Final Transcript

THE BLACKSTONE GROUP: Blackstone Second Quarter 2014 Investor Call

July 17, 2014/11:00 a.m. EDT

SPEAKERS

Joan Solotar, Senior Managing Director, Head of External Relations and Strategy
Stephen A. Schwarzman, Chairman, CEO, and Co-Founder
Tony James, President and Chief Operating Officer
Laurence Tosi, Chief Financial Officer and Senior Managing Director
Weston Tucker, Managing Director, Head of Investor Relations

ANALYSTS

Luke Montgomery – Bernstein
Bill Katz – Citigroup
Michael Carrier – Bank of America Merrill Lynch
Marc Irizarry – Goldman Sachs
Michael Kim – Sandler O'Neill
Dan Fannon – Jefferies
Glenn Schorr – ISI
Robert Lee – KBW
Patrick Davitt – Autonomous
Devin Ryan – JMP Securities
Craig Siegenthaler – Credit Suisse
Brian Bedell – Deutsche Bank

Bulent Ozcan – RBC

Warren Gardiner – Evercore

Chris Kotowski – Oppenheimer

PRESENTATION

Coordinator Welcome to the Blackstone's Second Quarter 2014 investor call. I would like to turn the call over to Joan Solotar, Senior Managing Director, Head of External Relations and Strategy.

J. Solotar Thanks. Good morning, everyone. Welcome to our Second Quarter 2014 conference call. So, I'm joined today by Steve Schwarzman, who is actually calling in from out of the country, Chairman and CEO; Tony James, President and Chief Operating Officer; Laurence Tosi, CFO; and Weston

Tucker, Head of IR.

So, earlier this morning we issued our press release and slide presentation illustrating our results. Those are available on the website and then we're going to follow up with the filing of our 10-Q in a few weeks.

I'd like to remind you the call may include forward-looking statements, which are uncertain outside of the firm's control. Actual results may differ materially. For a discussion of some of the risks, please see the risk factor section of the 10-K. We don't undertake any duty to update forward-looking statements. We'll also refer to non-GAAP measures on the call and for reconciliations back to GAAP, refer to the press release for those.

And I'd like to remind you that nothing on the call constitutes an offer to sell or solicitation of an offer to purchase any interest in any Blackstone Fund. The audiocast is copyrighted material and may not be duplicated, reproduced or rebroadcast without consent.

So, a quick recap of the results we reported record economic net income, or ENI, for the second quarter of $1.15. That's up very sharply from $0.62 in last year's second quarter. Performance, as you may have seen already, was strong across the board with greater appreciation in the underlying portfolio assets as well as higher management fees.

Distributable earnings were $771 million for the second quarter or $0.65 per common unit. That's more than double last year's second quarter distribution. We'll be paying a distribution of $0.55 per common unit and that's for shareholders of record as of July 28th.

So, thanks to all who are on the call and also those who attended our recent Investor Day either in person or via webcast. But if you missed it we have it posted on our website so you can scroll through by segment.

And with that, I'm going to turn the call over to Steve Schwarzman.

S. Schwarzman Thank you, Joan. And good morning and thank you for joining our call. Our results announced this morning reflect one of the two strongest quarters in the firm's history, in all respects. Our ENI of $1.3 billion was our second best quarter ever, up 89% from last year, and indicates the significant value we're creating across our platform.

For the past 12 months, earnings were $4.3 billion. I'm going to repeat that. Our earnings in the last 12 months were $4.3 billion or $3.76 per unit, which is a record for any 12-month period for any publicly listed asset manager in the world. If we look at the growth in earnings from year-end 2007 before the financial crisis, we compounded at a rate of 12% per year and grown our assets three times, despite the impact of a once in a generation global financial collapse.

Despite this challenge, Blackstone has shown impressive growth in earnings and AUM, in fact, one of the strongest performances in the financial sector in the world. Our current cash earnings also increased sharply, as Joan mentioned, up 128% in the quarter.

Realizations continue to pick up and we've indicated they would on previous calls, exceeding $13 billion in the quarter. While disposition activity has been accelerating to record levels, we've also been investing record levels of capital, creating new value. And we're getting additional balance from having more assets with the current yields for annual performance fee payout due to the significant growth in our credit and hedge fund solution businesses.

In effect, all is going well, in fact some would say very well. The strength of our results today is entirely the result of our singular focus on delivering good investment performance to our limited partner investors. And our returns, frankly, have been some of our best yet.

In private equity our portfolio rose 8.4% in the quarter and 28%, as Tony reported, over the past year, driven by strong portfolio operating performance. Revenue and EBITDA trends in our companies are some of the best we've seen in years, up 8% and 11%, respectively.

Our 2005 BCP V Main Fund crossed its preferred return threshold in the second quarter and is now in catch-up, as Tony and LT explained, and you'll hear more on that later.

Our real estate funds also continue to generate stellar returns with the portfolio up 6% for the quarter and 28%, surprisingly the same number as private equity for the last year. Strength has been broad-based in real estate with all of our major sub-segments gaining significantly. Our credit funds had gross returns between 2% and 5% for the quarter and 16% to 31% for the last year, which is actually quite astounding for credit investing, as Tony said, in a 2% world.

And our Hedge Fund Solutions business, or BAAM, produced a 2% composite gross return for the quarter and 11% over the past year, also quite favorable. One of the current debates, given strong markets, particularly in the US, is around manager's ability to find new attractive investments to deploy large scale capital.

At Blackstone we've invested significantly over the years developing global capabilities where our local offices are fully integrated into the broader platform. In this way we can identify opportunities anywhere in the world and move capital to where they are most attractive.

Our fund structures also give us great flexibility around when and where to invest and our scale lets us do deals that most others simply can't do. As such, we continue to invest record amounts of capital, deploying $6 billion in the quarter and $20 billion over the past year, with an additional $8 billion committed to deals, but not yet deployed at quarter end. So, that's a total of $28 billion.

Roughly half of our investments were outside of the United States. I want to repeat that because it's really an important thing. Roughly half of our investments were committed outside of North America. In fact, we've already invested or committed 34% of our new European Real Estate Fund as of quarter end and 27% of our new Asia Real Estate Fund and we're not even finished raising it.

In credit, 50% of our backlog is in Europe where we see a lot of interesting opportunities very much as we have in real estate. So, despite the challenges that exist today for investing in some regions and asset classes, I am excited about the opportunities we are seeing.

Our capabilities are greater today than at any time in our history and our sustained high pace of capital deployment is building the foundation for future value. Due to our active pace of deployment, we continue to raise new money from investors. Despite the sharp increase in realizations we, again, grew our total AUM by greater than 20%, ending the quarter with $279 billion of AUM.

In the second quarter we raised $14.5 billion in capital, bringing us to over $62 billion in gross inflows for the past year, which was predominantly organic. Just so you don't miss it, $62 billion in gross inflows for the past year.

The monies we've raised over the last 12 months equal as much as 50% to 100% of the entire AUM of many of the publicly traded alternative asset managers. And we have several significant fundraising initiatives currently underway in virtually all of our businesses.

In real estate our core-plus initiative is in early days with good momentum. We started with a number of separately managed accounts and we now have launched our first US-focused commingled fund. We also are having active discussions for additional SMAs in Europe and Asia, and we think this combined platform could exceed $5 billion from a standing start within the next year. And, by the way, I think we believe it's going to grow a lot bigger from there if the trends remain consistent.

Our current Global Flagship Fund, which started at $13 billion in size is now nearly $15 billion on its own, $16 billion with co-investors due to favorable recycling provisions and will likely grow further. At our current investment pace we're likely to be back in the market with our next global fund early next year, which gives out a fund deployment life of about two and a half years.

Our Asia-focused Real Estate Fund continues to march along and has raised $4.4 billion and we expect it to hit our cap of $5 billion. Our debt strategies business is expanding with additional capital raised for our liquid CMBS investment vehicle as well as our commercial mortgage REIT Blackstone Mortgage Trust.

In private equity we've got a very busy year. We commenced the fundraising of our second Energy Fund, for which we're targeting $4+ billion, with an expected first close in the fall. And Strategic Partners, our secondaries business, is making great progress in their new fund, benefitting from the synergies of being part of Blackstone with $3.2 billion raised on our way to the cap of $4.4 billion.

That's nearly twice the size of the previous fund before they joined Blackstone. In credit, investor demand remains strong and we have inflows into our hedge fund vehicles, as well as several separate account mandates from large investors. We've also just started the marketing process for direct lending fund in Europe, given the opportunity set there.

And, lastly, BAAM continues to take share in the quarter with $2.3 billion of fee earning net inflows, including July 1 subscriptions. This included an additional close with the new GP Fund interest, which is now $2.3 billion in size as well as the launch of our second 40 Act Fund, which raised $300 million just in the quarter.

There's a lot going on from a fund raising perspective and, as Tony said, this isn't episodic anymore. This comes from all over the firm on a reasonably consistent basis. And I'm confident of the firm's continued growth trajectory, even with our heightened levels of realizations.

We also successfully executed a loan against part of our Hilton position, which returned over $2 billion of capital to our limited partners, helped preserve future upside on the shares, which continue to perform very well.

Hilton's current share price equates to a multiple of 2.8 times our original investment and implies a total gain of almost $12 billion, which we believe is the largest private equity gain in history.

We also brought Michael's public in the quarter, although we didn't sell down any of our shares and we have three other companies on file for IPOs with more to come, markets permitting.

We now have $32 billion in public equities in our private equity and real estate funds, which we'll sell down in an orderly basis over time. We also have a substantial portfolio of office assets we're in the process of liquidating.

You've probably seen some news reports on the pending sale of more than $2 billion of our Boston office assets, and in credit, we continue to see realizations out of our first mezzanine and rescue lending funds, in many cases as our borrowers call us out at a premium in favor of lower cost financing.

Looking forward, our realization momentum is significant and given our investment performance the positive cycle of the business continues with our LPs returning those dollars to us in newly raised funds.

In summary, Blackstone's results continue to demonstrate the unique and compelling strengths of our business model. I believe we are the best positioned firm in the fastest growing part of the asset management business with the most recognized and most trusted brand name.

Our investment performance is outstanding and is driving record levels of demand for our products, resulting in sustained double-digit AUM growth, at least double to triple the rate of almost all traditional asset managers. And I believe there is much more to come for Blackstone as each of our business lines introduce exciting new investment products, which will appeal to potential investors.

I foresee continued controlled expansion of the firm on an organic basis consistent with us maintaining our unique culture of meritocracy, hard work, unflinching integrity and service to the public and all of our constituencies. The alternatives are evolving as a publicly listed class and have become a required course in financial services investing, not an elective.

And Blackstone is *the* core curriculum with global leading platforms in each of the major asset classes. Thank you for your support. And with that I'll ask Laurence Tosi to take over with a review of our financial results.

L. Tosi — Okay. Thanks, Steve. And thank you, everyone, on the call for your continued interest in Blackstone. I would like to begin my comments today by addressing what appears to be a couple of common misconceptions about alternative managers, in general.

First, that firms cannot create value and realize it at the same time. That asset growth is inherently constrained by returns of capital or that firms cannot be both a smart buyer and a smart seller at the same time. And, finally, that our results are more volatile than the assets we manage. Our performance we think, over time, shows why these assumptions are unwarranted.

For the quarter Blackstone had distributable earnings of $0.65 per unit, more than double the prior year period, bringing the last 12 months to $2.00 per unit, as we continue to realize seasoned investments while continuing to invest and raise new capital.

Strong returns across all of our investment platforms showed 61% growth in ENI to $2.1 billion year-to-date. Importantly, realized performance fees of $1.1 billion for the first six months were up 85% year-over-year. Following 11 sequential quarters of increases we now have $4.2 billion in net accrued performance fees, of which roughly three-quarters is either in public equities or assets that are pending exits.

Another way to look at what we call the compounding effect in our financials is the fact that with approximately the same level of fund appreciation as the first half of last year, the first half of this year produced record ENI and distributable earnings, up 61% and 72% respectively.

All indications are that we are actually at the early stages of exiting a number of scaled assets, which means $2.51 per unit of the net performance fees is associated with public holdings or pending exits, which should become realizations in the foreseeable future.

What we are seeing is not just market driven, nor is it temporary. You can see the long-term fundamental trends at play in private equity, as Steve mentioned, and in our BCP V Fund, in particular.

Private equity funds achieved 8.4% appreciation in the second quarter and 28% over the last 12 months on the 11% growth in EBITDA that Steve pointed out, well ahead of the S&P average. BCP V, the industry's largest fund, generated 10.5% appreciation in the second quarter alone and 34% over the prior year. And it reached its 80/20 catch-up phase of performance fees for the first time.

To give you some specific numbers, the Fund, BCP V, generated $579 million in revenues and $487 million in Economic Income in the quarter. Of those amounts, $274 million of those revenues and $225 million of the economic income are related solely to the catch-up.

Additionally and importantly, the Fund generated $174 million in net realizations. BCP V is currently 34% of the way through the catch-up and needs 13% appreciation or $2.5 billion increase in value to reach full carry.

While we generally guide you to a 40% to 45% compensation ratio on many of our drawdown funds, some of the larger pre-IPO funds have lower compensation ratios as partners sold carrying in exchange for Blackstone units. This is the case in BCP V, where we currently estimate 80% of the carried interest generated will go to unit holders. This lower compensation ratio, obviously, has a favorable impact on operating margin, which was 59% for the quarter.

Consistently strong AUM growth also continues to positively impact our performance. There are two ways Blackstone's assets grow: value creation and inflows. Over the last year the firm grew $37 billion by value creation and had $62 billion by gross inflows for a combined $100 billion from these two drivers. That is precisely how we were able to grow AUM 21% and fee earnings 23% in the past year, despite returning $50 billion in capital to investors.

We also view the $50 billion returned as an asset as most of our LPs have to put returned capital back to work to meet investment targets. In fact, almost 90% of our LPs invest in successive Blackstone funds and history shows that returns of capital are highly correlated to fund demand, explaining why all of our major fundraises have sold out over the last few years and why Blackstone itself has grown every single year since inception. You *can* return capital and grow.

Despite $20 billion invested over the last year our dry powder managed to grow to $45 billion, giving us plenty of capital to leverage the unique investment capabilities that we have built.

Of the $11 billion we have put to work in the first six months, 43% of that were in funds that did not even exist in 2007 and almost half was outside the US, something we were not capable of achieving just a few years ago.

We can be both a profitable seller and a discriminating buyer at record levels at the same time – capitalizing on our unmatched breadth of strategies, regional presence, vintages and assets sometimes within the same fund. It will never be the case at Blackstone that one fund needs to lose when another fund wins.

That is why Blackstone's fund returns are more balanced with higher growth than the markets over time and are less susceptible to short-term market fluctuations than investors think. When we look to invest we look at long-term fundamental trends, not short-term market prices, because all of our funds are designed to have flexible mandates and patient capital that allows them to be consistently buying, creating value and selling for above market returns.

That is what makes Blackstone different. It can all work at the same time. That is the way the firm was designed with the core mission to build by constant innovation and develop a balanced set of world-class investment platforms that can use patient capital and operating expertise to outperform across all cycles.

And with that, we'd be happy to take any questions.

J. Solotar Operator, we're ready for questions. But if I could remind everyone to just stick to one question the first go around and then we're happy to take your second and third and whatever on the second round.

Coordinator (Operator instructions.) Your first question comes from the line of Luke Montgomery with Sanford Bernstein. Please proceed.

L. Montgomery Thank you. Good morning, guys. So, it looks like the aggregate industry data suggests that PE deal multiples have spiked in 2014. I think by one vendor it was 11.5 times during the first half of this year, and that's up from 8 times in 2009. So, that's been accompanied, obviously, by easy debt financing and the median debt percentages now around 7%.

Given the amount of dry powder you've been sitting on it's encouraging to see you put $2.2 billion to work in the quarter and that's a good pace, but your firm hasn't been shy about calling out the pitfalls of the investment environment, so just really wondering how you're staying disciplined in this environment and how we can get some confidence that you know we might not have another BCP V coming down the pike.

T. James I was okay with you until you added that last clause. I think BCP V is going to double our investors' money on $20 billion. I think it will be a spectacular success and our LPs are very happy with it. So, let me just start with that.

In general, values are high. I think the last cycle was challenging not so much because the values were high, which they got high in 2007, but had we not had a historic meltdown of all meltdowns, you would have had very different investment results, too.

And it's too simplistic to just look at values. You've really got to look at what you're buying. And I can't comment on the industry because I think there's a lot of stuff, which is going for too high a price driven by too much leverage. And, of course, our job is to not chase those.

What we are investing in and we're finding a lot of good opportunities is companies that need capital to grow. So, they have very strong organic growth and like any company, it's a little simplistic to say, well, Company X is a bad deal, you know, because it's got a 20 P/E and Company Y is a good deal because it's got a 15 P/E when Company X might be growing twice as fast or three times as fast.

So, market's pay and values reflect growth rates. We're investing in, much more than before, higher growth companies and I don't think those multiples are particularly pricey often for the growth. So, that's one area.

The second area is we're putting a lot of money to work in sort of new build stuff, so we might be building a pipeline or a wind farm or a power plant somewhere. And in a sense, if you look at trailing multiples, that's an infinite multiple because we're putting money to work in a company that doesn't exist.

But the other sense is we're buying assets at book value and assets that we believe will earn a very nice return on equity, much higher than the cap rate, if you will, that we'll sell that asset for once it's developed, so we'll capture not only the profit of the higher return equity while we hold it, but then we'll get a higher multiple on sale because we'll be selling cash flow at the higher multiple than we went in.

So, I think we're finding some interesting things to do. They're not traditional public to privates of mature companies without a lot of value creation. And, in general, everything we do, everything, is dependent on value creation. So, the one big sort of LBO we did, Gates, is a company where we think we have, with our superstar, fantastic manager, Dave Calhoun, working with the management team that's in place at Gates, which is very solid, we can create a lot of value to that company that hasn't been created yet.

And it's just a great company, a great business with great market position, and, by the way, at the right part of the cycle. So, we like that business a lot and you know we had a lot of co-invest in that business and a lot of our very sophisticated institutional investors looked at that and joined us in putting money into that company.

If you're worried about what we paid on that, there's a lot of market validation from sophisticated third parties. So, all in all, we feel very good about what we're doing.

L. Montgomery Okay. Thank you very much.

Coordinator Your next question comes from the line of Bill Katz with Citigroup. Please proceed.

B. Katz Thanks very much. Maybe a bit of a narrow question for today's call, but LT mentioned that, on the BCP V you have sort of favorable margin opportunity as that moves further along just given the dynamics between carry versus ownership.

When you look at the second quarter earnings within fee-related earnings, it looks like a little bit of elevated comp and other expenses. I'm wondering if you could maybe walk through some of the dynamics there and how you see the dynamic between sort of the seasoning of the realization opportunity versus maybe new investments you need over the next 12 to 18 months.

L. Tosi So, a couple of comments. I'll take it in reverse, Bill. I think the comps generally in line, the fee comp related ratio tends to be around 49% to 50% and I think that's in line with where we've been for some time.

I think the difference in the non-compensation or other operating expenses or non-compensation was really related, Bill, to business development expenses and so we had some fund closing and some fund initiation expenses that were one time in the quarter.

Of course, those expenses will come up from time to time as other funds close, but if you back out bond interest and business development expenses the growth rate on our non-comp or other operating expenses is 4%, which is less than half of the growth in our fee-related revenues, which is about where we've been over the last couple of years just on a discipline basis. And I expect that to be the case going forward. We don't have any foreseeable large increases in basic operating expenses going forward.

B. Katz Okay, that's helpful. Thank you.

Coordinator Your next question comes from the line of Michael Carrier with Bank of America Merrill Lynch. Please proceed.

M. Carrier Thanks for taking the question. Okay, just on BCP V, you gave some detail, but you went through it relatively fast, so I just want to understand, in terms of the 80/20, what portion of the catch-up we saw this quarter. And then I think I got like the 13% in terms of getting that further catch-up, but I just wanted to make sure we got the details of that because, obviously, it will be important over the next couple of quarters.

L. Tosi First of all, Mike, my partners are chuckling at me because that was for me relatively slow, but I'll try it again. So, the way I would look at the quarter is about 50% of the revenues and the economic income in private equity for the quarter were related to BCP V. About a third of the revenues in economic income in the segment were related to just the catch-up piece. And that's how I look at it.

So, to give you, roughly speaking, BCP V's revenues for the quarter were $580 million, just the catch-up piece was $274 million. The economic income was $486 million and the catch-up portion of that was $224 million.

M. Carrier — That makes sense. I think I was referring more to the forward-looking. I think you mentioned that if you had another 13% increase in the fund that would reach full carry, so I was just trying to understand where the fund is and then how we would get to there, like why you had that gap in order to get to the full carry.

L. Tosi — Sure. First, Tony had a question which was, he asked what the realizations were. So, the net realizations in the quarter, which is investment income and net realized performances, were $175 million, so there's cash/carry coming out of the other fund.

J. Solotar — And that's net of compensation and expenses.

L. Tosi So, Michael, going forward the numbers I gave you was in order for the fund to reach full carry you need 13 percentage points of appreciation above the hurdle. That's about $2.5 billion of appreciation. If we were to get to the full 13% there would be about a billion seven of carry generated during that period, during the catch-up and of which I'd say 35% of the catch-up we've already been through, so 65 remaining. Is that helpful?

M. Carrier Yes, got it. Thanks a lot.

Coordinator Your next question comes from the line of Marc Irizarry with Goldman Sachs. Please proceed.

M. Irizarry Yes, just one question on private equity and I guess two parts to it. The first is on Hilton and the loan on the position. Is that unusual for your private equity business to take out a loan on the equity and maybe you can help explain how that maybe can enhance returns to LPs and if that's unusual?

And then, as it relates to other exit opportunities in the PE fund, how do you think strategic M&A, you know, just given what we've seen in some big headline deals in certain industries, what's sort of the outlook for strategic M&A exits for you guys?

T. James Okay, Marc, it's Tony. I'd say that recapitalizations as a general category are not at all unusual and with private companies sometimes it'll be leave the same leverage as the operating company, but you'll do a holding company debenture of some sort and pay out a dividend.

With public companies you have the option because they are publicly traded securities; we're doing more of a margin loan. As our portfolio shifted from predominantly private to a lot of public positions, some of them quite large, I think you'll see some more of that here and there.

And what it does, of course, is it arbitrages a little bit of cost of funds, so we can borrow a margin loan at very low interest rates, LT could probably give me a specific one, but I don't remember it off the top of my head, and replace with that and give that back to our LPs that are looking to get 20% a year return.

By arbitraging that they're very happy and even the pref on our funds, which was, in the old days the preferred return was set at about government bond rates. Today it's like 8% government bond rates or two or less. So the preferred return has become a really significant hurdle and so if we can borrow at much less than the pref it allows us to accrue carry faster on the remaining gains.

There's some interesting things about that and so that's why we do it. So, as a general category of things to do it's not unusual, but we haven't done a lot of it in this particular form because we haven't, until recently, haven't had big public positions.

And, by the way, we could sell the stock, too, but we love the company and the company is doing spectacularly well, so we're seeing what we think is a lot of value still on that equity, so this allows us to sort of have our cake and eat it, too. Gets the money off the table at a very low cost and continue to have 100% of the upside in the stocks, so we sort of like that.

On the strategic market, we're clearly seeing the strategics come back, and I think you should expect that that will accrue benefits to our exits over time. I would expect more of our sales, the evolution of the form of exits started off where the credit markets were the first thing to rally, and so it started off with recapitalizations; and then the equity markets rallied, so we did a lot of IPOs and secondaries. Now the strategic M&A is coming back, it's just they're later in the cycle, and more of our exits will shift to that, including come companies that are already public, of course, or have been recapped, so these things can go together. But that should be a beneficial trend to us, and it feels like it's still at the early stages of that.

J. Solotar — Okay. Next question.

Coordinator Your next question comes from the line of Michael Kim with Sandler O'Neill. Please proceed.

M. Kim Hello, guys. Good morning. So your cash continues to build, you just raised some debt, and the value of your GP investments continue to rise, as well as season. As your funds increasingly exit some of those investments, just wondering does the thinking change at some point in terms of still retaining capital for investment spending versus maybe looking at potentially changing the payout ratio?

T. James Well, this is Tony. We payout about 85% of our distributable earnings, and I think that's kind of we feel comfortable with that ratio at this point in the cycle. We like to retain some earnings, because in my time at Blackstone I don't think I ever have seen as many really exciting new products and new initiatives that we have today. So as we grow bigger the irony is we have more and more exciting new things to do, and each of those things takes alignment of interest from our LPs, and therefore skin in the game and therefore capital.

So when I look forward some of the new things we have can be the biggest businesses we have in AUM. Core-plus real estate, for example, can be gargantuan, and we have some other really, really interesting things in other businesses. We're optimistic, if you will, that we have tremendous growth needs, opportunities ahead of us, and that will require capital, even though, as you point out, our traditional portfolio has been maturing. We're going to continue to retain capital at this rate, unless something significant changes in the outlook.

L. Tosi — I would add to that, though, Michael, exactly what Tony said. I think we feel really good about where we are; we had a blow-up bond deal earlier in the quarter, obviously $2.7 billion in cash and corporate investments, liquid investments is a good place to be, the A+ rating we're solidly in the middle of that range. In this quarter to get to the 85% payout ratio, we did payout about half of the gains that we had on our investments. So when we have a good realization quarter, we obviously get our return to capital, then we had about $220 million of actual gains realized cash in the quarter, and about half of that we paid out to get to the 85%, which I think, frankly, reflects both our confidence in the forward operating outlook and in the balance sheet and having enough capital to do what Tony just referred to.

M. Kim Okay. That's helpful. Thank you for taking my question.

Coordinator Your next question comes from the line of Dan Fannon with Jefferies. Please proceed.

D. Fannon Thanks. One more question on the—some of the BCP V metrics, LT. On the comp ratio being favorable to you guys is that just during the catch-up period or is that throughout the life of the fund?

L. Tosi Well, Dan, that's for the whole fund, and it won't always be consistent, but if the fund plays out over time it should be. It's all deal-by-deal. So over time it should be 80%, whether we're in catch-up or whether we're not.

D. Fannon Okay. Thank you.

L. Tosi Thanks, Dan.

Coordinator Your next question comes from the line of Glenn Schorr with ISI. Please proceed.

G. Schorr Thank you. Maybe just a quickie, fee revenues up 7% year-on-year despite 19% fee earning asset growth. Is that just a function of geography of where you're exiting and where the new money flows are coming?

L. Tosi I think it's probably mixed and where the new inflows are coming, and some of the inflows also are not yet fee paying, so that's really the impact.

G. Schorr So something could be a fee earning asset but not fee paying.

J. Solotar Yes. So just looking at the roll forward of the fee earning assets, you had year-over-year a higher mix of areas like in credits—well, overall. Yes, I think it was, I think it's mixed.

L. Tosi It's mixed.

T. James Mostly mixed, but that ebbs and flows. We also have a number of products where you have one—they're fee paying assets, but there's one fee for committed and uninvested, and then that fee jumps up once the assets get invested. So when you have a lot of new funds with that kind of money, obviously, it starts off at a lower fee ratio. In general in business, because there will be some mix changes, but in general in our business, if you look at business line by business line, we are not seeing significant price cutting or fee reductions.

G. Schorr Yes, I didn't think so, I was curious on the mix. I appreciate it. Thank you.

Coordinator Your next question comes from the line of Robert Lee with KBW. Please proceed.

R. Lee Thank you, and good morning, everyone. This is I guess maybe it's a little bit of a technical question for LT, but if memory serves me, I think FASB recently passed a rule that on a GAAP basis at least everyone is going to have to go to Method 1, so should we be thinking there's going to be any change, though, in your financial reporting, at least to the public? You're not going to change ENI or whatnot?

L. Tosi The ruling is not definitive; they're still working through the application. Well, obviously, we've been, as the leader in the market, we've been intimately involved in the discussions. I've met with the FASB twice directly on this specific issue to work through both when the rule is being promulgated, as well as its application. So the application figures have yet to come out, Rob, and so we'll see how it applies.

There are some interpretation of the rule as written that might not require us to go to what you would refer to as Method 1, which is accrual of performance fees only after all the capital is returned. Even still if that happens we'll have all the same metrics, it's just that our reconciliations to GAAP will change if that happens. So I don't see any impact.

By the way, if it were to go through and it were to have the impact that our GAAP numbers then would have that type of accrual, it wouldn't be until 2017. And I'd like to point out that the two public managers, Fortress and Oaktree, that are on that basis today also show ENI on the same basis we do. So I actually think, while it will be a lot more work, it will be the exact same results and it won't have any impact on how they're reflected.

R. Lee Great. Thanks for taking my question.

Coordinator Your next question comes from the line of Patrick Davitt with Autonomous. Please proceed.

P. Davitt Hey, guys. Thanks. I want to talk a little bit about your discussion of the growth capital opportunities you're seeing. Can you compare and contrast how you approach something like that relative to how a VC firm would? And should we take that to mean that you're now more comfortable in taking non-controlling stakes than maybe you had in the past?

T. James Well, we've always taken non-controlling stakes, and really our positioning in the market has always been the big fund that can certainly do big deals, but basically does the full spectrum of stuff. In fact, large buyouts, and I think that's let's just say total enterprise value over $3 billion, has never been more than about 25% of any fund that we've done. We have a long history of doing sort of smaller stuff and more growth stuff.

Of course, outside the United States, if you're talking about Asia, for example, it's almost all growth stuff, and a lot of it is non-control. And some of the growth equity that we're doing is controlled; they're just companies that have a lot of growth and tremendous opportunity.

I'm not sure that control is the dimension to think about. And we're certainly not becoming a venture firm, however. These are all companies with well-defined business models, well-defined end profits and market position and customers and develop management team and on. Our skill set is not finding the next Google or understanding how someone is going to invent the next semiconductor and betting on science or anything like that. That's not what we're doing.

P. Davitt — Okay. Thank you.

Coordinator — The next question comes from the line of Devin Ryan with JMP Securities. Please proceed.

D. Ryan — Thank you. Good morning. I just have a question on the longer-term outlook for fundraising. At the recent Analyst Day, Steve hosted really an interview with Mario Giannini, the CEO of Hamilton Lane, and I think what stood out to me at least was just that many institutions are moving from a zero allocation to alternatives to something, and in some cases, the example I think that was given was moving to a $50 billion maiden investment.

It would be great to maybe put some perspective around how large you think this untapped opportunity is where institutions are still exploring the merits of alternatives, but just aren't there yet. Maybe it's more outside the US or was this example that was given maybe more the exception than the rule, in your opinion?

S. Schwarzman Well, I'll take a little of that. I was last week in a foreign country with a capital pool that was in the $50 billion to $100 billion range that has no exposure to the alternative class and wants to do it, and they've made a decision to do that and I think we're well positioned to be in their first group of companies that they give money to.

And these things are happening periodically where not being in the alternative asset class has really mathematically sort of been unsound for decades, and so people can see that that's a smart thing to do mathematically. What that's leading to is new pools of capital that have been created or have been managed with a very heavy emphasis on debt are switching, and they start small and then they go up to typically a 10% to 20% allocation. And existing investors are increasing sort of their allocations, and the retail class, which has only a 2% exposure, which is mostly just hedge funds, is still a huge area of growth.

So if you're in an asset class where you can perform for firms like ours 1,000 basis points or more in terms of your products you should expect that those institutions that observe that phenomenon would like part of that and will increase their allocations, because the asset class has been very resistant to loss in the down part of the cycle. That's something that's very important to understand, actual loss is almost negligible. There's some mark-to-market type of loss at bottoms of cycles. But I think we've now shown, as a public company and also as a private company, that's just a very transitory issue, these marks, and we historically have boomed back with very large profits.

So I think we're seeing increases from virtually every asset class. Occasionally there's an endowment that has been super huge, and alternatives that is trimming back a tiny bit, but that's only because they have exposures that are double or triple the normal investor. I think there's a lot of white space to come here with big numbers.

D. Ryan Thank you.

Coordinator Your next question comes from the line of Craig Siegenthaler with Credit Suisse. Please proceed.

C. Siegenthaler Thanks. Good morning. If we look at the entire business year increasingly you're seeing higher organic growth outside the private equity and real estate boxes. I'm just wondering, do you think this is partly a function of where we are on the macro cycle or do you think this represents the longer-term scale advantages in the hedge fund and credit platforms here?

T. James Well, I'll take that. I think it's some of both. I mean we're clearly in a favorable market cycle; returns are high, flows to alternatives are increasing, and so on. They're increasing because the reverse denominator affect partly, and because a big chunk of traditional portfolios are in fixed income where people are earning very little and they just need more returns. So there's clearly a favorable environment for fund flows in our industry.

Same time, we're opening a lot of new asset classes in new regions and new products and with great people and great returns, and that's secular, that's going to continue. There will be a cycle overlaid on that, but over the long term, it stuns me to say this, but I think looking forward our long-term secular growth rate, take the cycle out of it, at $270 billion is just as high as it was at $70 billion.

C. Siegenthaler Thank you.

Coordinator Your next question comes from the line of Brian Bedell with Deutsche Bank. Please proceed.

B. Bedell Great. Thank you for taking my questions. Just circle back on BCP V. If we look at this longer term in terms of its lifetime realization potential, just make sure I have the math right here, if you have about a total fund value of roughly $33 billion, and even if we used a conservative 1.6 multiplier on invested capital, about $12 billion of profit essentially. If we just take 20% of that we're looking at a lifetime realization of about $2.5 billion assuming that you get through the 13% and can accrue carry in full. Is that correct? And then how much have you realized in cash carry on BCP V so far?

L. Tosi Okay, so your math is directionally correct that you just went through on the $2.5 billion, $2.6 billion given the assumptions that you gave. I think the end of your question was how much have we realized in BCP V life-to-date?

B. Bedell In cash carry, yes.

B. Bedell In gross cash carry.

L. Tosi It's about $320 million gross life-to-date.

B. Bedell Great. That's great. And just one last one on the fundraising, looks like you're at a solid pace at $15 billion plus in fundraising, not just this quarter but over the last year. And from everything that you've said in terms of new markets, including core-plus being "gargantuan" of potential size, should we be thinking of that $15 billion on sort of an annualized pace moving up over the next one to two years?

L. Tosi So you're talking about whether we would be at a $15 billion pace net we'll call it gross inflows per quarter. Is that what you're asking, Brian?

B. Bedell Yes. Correct. Correct.

L. Tosi Well, if you look at the $62.4 billion over the last year has about $10 billion of inorganic, which is the acquisition of SP, so it will normalize around $52 billion. That's higher than it's been the last couple years; we've been somewhere around $45 billion, $48 billion, and then $52 billion. So, directionally I guess your $15 billion is right. It won't be consistent like that. I'm sorry; I'd say it's a little bit high, I think somewhere between $45 billion and $50 billion is a more normalized run rate.

B. Bedell Yes, which will be great.

T. James It's kind of a static business that's grown over time. Incidentally, I just want to note that your one-sixth assumption on where that whole thing comes out, we're already at one-sixth.

B. Bedell Yes. Yes, no that was conservative. Yes. I know there's potential to achieve a lot more than that.

Coordinator Your next question comes from the line of Bulent Ozcan with Royal Bank of Canada. Please proceed.

B. Ozcan Hello. Good afternoon. I had a quick question on capital deployment. I heard your first comments, but I'd like to dig a little deeper into it and to just get on the record levels of dry powder. For instance, Catalunya Banc came out today saying that it's selling its loan portfolio to Blackstone; it's an $8.6 billion worth of loan portfolio. It's just, again, it was a very competitive bidding process with a lot of your peers participating in this process.

My question is what is it for Blackstone that makes this deal work, what is it that allows you get to the IRR's that you're targeting? Essentially what's your secret sauce, because I would that it's a plain, vanilla kind of asset that you're buying. And maybe I might be wrong on that, but I just want to understand that they will get really targeted IRRs today when they deploy $2 billion or so of capital.

T. James Yes. Okay. Well, first of all, it obviously got attention from some other bidders, but there weren't a lot of them. There were very few of them, not only because it was complex, it's a portfolio with a lot of—a lot you have to work it, it's not just a passive asset. These are non-performing loans.

Secondly, our real estate people own a servicer in Spain already, so we're positioned to do the servicing, a lot of the servicing of loans ourselves, and have unique insight into how these loans can get worked out and how we can deal with the homeowner and so on and so forth. And we're buying this at a huge discount to face and with leverage and a discount to the underlying replacement value of the physical assets if we were to own them.

So we have the downside covered, we have leverage in it with our view of what we can do through our servicer, and a view, frankly, that Spain at least has bottomed out and the wind will probably be at our backs in terms of values, we think we'll get to our returns.

B. Ozcan I see. Maybe based on a similar transaction, because you guys bought assets in London from Carlyle. They're basically saying that it's a great time to sell right now, and it seems like they're trying to buy it, fix it, sell this kind of product, office property, anymore. What drove the decision to buy the property from Carlyle; what is your view, like what's the difference in your view versus Carlyle's view?

T. James Well, I couldn't tell you what Carlyle's view is, except that's being bought by our core-plus business so it's lower risk, stabilized assets with somewhat lower turn hurdles, but we think we'll get a double-digit return for our investors. We're very confident about that.

I didn't even know they were in the real estate business, actually, but our real estate people are the best operators in the world. We can buy an asset from anyone and run it better and get more cash flow out of it.

B. Ozcan — Sure, and congratulations on a great quarter. Thank you.

Coordinator — Your next question comes from the line of Warren Gardiner with Evercore. Please proceed.

W. Gardiner — Thanks. So you guys may have kind of already answered this, but just kind of remind us what's your policy around sort of the distribution of cash carry is now that BCP V has crossed. Will you or did you kind of hold some of it back just to build kind of a buffer or is it sort of more formulaic and immediate?

L. Tosi — Okay. It's LT, Warren. All of our funds and all of our deals we calculate carry on a deal-by-deal basis. When a fund is generating carry, i.e. it's above the hurdle, we payout realizations as they're earned, so there is no concept of holding things back. Now, in order to do that you have to look at where you think the entire fund will end up, and if you're conservative in forecasting the future values of the whole fund you should be conservative then in calculating what you're paying out, and that should cover you with respect to future changes. So that's how we do it.

So BCP V actually has been taking cash carry for a couple of quarters, because it consists of two separate funds, and there are LPs in one of the segments that we're already paying carry going back to the first quarter. Now a larger percentage of them in both sides of the fund, including the smaller fund and part of the larger fund are paying carry as well. But there's no concept to just indiscriminately kind of holding things back; it all goes to the conservative outlook that you have, and that would make your calculation of payouts conservative.

W. Gardiner	Okay. Okay. Understood. Thank you.

Coordinator	Your next question comes from the line of Chris Kotowski with Oppenheimer & Company. Please proceed.

C. Kotowski Mine was just asked. Thank you.

J. Solotar Very nice and I see that we have two follow-up questions.

Coordinator Your first follow-up question comes from the line of Brian Bedell with Deutsche Bank. Please proceed.

B. Bedell Alright, thank you for taking my follow up. Just wanted to circle back on the core-plus. You've raised $2 billion so far in that. I don't know if there's a way you can sort of size that opportunity for fundraising, given your expertise in real estate, over the next say two to three years in terms of going back to the fundraising size question. And then, also, can you remind us of the types of IRRs that you're underwriting in the core-plus portfolio overall?

T. James Alright. Well let me just clarify one thing and then I'm going to turn the ultimate size over to Steve, because he's our dreamer, he sets our standards and goals here, and whatever he sets it, we accomplish it.

So I said near $2 billion. Between what we've closed and another transaction we have in process it's actually about $1.8 billion now, someone tell me if I'm about right.

L. Tosi That's right.

T. James Okay. So that's where we are now, and then I'll turn it over to Steve for how big this business can be.

Oh, and let me just comment on the returns. The returns are in the low double-digit net area.

B. Bedell Okay.

T. James Steve.

S. Schwarzman Yes, this is an interesting one, because the core-plus asset class is about three times the size of what we're doing in the opportunity class. In the opportunity segment now I guess we're up to around $80 some odd billion, not all of which is equity. We have probably, LT, somewhere around $10 billion of debt products in there and a little bit, something like about $10 billion.

So, as I think about this, and this is my own personal view and not everybody always agrees with me, even within the firm that's for sure when we get into these new areas, but I look at a business like that if what we think is going to happen year one is about $5 billion, and if we can continue to do the kinds of things we think we can do in terms of producing returns Tony was just talking about. If you could look at a business like this over a 10-year period and have $100 billion under management now that's something that would make my general counsel really squirm, which apparently I can see him, he's squirming. And there's no guarantee; that's what I would call an aspirational goal. Most people would say if you could do half of that that would be pretty terrific.

I think the reality is somewhere in between. I am a believer in the high end of that. I think if you can deliver $10 billion, $11 billion, $12 billion returns to institutions who are really focused on making $8 billion, and if you can do it with real safety, you'll have good flows there. The advantage we have is that we have the most active deal flow in the world in real estate, and for us all we're doing is chopping off the lower return end of properties that don't meet our opportunistic criteria for our funds.

We should see an awful lot of this type of thing, and we're set up perfectly with a major asset management capability to improve properties. We also have a terrific set of relationships with people who give out real estate money around the world. In the opportunity area I guess we're like somewhere in the last year or two I forget whether we've raised six times more money than anybody else in the world or eight times. It's some number that LT or Joan can get you after the meeting, but it dwarfs what everybody else is doing.

So I think with a really good product like this with an asset class that is already three times the size, we should be able to do the kind of numbers over time that I'm talking about.

B. Bedell It sounds like your LPs have been asking for this or was it more of the creation on your side? It sounds like the demand would be very strong, given the increasing desire to immunize portfolios, pension-kind portfolios, and—

S. Schwarzman Yes. Finance is like a very funny business; what passes for innovation isn't so innovative. This is the kind of thing where we have product, really quality buildings that would fit this kind of model that really just simply do not meet the criteria for the opportunity part of our business. We took these products, you start with one opportunity then you go onto others, and there was a huge amount of receptivity on the part of the institutional community. What happens is once you discover that you do a second, you do a third, you do a fourth, and you see that there's really a big demand. So what we realized is that we can take our same set of skills and basically just segment them and the market would respond to it, and that's why we did it.

B. Bedell — Okay. Great. That sounds pretty compelling, actually. Great. Thanks very much for the thoughtful answer.

Coordinator — And the last question comes from the line of Robert Lee with KBW. Please proceed.

R. Lee — Thank you, and thank you for taking my follow-up, and I appreciate the patience with the call today. The last follow-up is I mean clearly you guys have had a lot of success in a lot of places, launching new strategies, raising assets in those strategies, starting some 40 Act product. But I guess just kind of curious, I'm sure, I think, most businesses, as successful as they may be, always have one or two things that they've tried that didn't pan out as expected or as hoped. I'm just curious to know over the last couple of years if there's some new strategies that you've launched or took a stab at or new markets or geographies that you were thinking of entering that didn't seem to pan out. Just trying to get a feel for maybe what some of those were, but, more importantly, maybe why you think those didn't succeed as you had hoped and how that maybe altered how you approach new product development or going forward.

T. James Okay, well I guess I'll take that one. Of course we've had initiatives that didn't pan out as we hoped. Sometimes the performance wasn't sometimes it was our own making, our performance wasn't what we'd hoped; sometimes it was a great idea, but the market just didn't want to fund it or the timing was wrong; and sometimes whatever the business premise was the world changed and, therefore, the opportunity sort of disappeared.

Examples, we had at one point in this business a mutual fund business, ran closed-end funds, they were the largest mutual fund in India, and they had one invested in—not India, in Asia. It was a closed-end fund, as I mentioned. It was obviously the meltdown in global markets and those currencies and their stock markets in particular made that performance not very good, and it kind of got subscale, and we just decided, having owned the business for a while, we decided there weren't a lot of synergies, and we sort of went our way.

One of the earlier calls someone asked about getting long-only business, and I think one of the learnings there was there's not a lot of synergies between a long-only business and what we do generally.

So that's an example. We've tried other things, whether that be an office or not or a product, but nothing big. I think we do a pretty good job focusing on really good opportunities and getting really good talent to do it. I think the most important thing that we have is we have to attract the best talent in the world, we have to train it, we have to adapt our culture and the way we think about things, and if we do that and we put really great talent against the opportunities we see, we don't miss that much. So we're not perfect, but we feel very confident about the opportunities on the page.

R. Lee Great. Well, thank you for taking my question, and I hope everyone has a great summer.

J. Solotar Great. Thank you, and thank you, everyone, for dialing in, and look forward to any follow-up questions after the call.

Coordinator Ladies and gentlemen, that concludes today's conference. Thank you for your participation. You may now disconnect. Have a great day.