

Devin Banerjee: Okay. Thanks.

Operator: Our next question is a follow-up from Miriam Gottfried. Please proceed.

Miriam Gottfried: Thank you. Jon, you talked about the pace of real estate deployment. Could you talk about the pace of private equity deployment, and how you feel about that, and what the challenges are in this market?

Jon Gray: Well, it's funny. We've been talking for a while that it's not an easy private equity investment environment, and the reality is, I think we put out $5 billion in corporate private equity in the last year. And I think the unique thing has been really large scale opportunities that we've found. Thomson Reuters is a great example, Aon's benefit management business. We're looking at a number of interesting situations as well.

So the scale of our capital, which is pretty unique, and our ability to intervene operationally is very helpful as well. And we're still finding things. And the fact that we do things globally, we've got a number of investments we're looking at in India right now, in Europe as well. So I would say the pace actually feels good, frankly better than we probably would have expected in an environment like this.

Tony James: Let me just add, there's a lot of – markets are high. What that often does is it means there's a lot of sellers and a lot of assets for sale. They're not all good values, but many times, we're able to buy companies that have been capital starved and take them to a whole other level.

The other thing is if we actually put money in the ground into new energy assets, whether they be renewables or oil wells or power plants or whatever, we're essentially disconnected from valuations, because we're just paying the building costs for these companies. So a lot of company creations are interesting, and allow us to get into something at about book value.

Miriam Gottlieb: Thank you.

Operator: The next question comes from the line of Dan Primack. Please proceed.

Dan Primack:Hey, Jon, I'm calling just to ask if we can get an update on kind of where you guys are on infrastructure fundraising, and I'm particularly curious to know if the fact that the administration infrastructure plan seems if not DOA, at least on the shelf indefinitely, if that's having a negative impact on your ability to get it done.

Jon Gray: No. I would say that the policies at the federal level is not having an impact. In terms of infrastructure overall, I'm somewhat limited in what I can say, because we're in the midst of a fundraising. But there has been some information out there that I'd love to clarify.

We started on the infrastructure project about a year ago, when we announced a memorandum of understanding with PIF to make a large commitment. We actually documented that at the end of last year, in late October. We got on board our team, including internal people, Sean Klimczak, who's leading that business, as well as some external hires. And we now have the people in place, we have the documentation, we sent out our PPMs, and we're set up for a closing here this quarter.

So we feel good about this. I think there was maybe a set of expectations, because of the big number, the $20 billion number. We never intended, as I said, that we're going to match that right away. What's going to happen here is this is a long term commitment, and as we deploy capital and raise capital, it's on the shelf to match what we do.

And our confidence level on the business is really high, because the needs are so great. In the public sector, I think all of us know about the couple of trillion shortfall here in the US. But then you look across what's happening in the midstream sector, in the shale revolution, what's happening with the need in utilities – there's just a lot of capital needed, big things here, and so we think this is a great long term business.

Dan Primack:I appreciate it. Thank you.

Operator: Our next question comes from the line of Sam Sutton. Please proceed.

Sam Sutton: Hi. Thanks for taking my question. Blackstone has a couple of deals this quarter to take minority stakes in management companies of other private equity firms – Kohlberg and Co., PAG. I'm just curious sort of what firms – what characteristics of firms that you guys are interested in for kind of future deals of this type.

Jon Gray: Well, we're trying to invest in best-in-class firms, firms that have terrific investment track records, great relationships with their limited partners, domain expertise in their areas, and as a result of all that, are going to grow over time. It's really no different than buying operating companies. You want to buy well-positioned investment firms.

We're very fortunate in that business, because in many cases, we compete with these firms, we lend to them in the GSO context, we have secondary interests, because of our strategic partners' business. We really know this space well. And so I think our teams are pretty uniquely positioned as they underwrite the different firms in this area.

Sam Sutton: Thank you.

Operator: We have a follow-up question from Devin Banerjee. Please proceed.

Devin Banerjee: Thanks. Question for Tony, if I can. Tony, how has the past six weeks kind of felt for you, and what have you been up to?

Tony James: Well, I would say that it's not yet all that different, frankly. I'm trying to help the firm in many ways, and at the same time stay out of Jon's way. But as Jon said, it's a big job. It's a big firm. There's a lot of things going on in a lot of directions. I've been able to spend – when you have Jon's job, you've got to deal with a million incomings every day that need a decision to keep the firm moving forward, and it makes it hard for you to get out of the office as much as you should. So I've been able to take some of that time. I've spent more time – God, I think I've made like 12 speeches in the last 6 weeks. I've spent a lot more time with some of our biggest limited partners, which are cross-group strategic partnerships, which is where a lot of our money is coming, which is actually one of the great strategic advantages that Blackstone has. Because we are best in class across the whole alternatives spectrum, we can do things no other firm can to offer huge institutions access to best products and a full distribution of the kinds of assets they want.

And so leading those discussions, because they cut across groups, is kind of a roll that really Jon or Steve or I are uniquely set up to do. But I've been involved in a lot of that. So far, so good, I think. But I'll let Jon comment.

Jon Gray: Yeah, I think it's been great, Devin. Having Tony out there interfacing with our big LPs, helping on some of these different strategic initiatives we have out there, and the investment side. I mean, the volume of investment committees here is pretty significant. And really, no one human being I think can process all this information.

And so Tony obviously is an incredibly talented investor, tons of experience, and he is continuing to play a very active role there. So far, this has worked out extraordinarily well. Steve, Tony, and I have obviously great professional relationships, but also personal relationships, and that's made this very easy.

Devin Banerjee: Great. Thanks.

Operator: There are no further questions at this time. I would now like to turn the conference back over to Christine Anderson for closing remarks.

Christine Anderson: Thanks, Joyce. Thank you all for joining us. Please give us a call if you have any questions. Thanks so much.

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