THE BLACKSTONE GROUP

Q4 and Full-year 2013 Earnings Conference Call

January 30, 2014

Ubiqus/Nation-Wide Reporting & Convention Coverage
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Q4 and Full-year 2013 Earnings Conference Call

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OPERATOR: Ladies and gentlemen, thank you for standing by. Please continue to hold. Your conference will be underway momentarily.

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OPERATOR: Ladies and gentlemen, thank you for standing by. Welcome to the Blackstone's Fourth Quarter 2013 Earnings Call for the Media. During today's conference call, all participants will be in a listen-only mode. Later we will conduct a question and answer session. Instructions will be given at that time. If you should require assistance during today's conference call, please press the star (*) followed by the zero on your telephone keypad. As a reminder, today's conference is being recorded.

I would now like to turn the conference call over to our host, Senior Managing Director Peter Rose. Please go ahead.

MR. PETER ROSE: Good morning everyone, and welcome to Blackstone's 2013 fourth quarter and full-year earnings call for the media. With me is Tony James, Blackstone's President, Joan Solotar, Senior Managing Director for External Relations and Strategy, and Laurence Tosi, our Chief Financial Officer.

As always, Tony will open with a brief summary of our highlights of the quarter and the year, and then we would be delighted to take your questions. Before handing over to Tony, let me remind you that at 11 o'clock Eastern Standard Time this morning, we will have a call for our investors. You're all welcome to listen to that, and the dial-in numbers are in a press release on our website. Tony.

MR. TONY JAMES: All right, thanks Pete, and thank you all for tuning in. I'd have to say we had just a fantastic fourth quarter. Virtually every business was humming. And while the balance of the firm in general is a great strength, it is amazing to see the power of this place when it fires on all cylinders at once.

Revenues jumped 63% and ENI, or economic net income, soared 76% to $3.5 billion.

Distributable earnings per unit for the year were $1.56, an increase of 68%, providing about a 5% yield on our current stock price.

We raised over $50 billion in new assets during the year, bringing our year-end AUM, assets under management, total to $266 billion, a new record. That's up 26% year over year, despite the staggering sum of almost $30 billion in realizations and distributions to LPs. Since 2007, when we went public, our AUM has nearly tripled.

In private equity, revenues were up 76%. This was driven primarily by increased values of our portfolio companies, which appreciated 11.5% in the quarter. Total portfolio return for the year in private equity was 28.5%. Our portfolio companies are seeing steady improvement in economic conditions and offering results, and they expect growth in the U.S. to continue building. Average EBITDA of our portfolio companies last quarter grew about 11% year over year.

Realizations in private equity, driven primarily by public equity sales, were 3.3 billion for the quarter, and a huge number, 9.6 billion, for the year. The average multiple of invested capital for our LPs in these deals was about 1.9 times cost on average, continuing excellent performance.

We also invested or committed $3.4 billion of new capital during the quarter, bringing the total for the year to $5 billion, a very respectable amount, given the tight market for new deals.

Finally, we raised about $2.5 billion in new funds during the quarter, primarily for our Tactical Opportunities and the Strategic Partners' secondaries business.

For the year, AUM in PE jumped 29%, to $66 billion.

Real estate continues to rock. Revenues were up 239% for the quarter, and 96% for the year. As with private equity, this was driven primarily by performance from strong investment returns.

Overall the carrying value of our real estate funds appreciated 13.1% for the quarter, driving portfolio returns to 31% for the year.

We also had a big year for realizations, at $2.8 billion for the quarter, and $7.4 billion for the year. The average multiple of invested capital on these exits for our investors was about two times.

Fundamental economic conditions in U.S. real estate continue to improve in terms of both rising occupancies and higher rent, while new supply of commercial property remains very modest and building costs are still generally well above what can be justified by today's rents.

We invested just over $4 billion for the quarter, mostly outside of the United States. This continues our high rate of investment and brings total investments and commitments for the year to $11.6 billion, an amazing feat, and our most active year for new investing ever.

Fundraising also delivered a record year in real estate, with almost $16 billion raised. During the quarter we raised about $6.5 billion, predominantly in our Asian and European real estate funds, both of which we expect to hit their caps. This drove total AUM in real estate for the year up 40% to nearly $80 billion.

Hedge fund solutions also had a great quarter with revenues up 44%, earnings up 63%. The main driver for these big increases was a surge in performance fees, driven by strong investment performance.

Composite investment return was 3.8% for the quarter, and gross returns were 12.8% for the full year, all the while maintaining volatility of only about one-third of that of the S&P.

On the basis of this excellent risk-adjusted return, fundraising was strong, and assets under management jumped 21% to $56 billion.

Despite rising interest rates and the beginning of Fed tapering, our credit business, GSO, performed very well. Coming on top of a great 2012, revenues for GSO for the year were up 13%, and earnings were up 10%.

GSO's investment performance was nothing short of spectacular. Our hedge funds were up 24% for the year, our mezzanine funds were up 26% for the year, and our rescue lending fund was up 33% for the year. Most equity funds cannot match these returns.

On the strength of this performance, fundraising was robust with over $4 billion of new money brought in during the quarter, driving AUM up 15% in the last 12 months to $65 billion.

Financial advisory revenues grew 15% for the year, driven by increased activity in the Park Hill Fund Placement business, and surprisingly strong performance in our restructuring advisory business. Restructuring had its second best year ever, despite an improving economy and abundant access to capital for even troubled companies.

In addition, our new Blackstone Capital Markets business had a great year, co-managing or advising on 34 different equity deals, and 51 debt financings. Overall, earnings for the advisory segment jumped 61% to $76 million for the year.

Beyond the numbers, we are very proud of the recognition we have received as the best place to work in financial services in both Pension and Investments, and in Vault Magazine. We also received a huge number of industry awards including, to name just a few, Global Firm of the Year in Real Estate, and the top-ranked Bankruptcy and Restructuring Advisory Firm, along with two surprises: Issuer of the year in capital markets, and recognition as one of the leading companies in America in technology innovations and infrastructure.

In addition, we combined with First Lady Michelle Obama on the Joining Forces campaign and have hired 8,000 veterans into our various portfolio companies.

Finally, the Blackstone Charitable Foundation has rolled out its Blackstone Launch Pad Program on 15 university campuses in six states, connecting 350,000 students to their entrepreneurial dreams.

For the financial results, the investment performance, the commitment to society, I would like to thank our amazingly dedicated and talented employees. I thank all of you, and I'd be happy to take any questions.

MR. ROSE: Operator, we'll take questions now. Thank you.

OPERATOR: Thank you. Ladies and gentlemen, we will now begin the question and answer session. If you would like to ask a question, please press star (*) then 1 on your telephone keypad. If you are using a speakerphone, please pick up your handset. Once again, if you would like to ask a question, please press star (*), then 1 on your telephone keypad, and you may remove yourself from queue at any time by pressing the pound key.

One moment, please, for the first question. The first question comes from the line of Steven Foley with Financial Times. Please go ahead with your question.

MR. STEVEN FOLEY: Good morning. I just wanted to ask on investments. You say that most of the investment is outside the U.S. To what extent is that you were elsewhere and to what extent is that an economic call for the coming years, and perhaps you can put that in the context of what's going in emerging markets.

MR. JAMES: Okay, well, that comment was in the context of our real estate investing, just to be clear, and what that's really driven by is a lot of our focus in real estate is buying distressed, good quality properties owned by distressed owners where the properties are sub-optimized and we can go in and fix them up, improve them, and lease them up and increase the cash flows.

What's happened is, though, for the last few years, there was an awful lot of opportunity in the U.S., but not much for sale in Europe, as the banks really sat on their assets. That shifted in both markets. U.S. has healed a lot, so there are less distressed properties for us to focus on, and values have come up a lot. And in Europe the banks are starting to be more aggressive, given their healthier balance sheets, about disposing of assets. So there's now a lot of opportunity in Europe that we see.

So that's kind of a market-driven shift. It's less a call--based on where the values are, less a call on projecting the market improvement. We actually think that the economy in the U.S. is a great place to be. It's probably the strongest place to be in the world right now, but the values are better in Europe, Europe, we feel, has bottomed out and will get better.

As far as emerging markets go in real estate, there's some fantastic opportunities all of a sudden because of the flight of capital out of emerging markets and the tighter money in a lot of those countries. We're suddenly able to buy real estate properties in fast-growing long markets, longer term and below physical replacement cost. And that combination of still being able to buy at bargain prices yet, very strong long-term growth is very appealing.

So our investment rate and our opportunity set in emerging markets have expanded a lot also.

OPERATOR: The next question comes from the line of Devin Banerjee with Bloomberg. Please go ahead with your question.

MR. DEVIN BANERJEE: Hey Tony, thanks for your time, as always. My question was about recent deals, recent private equity deals in the past, say, five to six months, that other firms have done but that we know you were in or around as a bidder. Now presumably if these other firms are, quote, unquote, "winning the deals", it means in most, if not all cases, they are bidding higher than you, you are bidding lower than they are, and I think we've tracked this several times in the past six months or so.

And my question is, does this mean you think the prices, the multiples that your peers in the industry are paying for companies are unwise, shall we say, and are you frustrated at all that your private equity group is putting in the due diligence, putting in the modeling, putting in the time, and then not coming away with these companies?

MR. JAMES: Well, let me start by saying, in general prices are high. There's no two ways about that. The combination of robust credit and a high equities market and the return of some strategics mean there's a lot of demand for companies, and the supply of companies for sale is not all that high. So that combination has pushed prices up.

I wouldn't go so far as to say that what our competitors are doing is unwise, however, because a lot of these are quite good companies, they'll earn better than public market returns for their investors, and often those other companies have an insight or an edge that we don't have that means they can sometimes get to higher prices. So I think it would be premature to conclude that those deals are unwise. We maybe couldn't get there looking at the cards in our hand on some of those prices, but that doesn't mean that, by any means, that they made a mistake.

But you're right about one thing. It is frustrating for our guys to keep going after things and keep getting outbid. And the things Steve and I have to do as managers is just make sure that that frustration doesn't bubble over into people over-paying, on the one hand, or just getting discouraged and retreating on the other. We have to stay in the game. We stay in the game every day, but we do that in a disciplined way.

MR. BANERJEE: Okay. And Tony, can you give us an outlook then for U.S. deals this year? I mean, do you think--I think you've said in the past that with Fed tapering picking up, there should be some more disruption, prices should come down.

MR. JAMES: Well, I don't know that I've said that particularly. I have speculated that the Fed's aggressive stimulus program has pushed up asset values, and as that's withdrawn, you can see asset values under pressure. However, the tapering is so gradual and so well communicated that so far, unlike the way the market got spooked last June when the Fed first mentioned it, when they started the tapering, the market actually rallied pretty strongly. Now lately it's been a little choppier.

So I think where our view would be equity markets hang in there, and there's still a lot of cash on the sidelines, interest rates still are attractive in a historical context, and so I'm of the view that prices will still stay high.

In addition to that, we're seeing, on some of our other businesses, more interest from strategics in making investments. So I think there will be more strategic acquisitions. That can be bad if we're going up against a strategic, but it's also good in a way, because usually when there's a lot of strategic activity, somehow it spawns spinoffs in other things being sold and rationalized, and the private equity volume usually goes up as their strategic volume goes up.

MR. BANERGY: Okay, thanks, Tony.

OPERATOR: The next question comes from the line of Greg Roumeliotis with Reuters. Please go ahead.

MR. GREG ROUMELIOTIS: --a strong year. I had a couple of questions. Can you talk generally about expanding the Blackstone investment platform, particularly how you think about physical commodities. Philosophically in general, then any particular appeal of this asset class and how you would go about it, and particularly if you were to pursue the commodities unit of a major Wall Street bank, and I'm completely speculating here, how would you deal with - - liabilities given Blackstone's balance sheet and issues like that?

MR. JAMES: Okay, Greg, well, commodities is an area that we have been thinking about for three years and looking at. We've looked at several opportunities in that space. We think it's interesting on one level, but very, very challenging on other levels for us.

Our business is to manage other people's capital, and most of the successful commodities businesses are firms that are based around having a strong presence in actual physical assets and a lot of infrastructure, and that provides some asset management or trading opportunities, but you've got to have that chassis, if you will, to build the business on.

And putting all of that--that's inconsistent with sort of an asset light asset management model, which is the model that we've taken to our business. So in that sense it's somewhat incompatible. I can't see having a vast balance sheet with lots of assets on our balance sheet; it's just not the way we are.

And in addition, as you point out, if you're in the physical business and you have oil spills and stuff like that, it's complex. So we're trying to figure out what is right--is there a strategy that's a winning strategy in commodities that's compatible with us and what we do well, and I don't think we've got that figured out just yet.

MR. ROUMELIOTIS: Okay, and just to follow up on Devin's question, can you talk a little bit, if the micro-economic environment changes this year and monitoring policy tightens a little bit, how could this affect your credit business in particular given that in 2013, given where interest rates were and where the higher market was and all that, obviously it was the least successful of your businesses in terms of ENI. But I appreciate it's only a year, but maybe you can talk a little bit about the outlook for 2014.

MR. JAMES: Well, I think that--I mean, percentage increases in that business were lower, but it was at a great 12, so it had a much higher starting base than the other businesses. So I think that's not quite a fair way to say it. I would say that it probably had the most successful investment performance of any of our businesses, not the least, just to put that in context. But anyway--and I don't mean to split hairs.

Our guys have basically no interest rate exposure in their book, so they've been expecting higher rates for a long time, they've got a lot of cash, they've got a lot of floating rate stuff, and they've got very short duration assets. So if anything, what they're hoping for is higher rates so they can reinvest that money, and their floating rate stuff will float up, obviously, but the cash in the balance sheet--the cash in the sidelines can come up off the sidelines and into longer term stuff at more attractive yields.

And so I think they're rooting for more aggressive tapering, and of course we never root for market disruptions, but we're well poised to take advantage of it if it happens.

MR. ROUMELIOTIS: Okay, thank you so much.

OPERATOR: The next question comes from the line of Sasha Day with Dow Jones. Please go ahead.

MS. SASHA DAY: Good morning, everybody. Hi, Tony. First question I have in regards to Tactical Opportunities - - it seems that that account has been deployed more than 70%. We understand that has been organized more as a separate account versus close-end funds. But still wondering if you plan to raise new capital for that bucket, and if so, in what form or shape would the new capital be? Would it be a re-up with existing investors, or will it be new investors?

MR. JAMES: Sure, Sasha. Well, Tac Ops is like, for me, the most interesting and exciting new thing we've done in a long time. And this is his first full year in business. We closed off the fundraising now and it'll be--there's a few documents still to sign, but it will be somewhere between 5 and 5½ billion dollars that we'll have to invest. So a remarkably successful start.

But what makes it really interesting for me and the other people in the investment committee are a few things. Sorry to get on my soap box about this, but #1) it's the only business we have in the firm that's got the leaders of all the business on the investment committee. So I get to sit in a room with Bennett Goodman and John Gray and Tom Hill and Steve Schwartzman, Joe Baratta, and talking about the world and concepts, and wow, this is an amazing group. I mean, just being able to sit in there with those guys of that intellectual caliber and that insight, it's stunning. And so that's the one thing.

Secondly, the things we're looking at are just really interesting, really varied, all new, all different. I've been doing this for near 40 years and when you do that that long, you really want to keep learning. And the learning associated with what we're seeing here is amazing.

So I'd have to say that this business is off to a spectacular start, and it's really a credit to David Blitzer who has built this business from scratch, simultaneously building a team, conceptualizing the business, fundraising, finding investors, making investments, all at once. He's a three-arm paper hanger here and he's done an amazing job.

The investment--I think you've got the investment pace a little wrong. We're not 70% invested yet. We're closer to a third invested. At the pace we're going, we'll be back in the market probably in a little over a year. The pace has ramped up a lot. And we expect both re-ups and a lot of new investors because we've turned away a bunch of investors who couldn't get into it. And the returns have been just unbelievable, by the way, with double digit cash and cash yields, and mid-20s for IRRs.

MS. DAY: Okay. The second question has to do with the exit outlook and perhaps more specifically the IPO outlook, and the shown returns from this quarter, it was on the backup as showing IPO performance of several portfolio companies. How long do you think that window is going to remain open?

MR. JAMES: Well, Sasha, you tell me, and you probably know as well as I do. I hope it's a long time, because we have more to do. I personally believe that it will stay open for the foreseeable future. And let's just--by that, I mean, let's say another year. Because I think there are more tail winds than head winds. I think the tail winds are, the U.S. economy is definitely picking up strength. We see that in our portfolio companies, we see that in our CEO attitudes. It's wanted to grow for a while, but at this point it doesn't have the head winds that we had last year.

Remember last year, we had all kinds of fiscal drag. We had sequestration, we had higher taxes, and so on. We had a shutdown on the government, and a lot of stuff that--and the economy just sort of bulled right through that.

And meanwhile what we've got in terms of growing forces for good and the economy is a pick-up and construction activity, which we think must happen, because we're way behind where we need to be in terms of building both residential and commercial real estate, and, of course, the beneficial effect of low energy prices, which is pulling manufacturing back to the U.S., and also driving exports, because it makes us globally competitive. So those things drive a strong economy.

I think there's still a lot of cash on the sidelines and I don't think--it wants to go into credit now; rates are still low, and if rates go higher, it's not going to want to go into long-term credit. And so I think that there's still a pent-up demand for equities. And if you look at the equity multiples in the historical context, they're not near a peak in terms of multiples, they're sort of in the middle of somewhere, about right, about long-term average.

So I think that's a pretty benign outlook for equities. Do I expect the market to be up 30% again this year? No, I don't, but I would expect the S&P to be up something, and I think as long as it stays solid, it will be a good market for IPOs.

MS. DAY: Okay, I appreciate it.

MR. JAMES: Let me just add one other thing. The IPOs that we have done have had spectacular individual performance. So I think investors are smart enough to realize that when we sell, we're selling good companies, we're selling them at fair prices. We ourselves are holders. We continue to think there's a lot of value we can add and create in the company, and the performance of the stocks of these companies with IPOs has been great.

So I think with that picture, investors would be nutty not to buy our IPOs.

MS. DAY: Tony, thanks so much. And one last question from me. Steve last week on CNBC made a comment about the whale accident at a Sea World back in 2010, and Blackstone had to issue a press release later on, essentially to retract his comment.

Now putting aside all the specifics of that tragedy or the implications thereof and who was at fault there, but just from a reputation management or crisis communication and management standpoint, what would you take away from that?

MR. JAMES: Well, I mean, I'm not sure exactly how to answer your question, but I'll say that it's a bit--for me, I don't know about Steve, but for me it's really nerve-wracking to be up there on TV. At the end of a long interview you get tired. I think Steve's apologized, and inevitably, when you're talking to people in public, this call also, there are always things I say on this call that I regret. And half of them, I don't even mean, it just sort of comes out. So I don't know about Steve. He's better at it than I am. But I can tell you, this is fraught with risk.

MS. DAY: Thank you so much, Tony.

OPERATOR: The next question is from the line of Ryan Dezember with *Wall Street Journal*. Please go ahead.

MR. RYAN DEZEMBER: Yes, good morning. I wanted to follow up on Sasha's question about IPOs. And I wanted to see if you could provide a little color on your queue of potential IPOs going into this year. And also you mentioned the strategics are kind of back in the game, and you had some really big sales, you know the sales, the GeoSouthern assets to Devon, the tanker company to Kinder Morgan. How does their return to the M&A market as buyers affect your decision making on kind of when to pull the trigger on an IPO? Is that something you guys are wrestling with now? What's your outlook there?

MR. TONY JAMES: Well the tried and true way to exit now is sort of what they call a dual track, where you file an IPO and then you sort of put out feelers to strategic buyers to see if they're interested. So many times the strategic buyer will let something go public, and then lo and behold after it's public, a year or so later, one, two years later, the strategic buyer comes out of the woodwork and buys it at a premium to the public market. And I think that's one of the good things frankly about private equity IPOs in general, is public investors know there's a committed, rational, influential shareholder who still might have a majority of the stock.

So if there's a strategic bid that develops, instead of like so many companies trying to stay independent, they'll take advantage of it. And I think that's a benefit to public investors owning private equity backed companies. But we kind of look at those independently. We try to assess what the IPO value is, and it's less the value when we IPO, but it's because it's what the public value is apt to be over the next few years, which is a hard thing to assess. Because when we IPO, we expect it to trade to a premium. We price it to trade to a premium, and we're not going to sell any IPO as I mentioned. So it takes us several years.

If we are going to exit the public markets, it takes at least three years to exit after the IPO. So we're trying to assess how will this company trade long-term as a public company. And does that justify embarking on that trail? At the same time we - - that is what would a strategic sale value be? And frankly what would a sale value be to another LBO firm at a tertiary or secondary buyout? And when we can see roots there that we're confident about, then we begin to move towards an exit. And now we probably, in terms of what we anticipate this year, we've got a couple of deals filed. But I would say we've got a clear line of sight on probably seven or eight equity financings this year.

MR. DEZEMBER: Oh, okay. And then switching over to real estate, your rental home platform, I think last time you guys did a call you were still investing something, some staggering rate, 100 million a month or a week or whatever it was at the time. Any color there on kind of your rate of investment? Have you put on the breaks a little bit, or is inventory running low on your targeted markets, or what's that looking like?

MR. JAMES: Even recently, we were still investing at the $100 million a week rate. It's slowed down somewhat, as values have come up. And there are some markets where we're not putting more money to work, and there are other markets where we still see opportunity. We still believe there's more to go. And we still are very positive on continuing to put capital to work on this. But I'd say we're in the, I don't know, seventh inning. It's slowing down.

MR. DEZEMBER: Okay. Thank you.

OPERATOR: And our final question comes from the line of Joe Mantone, with SNL Financial. Please go ahead with your question.

MR. JOE MANTONE: Hi, I saw that there was a stock sale of BankUnited announced recently. Do you have any idea on where that will put your stake - - how much is left?

MR. JAMES: I'm going to turn that over to LT.

MR. LAURENCE TOSI: Yeah, - - less than 10% of the whole entity right now, and that was I think the fourth or fifth realization that we've had since the time it went public.

MR. MANTONE: And any areas in financial services that you kind of see as interesting right now?

MR. JAMES: Yeah, well we still like, especially finance in general, we continue to be active there. And the thesis goes something like this. When the financial crisis happened, a lot of the large providers, and especially finance, had troubles, not because the asset quality, not because they were write-offs on the assets, but because they couldn't finance their own liabilities anymore. They couldn't roll their debt. So a lot of either pulled back, shrunk, or exited the market. And so a lot of capacity to make, especially finance loans, has left the market.

At the same time, as I mentioned, the asset quality held up fine, generally. And the demand, the need for capital from less than investment-grade borrowers, whether they be individual or corporate, has not only not diminished, if anything, it's higher. And with the banks pulling back, that’s taken more supply away. So we see good assets, lots of demand, less supply. And so we've been able to identify some great management teams, good companies, and fund them with new equity and growth capital to fill this need.

And the beauty of that is we've been putting money into these companies, as equity, so to speak, at book value, earning a very nice return on equity. And we expect as these, and these are rapidly growing companies now, and we expect to be able to exit at a good multiple-to-book value. So the compounding effect of a high return on equity growth and multiple expansions in terms of book value, we think will lead to some very nice returns in this area for us.

MR. MANTONE: Are you getting close to exits there?

MR. JAMES: No, we don't have anything that we're close to on that.

MR. MANTONE: And then finally, I mean I don't know how specific you can get, but today there was a report that RBS Securities was on the block. Might a business like that be something that you can be interested in?

MR. JAMES: No, we're an asset manager. I don't want to be in the investment banking business.

MR. MANTONE: Even from a private equity standpoint?

MR. JAMES: Well, we'll look at anything in private equity, but it's a hard business because you need to have a lot of balance sheet. You need to have a lot of capital strength. It's volatile; it's highly regulated. The regulatory rules are changing. And it's a very hard fit for private equity.

MR. MANTONE: Okay, thank you very much.

OPERATOR: Please continue. There are no further questions.

MR. PETER ROSE: Okay, thank you everyone, for joining. If you have further questions in the course of your reporting, please just call the Media Relations office and we'll do our best to help you. Again, thank you for joining.

OPERATOR: Ladies and gentlemen, that does conclude our conference for today. Thank you for your participation, and for using AT&T Teleconference. You may now disconnect.

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