Blackstone Third Quarter 2015 Earnings Call
October 15, 2015 11:00 a.m. ET

Coordinator: Good day, ladies and gentlemen, and welcome to The Blackstone Third Quarter 2015 Investor Call. At this time all participants are in a listen-only mode. Later, we will conduct a question and answer session. (Operator instructions.)

I would now like to turn the conference over to your host for today, Miss Joan Solotar, Senior Managing Director, Head of Multi-Asset Investing and External Relations. Please proceed.

Joan Solotar: Terrific. Thanks, Jasmine. Good morning, everyone. Thanks for joining us today for Blackstone’s Third Quarter 2015 conference call. I’m joined by Steve Schwarzman, Chairman and CEO; Tony James, President and Chief Operating Officer; Michael Chae, our newly appointed Chief Financial Officer; and Weston Tucker, Head of IR.

Earlier this morning we issued the press release and the slide presentation illustrating our results and that’s available on our website and we expect to file the 10-Q in the next few weeks.

I’d like to remind you that today’s call may include forward-looking statements, which are uncertain and outside of the firm’s control and may differ from actual results materially. We don’t undertake any duty to update the forward-looking statements and for a discussion of some of the risks that could affect the firm’s results, please see the Risk Factors section that’s in our 10-K.

We will refer to non-GAAP measures and you’ll find the reconciliations for those on the press release and I’d like to remind you that nothing on this call constitutes an offer to sell or a solicitation of an offer to purchase any interest in any Blackstone funds. This audiocast is copyrighted material of Blackstone and may not be duplicated, reproduced or rebroadcast without our consent.

Just a very quick recap. We reported economic net income or ENI per unit of -$0.35 for the third quarter due to the unrealized marks on our public holdings in private equity, real estate and credit. For the year-to-date period we reported positive ENI of $1.45 per unit.

Distributable earnings were $692 million in the quarter or $0.58 per common unit, that’s up 7% from the prior year as realization activity was strong. And we will be paying a distribution of $0.49 per common unit. That’s to unitholders of record as of October 26, 2015 and that brings us to $2.90 paid over the past 12 months, which if you want to calculate it equates to a pretty compelling yield of 9% on the current stock price, which makes it actually one of the highest yields of any large companies in the world.

With that, I’m going to turn it over to Steve and we’ll take questions after Steve and Michael speak and I just want to remind you to please keep it to one question on the first round because we have a lot of folks on the call. Steve?

Steve Schwarzman: Good morning and thanks for joining the call and thanks, Joan. The third quarter, as you know, was a turbulent period for global markets with sharp declines and heightened volatility in basically every publicly-traded asset class. Volatility in the US stock market, for example, reached its highest level in four years.
Markets have moved as though the world is heading into a recession or, at the very least, that the world is facing an enhanced risk of slowing growth. From our perspective, we do not see a recession, but we are seeing slowing in certain regions and sectors with some excess coming out of markets.

Here in the United States with the dollar up 10% to 25% versus many other currencies around the world we’ve effectively experienced a Fed rate hike without actually having one. With that said, we’re seeing lots of positive signs as well. Restrictive building in real estate around the world leaves supply often below demand.

Housing in the US is strong and expected to get stronger. Office leasing is good. The auto and tech sectors are healthy and low oil prices should be good for the consumer. In the lodging space, which has been one of the hardest hit sectors this year in terms of public market valuations, revenue trends actually remain quite strong with industry RevPAR estimated at around 6% year-over-year, which certainly is not reflective of a recession and I find it’s very surprising in terms of a public market valuation.

Overall we see good growth in the US, perhaps slowing a bit from 2014 levels, while Europe appears to have bottomed and is growing slightly faster than we anticipated. In emerging markets, India is in very good shape growing at over 7%, while China is definitely slowing, but still growing faster than much of the world and certainly faster than the doomsday scenarios that I sometimes see on television.

Brazil is facing significant challenges in a serious recession, but it’s becoming more interesting as an investment opportunity ironically as it weakens. In Japan, stimulus appears to be working with slow growth expected for next year.

These are generalizations, however, and our holdings are not reflective of a market. We carefully select sectors and companies, then implement a specific plan to improve those companies and create value and that’s what gives us the super performance we’ve had historically.

Against this backdrop of significant public market weaknesses, Blackstone’s ENI was negatively impacted. The value of our public holdings declined and I think Tony gave you this. Importantly, these declines historically have been temporary. With locked in capital in our drawdown funds we are never forced sellers and can ride out any period of volatility.

Already in the fourth quarter our publics have rebounded sharply, up 7.3% and based on where they are today our ENI of course would have been significantly higher. Most importantly, the growth of our underlying portfolio companies and the long-term value of our holdings continue to build just as the stock market says just the opposite.

In private equity, our companies reported aggregate EBITDA growth of 9% year-over-year. That 9% year-over-year doesn’t quite match what the stock market thinks. In real estate, our companies continue to see strong fundamentals across the board, including high single growth in office rents in the US and the UK and healthy hotel RevPAR growth.

In India, which is one of the hottest office leasing markets in the world, we’re seeing 17% rent growth on new leases. And our Chinese shopping malls, which will shock you, are reporting same store sales growth in the area of 15% to 16%. 
Global recession? Go figure. Overall, we’re not seeing recessionary signs in the portfolio and we feel very good about our current investments. All of this positive performance underlying companies simply does not square with the large declines we’ve seen in several of the stocks, nor in the decline of Blackstone’s stocks.

Volatility is, however, ultimately good for our business, a little bit painful from time to time. We are uniquely positioned to take advantage of dislocations. We’ve seen the public markets correct many times before and, as always, it presents the potential for greater deal flow with favorable risk-adjusted returns. We have the confidence of our limited partner investors and we’ve raised nearly $100 billion in new capital in the past 12 months. Just think about that. That is a stunning number giving us the industry’s largest dry powder balance at a time of significant market dislocation.

We have great flexibility in how and where we can invest depending on the environment. It’s a good thing. For example, in real estate as public REITs decline 15% and lodging REITs went down unbelievably 30% peak-to-trough, as well as some individual companies, we pivoted the public to private transactions.

We’ve already announced three this year representing over $5 billion of invested or committed equity capital, that’s forgetting the debt side of the deal, which is infinitely bigger, of course. With the largest pool of opportunistic capital globally by far we don’t need partners and we can move with speed and certainty to close the largest transactions in the world.

In private equity, where it’s been more difficult to invest recently because of high prices, the pullback in markets broadly is helpful. To the extent that financing becomes less available we can continue to pursue proprietary transactions with well-defined value creation strategies and less leverage at the outset.

Easy credit, the opposite of what you think, tends to simply drive pricing higher, which benefits the seller, but not us when we’re buying. For GSO the recent increase in spreads combined with the lack of liquidity in high yields generally means greater opportunity to deploy our $17 billion in dry powder, which includes new dedicated energy and direct lending funds.

In terms of our existing portfolio we’ve taken a cautious approach towards rates and concentrated on floating rate exposures, not fixed rate, positioning us well in the current investment environment.

For BAAM, our hedge fund complex, we can selectively invest in difficult markets to produce strong risk-adjusted returns. BAAM’s lower volatility approach to investing has produced positive returns year-on-year, outperforming the S&P and many other market indexes.

BAAM continues to be an engine of innovation at the firm and the firm itself is like an innovation machine, creating successful scaled products, such as our new Multi-Manager Hedge Fund. This fund is off to a terrific start raising $1.4 billion and substantially outperforming its peers and any relevant index through September 30.

In terms of realizations, given the long term and locked up nature of our drawdown funds, with no redemptions, we don’t have to sell at the wrong time. And while sustained weakness
in public markets might delay certain dispositions in the near term, the public markets alone do not dictate realizations the way many people think they do.

We rely also on strategic and private sale opportunities and we have several that will close in the coming quarters, which Michael Chae will describe in more detail, driving healthy expected realizations. In other words, the perception that our cupboard will run dry is misplaced. It’s misplaced. Some of you still believe it. You’re wrong.

Even with the recent market volatility we returned, as Tony mentioned, $9 billion to our investors to realizations in the third quarter alone and $45 billion in the past 12 months. And that is clearly not a melting ice cube. We’ve been both raising and deploying record amounts of capital into what we believe are very attractive opportunities across all of our businesses.

This is not the result of raising and investing bigger and bigger funds, but rather having broader, more global platforms and capabilities. In real estate, for example, our core-plus business has already invested nearly $3 billion this year, helping to put real estate on track for another record year of deployment. And core-plus is a business that didn’t even exist here two years ago.

Our average investment pace over the past four years exceeds $20 billion per year from our drawdown funds alone, which is multiples of the investment pace that planted the original seeds for what you see for today’s quite good level of distributions, areas that are at our strongest levels ever.

The logic holds that if you believe in our ability to invest well and we have proven that over 30 years and our LPs believe it, obviously, then you should believe today’s investments are planting the seeds for potential distributions of a larger order of magnitude than what we are harvesting today. It’s all logical.

From a BX stock perspective the firm has demonstrated an incredible ability to generate high levels of current cash flow for our unitholders with sustained growth over time. And I am confident this will continue through any reasonable market and economic backdrop.

To maintain an above average distribution yield on today’s depressed stock price, the medium yield of the S&P is around 2%. We don’t need any realizations for us to have a 2% yield, which is average for the S&P. That’s no realizations whatsoever. We generate more with just our fee earnings, most of which is locked in.

To generate a top decile 4% yield we would need to realize just $0.60 per unit in net performance fees from our nearly $250 billion of performance fee eligible AUM. This is far below our long-term expectations. By comparison, in the past year we generated $2.30 per year in net realized performance fees.

So, generating 25% of last year’s performance fees gets us to the top decile of yield for the S&P companies. It doesn’t sound so hard. Anything can always happen my general counsel would say, but it seems pretty reasonable to me.

As evidenced by the recent declines in stocks, including Blackstone’s, it is clear that the public markets really don’t take the long view. At Blackstone, that’s all we do. And I believe that’s why our funds have outperformed the public markets since inception typically at about double the S&P return in our high performance products.
This month, as Tony mentioned, is Blackstone’s 30th anniversary. The firm has come a long way in the past 30 years from our $400,000 in start-up capital, half of which was mine, to a market cap of $52 billion earlier this year. That’s not a bad rate of return.

We built the strongest brand name in the alternative space by delivering consistently strong returns through the use of our unique intellectual capital and ability to analyze market cycles and select successful strategies to benefit our customers. Our brand allows us to raise large scale capital for basically any investment opportunity that we see around the world now.

While the past 30 years have brought much success to Blackstone, I am most excited for what I think is in store. The firm is getting better and better. We have remarkable people here and great processes. I am confident in the long-term trajectory of our business and our ability to outperform over time driving significant benefits to our unitholders and to the people who work at the firm.

I’d like to thank everyone for joining our call today. I’m going to turn things over to our new Chief Financial Officer, Michael Chae. For many of you, this is your first opportunity to interact with Michael. For those of us who have been here a long time we’ve worked with Michael closely for 18 years. He’s a tremendously talented individual and is already off to a great start.

As you get to know Michael I think you’ll come to understand that our company is in great hands in the financial area and part of the fun of Blackstone is that people grow and they get new responsibilities and when we know them and trust them and we think they’re super smart, that’s the way to grow a great firm.

Now, with that big build up, his mother will be very happy with Michael. Go for it.

**Michael Chae:** Thank you, Steve. And good morning, everyone. With respect to our financial results, performance and outlook I’d like to cover three key areas: First, digging into our ENI result a bit more and putting it in context; second, highlighting key performance trends in the business; and, finally discussing the outlook for distributable earnings and the cash generating power of the business.

First on ENI; the driver of the negative ENI result for the quarter was the decline in our public holdings and the associated unrealized performance fee reversals. As you know, unrealized performance fees and unrealized investment income are two of the key components of ENI.

These unrealized metrics are driven by the change in marks between two days, the first day and the last day of the quarter and are a snapshot based upon that beginning and end point. As Steve mentioned in the brief period since quarter end, our publics in both corporate private equity and real estate have appreciated over 7% as of yesterday’s close.

The effect of that is to largely reverse the ENI decline in the third quarter and the first two weeks of the fourth quarter. Now, this is not to minimize ENI as a metric, especially over longer measurement periods, but to step back and put it in context over the shorter term, particularly during volatile periods.

We also want to highlight the effect of the BCP V catch-up, which amplified the ENI impact of the markdowns in our public positions. A substantial portion of the overall decline in the
firm’s economic income came from the impact of the catch-up in BCP V, which declined 7% in the quarter due entirely to its publics, which now comprise about 59% of that fund’s value.

The fund overall has performed very well, particularly given its vintage and ended the third quarter marked at 1.8 times original cost. BCP V publics are up meaningfully so far in the fourth quarter and we feel good about the fund’s position.

With that as context, in terms of reviewing specific ENI drivers within the overall publics’ movement, two contributors were our Hilton position and the energy area. Hilton traded down in the quarter along with much of the lodging sector. We continue to feel great about the company and, indeed, its stock has bounced back since quarter end.

In energy, again, it was largely about public positions and similarly since quarter end we have seen meaningful rebounds in the public prices of certain positions. But looking past the headline ENI number, trends in the business remain very healthy, as Steve described.

AUM – total AUM rose 17% over the last 12 months to a record $334 billion as $97 billion of inflows in capital raised, plus market appreciation of $12 billion well outpaced capital returned in that period to investors of $60 billion. The strong growth was broad-based across all businesses.

Investment performance – the competitiveness and growth of our firm begins and ends with investment performance. Our overall investment performance so far this year has been strong on an absolute basis and relative to broader market indices we’ve delivered quite extraordinary outperformance.

Our private equity segment funds are up 8% for the first nine months of the year and our real estate opportunistic funds are up 9% versus declines in the S&P and other global indices as well as real estate indices. This represents outperformance of 1,400 to 1,800 basis points.

BAAM is up 3% year-to-date versus a 3% decline in the Global Hedge Fund Index, an outperformance of 600 basis points and our credit strategies are also outperforming their benchmarks across their broad array of strategies.

Our balance sheet is strong with $4.2 billion of cash, corporate Treasury and liquid investments. We have $5.25 per unit of total cash, liquid and illiquid investments. Our outstanding debt has attractive cost with a very long-dated maturity structure, a weighted average maturity of 15 years. Both S&P and Fitch recently affirmed our A+ credit rating.

Let me now turn to the distributable earnings picture and shed some light on the engines firing our cash generation. In addition to reviewing the recent strong DE performance, I’ll talk about a few different drivers of the outlook for cash generation, the near-term distribution picture, the FRE dynamics around the business and the performance fee outlook.

First, in terms of the quarter and year-to-date, our realization activities remain very strong helping drive year-over-year growth in distributable earnings in the quarter, notwithstanding the markets, for total DE of $692 million in the quarter and $0.58 of DE per common unit, which represents an increase of 7% versus the third quarter of last year.

The quarter contributed to a record $2.97 billion of DE year-to-date, 54% higher than the same period last year and to DE of $4.1 billion over the last 12 months. Looking forward
our realization pipeline is fairly robust and I’d expect a favorable fourth quarter for distributable earnings, based solely on what’s already been signed and announced.

This includes the sale of Avintiv, which closed on October 1st, the pending closings of announced sales of AlliedBarton, SunGard, Vivint Solar and some of our office properties in Boston. There are other potential asset sales in process and, of course, market conditions permitting, we would evaluate secondary offerings of certain publics.

That’s the near-term tactical outlook for DE and realizations. Now, let me step back and talk a bit about the fundamental drivers because the fundamental drivers and structural position of the firm to produce cash for our shareholders over time are very, very strong. First, with respect to fee-related earnings, our FRE for the quarter was $266 million, up 12% over last year and just over a billion dollars over the last 12 months.

As we find ourselves in a period of public market volatility that can cause swings in our marks and in ENI, it’s worth focusing on the mass and stability of this substantially locked in, recurring fee-generating base of the firm. To put this in perspective, the last time we saw a quarter with similar downward pressure in public markets that weighed heavily on ENI was the third quarter of 2011.

And our current fee-related earnings are nearly double now what they were back then and that’s because the fee earning AUM of the firm is $241 billion now versus $133 billion then, over $100 billion higher. This large, stable base of fees is an extraordinary asset of and ballast for the firm in all markets.

Furthermore, we have significant embedded near- and medium-term growth in fee revenues from funds that have been raised that are not yet contributing full management fees. As you know, our eighth global real estate fund was activated this year and will experience its first quarter of full fees in the current quarter and first year of full fees in 2016.

Our seventh flagship private equity fund is expected to activate in 2016 and will experience its first year of full fees, we expect, in 2017. Projecting forward the combined management fee revenue stream from these two new funds and their immediate predecessor funds we anticipate incremental management fee revenues in 2017 of $200 million to $250 million over the current year base of approximately $415 million for just those funds.

This is but one example, though a significant one, of the structural embedded growth in our fee base. Turning to performance fee drivers going forward we know a key question on investors’ minds is: what will future harvest be like?

Well, the sources of current and future harvest, we believe, are rich and deep. I would think about these drivers in three parts. First, our mature liquidating vintages. Just over half of our net accrued performance fee receivable is from vintages 2010 and prior and 90% of these are public and/or liquidating.

Consider these fees as producing proven reserves, so to speak, in terms of having been a well-established and continuing source of realizations. The firm has over $24 billion of public market cap across its private equity and real estate portfolios, with a large portion from these older vintages.

Second, is our more recent last five years’ vintages. These portfolios are fundamentally strong and performing well as exemplified by the returns of the major funds of the time
period. BREP VII conception to date net IRR of 24%, BREP Europe IV is 21%, BEP is 20% and BCP VI is 12% with that fund continuing to appreciate through a J-curve with a realized IRR of 47%.

We believe our teams chose well and selectively in a price year vintage period. The value of these investments is seasoning steadily, but the ultimate realizable carry potential we believe is not reflected in the current marks nor in the performance receivable on the balance sheet.

And we’re seeing proof of that and in the ability to generate monetization events even in a younger portfolio and very recent IPOs in the last two weeks at companies like Scout24 and Intertrust, whose public market values imply approximately 2.4 times our invested capital in aggregate on one and a half and two and a half year old investments and represent premia over the prior private marks.

We anticipate that these more recent vintages will be steadily coming into their own in terms of monetization realization events for a while to come.

Finally, the third driver of these performance fees is from the deployment of the $85 billion of dry powder we’ve amassed. The average lock-up period on this capital is nine years, which is at the heart of the fundamental advantage of our business model to be able to patiently attack opportunities and sell only at the right times. We are extraordinarily positioned in massive scale with our strategies made to be deployed opportunistically in times of dislocation and volatility.

Our investment pace is at record levels with $25 billion deployed over the past 12 months, $6.5 billion deployed in the third quarter and $11 billion currently committed, but not yet funded, which with much of this recently committed and our ability to do so directly benefitted by the volatility in the market.

So, like Steve, I feel very good about the underlying momentum in the business, the deployment environment and our ability to generate robust distributable earnings for our unitholders over the long term. We have a significant base of performance fee generating assets with great diversity across vintage year and asset class.

In addition, our management fee base continues to grow in size and diversity, ultimately driving an upward trajectory in fee earnings. Looking ahead to the fourth quarter our advisory segment will no longer be included in our financials following completion of the spin on October 1st so we will no longer have that segment’s contribution to earnings, which was approximately $0.06 ENI per unit in our last fiscal year.

It’s comprised in the area of 3% affirmed DE over time, and so, from a financial contribution point of view we feel our growth will absorb its effect fairly readily.

In closing, I feel great about Blackstone’s position and our ability to thrive through any environment. I look forward to working with all of you going forward.

Thank you for joining our call and we’d like to open it up now for any questions.

Coordinator  (Operator instructions.)

Joan Solotar: And just a reminder, if you could keep it to one question on the first round, we’re happy to answer all your questions.
**Coordinator**: And our first question comes from the line of Craig Siegenthaler with Credit Suisse. Please proceed.

**Craig Siegenthaler**: Thanks. Good morning, everyone. I know this question may sound a little premature, but how do you think about the capacity constraints on the individual investor hedge fund products, especially given their fast ramp here?

**Tony James**: Craig, it’s Tony. There’s obviously some capacity limitations to our individual hedge fund products, but we’re a long way from testing those right now. We set up, as you know, we set up that product with Fidelity and because of exclusivity arrangements we sort of mimicked it actually. So, we’ve shown we can replicate it already so if any one of those products runs out in capacity we can sort of recreate a lookalike and I think we can scale that business quite substantially over time.

**Coordinator**: And our next question comes from the line of Bill Katz with Citigroup. Please proceed.

**Bill Katz**: Thanks so much. Appreciate all the color, Michael, as well, thank you. There’s been I think some uncertainty about what’s going on with some of the sovereign wealth funds. I think this industry has been quite a big beneficiary of a lot of growth coming out of the sovereign wealth funds.

Can you frame your exposure to some of the sovereign wealth funds, what you might be seeing in terms of any kind of liquidation or redemption pressure and more broadly, what you’re seeing in the institutional channel for incremental demand?

**Steve Schwarzman**: The sovereign wealth fund group is divided into sort of two categories, one of the ones that are most affected typically by the oil business and the others are all else. The all else group is continuing to enter, some of the first time investors in our asset class, and some of those funds will be very, very substantial investors in the asset classes.

It’s sort of business as usual with that group and the other group of the energy-oriented economies have had mixed approaches. We’ve not really dealt with redemptions and things of that type because what’s also going on in that group as well as the non-oil people is that they’re increasing their allocations to alternatives and then within alternatives they’re increasing their allocations to their best performing managers and we’re sort of it.

And so, we don’t experience a lot of problems. The biggest issue with the oil-oriented sovereigns is that some of them are not increasing their aggregate money in their funds, which means that for us to grow with them you have to take share, which is happening. But even some of them, interestingly, are significantly increasing their share of alternatives because of the performance characteristics.

We’re not really feeling the effect of anything particularly major. In fact, we’re growing in that asset group.

**Joan Solotar**: And one other point, as you know two-thirds of the capital we have is locked up for life of asset or life of fund and we just raised the flagship product, so on that two-thirds the average life remaining is like nine years.

**Steve Schwarzman**: The other thing I’d mention is that in terms of taking more share in both of these categories, oil and non-oil, by sovereigns that we’re engaged in a number of
discussions, which is quite interesting, where they want to very significantly increase their exposure and they’re talking about multi-billion dollar commitments to us as opposed to just commitments on single funds.

It’s quite an interesting area and an important area and a growing area for us, just the opposite of what the underlying assumption was I think of your question.

Tony James: And I’ll put one more fact in there, the most sophisticated investors in the US, which are really the endowments, have about 50% of their assets in alternatives. Most pensions have 20% to 25%. Sovereigns are still way behind that and have a long way to go.

Coordinator: Your next question comes from the line of Alex Blostein with Goldman Sachs. Please proceed.

Alex Blostein: Great. Good morning, everybody. Thanks for taking the question. As a follow-up to the, I guess, distribution discussion and the outlook there, understanding that it’s obviously pretty difficult to predict with a lot of precision on what realizations will look like, but if we take a step back and think through just a more stressed capital markets scenario, whether or not it’s more difficult to exit via equity markets or via M&A transactions, which businesses do you guys expect to contribute the most in that scenario to your realized investment income and incentive income businesses? Just to kind of help us, again, gauge what potential downside could be because the outside cases it’s clear it could be quite significant, but I think the market is just more concerned on the downside.

Steve Schwarzman: We’ll have an open discussion with Michael and Tony on this one because it’s an interesting question. I think the real estate sector will power on in that environment. The only difficulty that sector would have would be access to capital that would slow it down.

At the moment, that does not appear to be happening. The leverage sector has had the price and availability and some kind of mix affected in certainly on the junk side, less so on bank debt. Real estate will continue in all probability quite strong because their exits are not typically through public offerings. They’re through sales of individual properties or group properties.

The supply demand characteristic in real estate in many, many places around the world is very good. What you would need to really negatively impact that is just literally a sort of recession, a huge number of sort of non-performing loans generally so that banks wouldn’t be financing, capital markets sort of locked up and turned off and then it’s hard for anybody to do business.

The number of times that that scenario happens is quite low, it’s usually around, if I was to not study it, but just sort of do it by feel, it’s like once every ten years something like that happens, a relatively brief period of time. I think we’ve got a very good situation there if you’re asking us what would be the part of the business that would be least susceptible.

Tony James: Even then, if you don’t get over-building in real estate, then you’re going to have a lot of value. To get over-building you have to have an extended good part of the cycle before you come to that. Otherwise, inexorably people need more space and rents go up and you get the leverage on the operating income.
So even in higher interest rate environments in that scenario, without over-building, real estate holds its value.

**Michael Chae:** And I would just chime in that in real estate, and agreeing with Steve and Tony, that there has been a bifurcation recently between the public market performance where there has been a pullback and the private cap rate environment for real estate assets, which has remained very strong and we are in the market with some assets. We continue to see strong interest apparently unaffected by the public market turmoil.

And, as Steve alluded to, particularly in the real estate business we can sort of buy wholesale and sell retail, we can buy big enterprises, but then sell individual assets in smaller chunks to those private buyers.

**Tony James:** The other thing is if we get economic softness we should have low rates and at some point even if you can’t exit a private equity company into the IPO market or into the M&A market then you have the advantage of recaps where we can, as long as our companies continue to perform, which they are, with EBITDA up 9% this year, that’s great performance. Let’s none of us lose sight of that. Those companies delever quickly and with growing EBITDA you can pay yourself some nice dividends, so the credit markets are sort of an offset to the equity markets in this whole sustaining our distribution question.

**Michael Chae:** And meanwhile, on private equity in the face of, obviously, quite choppy markets in the last few weeks we did successfully execute three IPOs in the last three weeks, so that’s an environment where markets are not closed. They’re open from time to time for good companies.

**Steve Schwarzman:** That’s because the performance of those companies was really terrific and people like to buy terrific things and if that’s what you have on order, what the heck, it works out.

**Coordinator:** And our next question comes from the line of Michael Cyprus with Morgan Stanley. Please proceed.

**Michael Cyprus:** Thanks, good morning. You have a greater skew to public holdings than you did even just a couple of years ago and it seems to make your ENI a little bit more correlated to public markets than in the past. I guess just more strategically how are you thinking about balancing your portfolio exits from here? Do you want to be more skewed towards strategic sales as opposed to IPOs perhaps to reduce some of the volatility in your ENI? And then separately, how do you balance some of the strategic exits, potential challenges whether it could be a larger portfolio sale, which could be maybe more challenging to do or even some of the antitrust concerns that have come up with some strategic sales recently?

**Michael Chae:** Mike, let me, it’s Michael Chae, nice to talk to you, hit the first couple of parts to your question. First of all, in terms of the public component of our portfolios I did allude to BCP V, which, obviously, is a quite mature fund at 59% publics, but for real estate overall – their portfolio, the public component of that is in the low 20s percentage and for private equity overall, it’s about a third and that’s, obviously, concentrated in BCP V.

When you step back, that’s still the balance around it. And I’d say certainly to something you alluded to, we don’t manage our exits to ENI. We’re patient and we manage our exits,
as we have for 30 years, against what the right moment is and how to optimize the outcome for our limited partners.

**Tony James**: Let me chime in a couple of things, too. When we go public, we actually don’t exit very much, so it’s important to keep that in mind. And a lot of times once a company is public we can actually exit either with subsequent equity sales or as a strategic sale of the whole company. Sometimes we go public and then sell the company.

As Michael says, all we’re trying to do is exit in the best way at the best time for our limited partners and drive underlying investment returns that are actually realized. The mark-to-market returns quarter-to-quarter, we don’t worry about.

**Stev Schwarzman**: And actually this isn’t so hard. You do what the market will give you. If you have a hot equity market you take companies public and you make money that way. If those markets aren’t so good, you don’t worry about it because our businesses typically don’t need the capital. We’ve got almost an infinite ability to fund these companies.

Then you just sell them if the sale market is good and, if not, you recap them and you make money that way. We just sort of go with the flow, if you will.

**Coordinator**: And our next question comes from the line of Brian Bedell with Deutsche Bank. Please proceed.

**Brian Bedell**: Good morning. Thanks for taking my question. Maybe just to flip it around to deployment, obviously, with the markets pulling back late in the third quarter, how are you feeling about that going into the fourth quarter? I know we’ve had some rebound here, of course, but maybe if you want to comment on some specific sectors, particularly energy, also overseas and in real estate in terms of putting some of the $85 billion of dry powder to work in the near to medium term.

**Tony James**: Energy is a major area of focus, both in our credit business and in our equity business so that jumps to mind when you sit back in the world and say where is there distress, where is there value. While there is certainly risk and certainly issues, I think we feel pretty comfortable that energy is not going to be down here forever and that there’s an opportunity to create value and capture value with the companies that can get through this.

And energy is a subset of broader commodities. There are other commodity areas I’d say the same thing about. Real estate, we’re putting a lot of money to work in Europe still. There’s still a lot of ability to buy up below replacement cost there, those markets, the capital markets in real estate have not really recovered.

Here, obviously, we’re trying to arbitrage the difference between fairly robust values asset by asset, but public REIT stocks that have been hit with the market drops overall, so that’s created some values. We’re focused on that, obviously, with two big transactions we’ve announced recently.

I think we’re also doing a lot of looking around building new stuff, particularly power assets around the world. A lot of the world needs electric power, whether that be traditional power plants or whether that be renewables and the infrastructure that goes with that to move gas, to move oil, to move electricity and all of that stuff our money goes in at cost, goes in at book value and as long as the underlying economics of the projects are good we know we’re going to get our return on that and it’s decoupled from market movements.
We’ve got $85 billion and it sounds like a lot, but we’re also putting to work a lot. I think we’ve put to work, I think we mentioned it’s about $16.5 billion we’ve put to work year-to-date and we’ve got another $10 billion that’s committed and not even drawn down yet. So, just this year, with just what we’ve got on the plate, that’s already like $25 billion.

I think we’ll be able to make some really good investments in here.

Michael Chae: If I could chime in, as Tony mentioned, that $10.7 billion or close to $11 billion of currently committed, but undrawn, much of it recent, I think is a good metric for the opportunity set improving. I would say for real estate and our credit business the last couple of months there’s been a tangible, I would say, shift in the deployment environment and a good one in terms of the ability to be opportunistic and find more opportunities for sure.

And I think in private equity these things tend to take a little while to season, a little bit longer, but I can tell you my partner Joe Baratta is happy when he sees market pullbacks from the perspective of being an investor. Market pullbacks we think in volatility are ultimately good for creating good private equity deals. It takes some time.

I would say even in private equity or as well in private equity there are a number of situations where some months ago we felt like we were priced out of the situation, but now they’re coming back in line with actionable opportunities.

Coordinator: And our next question comes from the line of Glenn Schorr with Evercore ISI. Please proceed.

Glenn Schorr: Hi, thanks. I’d just like an update on the progress of core-plus real estate. Also, just wondering how long before core private equity rolls out? Can you run that just with your existing infrastructure? Any color on that would help, thanks.

Tony: Core-plus real estate we’re at about $8.5 billion. There’s a lot of investor interest and there’s a lot of transactions. We try to kind of balance those two things. We try to take in money when we’ve got our sights on money to put to work, so I think that will continue to grow steadily and well.

Core private equity, we’re really doing that – we don’t need much new infrastructure at all and we’re kind of in the process of assembling capital for that. We have a couple of transactions we’re looking at, but nothing we’re about to announce.

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

Dan Fannon: Thanks. Could you guys update us with regards to BCP V as to where we sit in the catch-up period? I think there’s a gap between ENI and DE and I assume they went opposite directions this quarter, but could you give us where you are with that as of the end of the quarter?

Michael Chae: I think in previous calls we’ve used this parlance of what percent we’re through the catch-up and I think in the last call we talked about 84% on an unrealized-realized basis. That same metric would be about 73% today, but I think maybe the simplest way to think about it, frankly, is about half of our BCP V LPs by value or full carry, including all the BCP AC LPs and about half are in catch-up mode. And over time with,
hopefully, more appreciation, more will go from the catch-up bucket into the full carry bucket.

I tend to think about it that way as opposed to a kind of percent through the catch-up.

Coordinator: And our next question comes from the line of Mike Carrier with Bank of America Merrill Lynch. Please proceed.

Mike Carrier: Thanks, everyone. I had a question on both credit and energy and I hear your comments on the portfolio companies in terms of the outlook versus people worried about recession. I guess in both areas just given that they were under pressure during the quarter if you can give us an update. In energy just what your current, I don’t know if you look at it from a private equity standpoint, things that you invested maybe prior to 2013 versus the capital that’s ready to be deployed or the opportunity to take advantage of the pressures.

Then the same thing on the credit side. When I think about the private equity business, the average leverage or the maturity, the debt that’s in these companies like how stable are they versus maybe past cycles and then same thing on the credit side, how much dry powder you have available to take advantage of certain industries that might come under pressure?

I know it’s a long question, but just a couple of areas that I feel like we keep getting questions on.

Michael Chae: I think with respect to energy, certainly from an opportunity standpoint both our second energy fund, which as you know, we activated at the beginning of the year and our new opportunities fund, which we call BSOF in GSO, both I think showed great discipline by not deploying capital in that first half of the year where it turned out there was a bit of a false dawn in the sector.

Between the two of them they stand with combined, something like $7.5 billion, $8 billion of dry powder to face into that opportunity set. I think from an exposure standpoint we feel good about it.

Our private equity fund, as we’ve talked about on past calls, we think did a nice job divesting assets, particularly ones directly impacted by oil prices and today the exposure to companies directly affected by oil prices we think is manageable. It’s about a fifth of the portfolio.

They’ve done an excellent job putting in hedging. I think importantly the vast majority of our investments in BP are not highly levered. They’re investments with little or no leverage going in, and so compared to some of the more infamous large deals in the sector, if you will, in the past few years it’s a distinct difference.

Tony James: And they’re still marked above cost.

Michael Chae: That’s right. And on the credit side we, obviously, have different kinds of investments and exposures in energy and GSO, private energy investments in our private drawdown funds and then liquid investments in our hedge funds and in our BDC.

And, certainly, energy credit in terms of the indices overall took a beating in the third quarter, and so, from a mark-to-market perspective that’s going to impact to some degree some of our portfolios. Overall, I noted the discipline we showed in our investing strategy earlier in the year. We felt good about that and we feel good about our overall portfolio.
**Steve Schwarzman:** One thing just to mention, I guess, is that our first energy fund is, despite just the collapse of the oil business, is still up approximately 25%, 26%. This is not what you would call a national tragedy and there are many people who have gotten severely damaged in these sectors and we’ve done quite well.

**Tony James:** Just to clarify, Steve, the 26% is the IRR. It’s actually 2.5 times multiple of money for investors, so as Steve says, they’re happy.

**Steve Schwarzman:** It’s pretty amazing. And I was at a conference yesterday with a lot of LPs and the people who put money out in the first six months of this year and it’s hard not to do that, but our people put out really great discipline. Wow, people got crushed, they really got destroyed and part of what you do in our business is don’t do things where you think there’s real risk. I think we’ll be well rewarded deploying our money at the right time.

**Tony James:** Obviously, we’ve had in the credit side some investments in companies that had a lot of leverage that are suffering. I don’t want to say we’ve been flawless on this. We haven’t. And we’ve also taken some, in private equity we had bigger write-ups than we have today, so we’ve written some of the write-ups down a little bit.

We’re still ahead of the game, but we’ve definitely given back some value on a temporary basis, but I think the strength of the company and our conviction that, as I say, this is not, today’s spot prices are not long-term energy prices and I think if we’re right about that, we’ll earn some very nice returns for our investors.

We’ve been very careful also in investing in companies that are unlevered, as Michael said, or have plenty of liquidity to ride through the next couple of years to prove ourselves right. We’re not making speculative bets that require quick bounces in energy prices.

**Coordinator:** Our next question comes from the line of Luke Montgomery with Bernstein Research. Please proceed.

**Luke Montgomery:** Thank you. I think there is a tendency to view the accrued carry balances as a key indicator of where distributions are headed. It’s declined about 25% in the last two quarters. I think clearly a key driver of that has been BCP V in the catch-up.

My question is whether you think the focus on that metric is appropriate and how concerned you think we ought to be about the trajectory of the balance in accrued carry as we think through whether distributions could step down over the intermediate term? And I think finally maybe the answer to the question would be approximately how much better might the balance look today versus at the end of the third quarter?

**Michael Chae:** In terms of the receivable, as you know and we have it in the 8-K, the vast majority of the decline quarter-over-quarter was from BCP V and BREP VI. To break that down for you a little bit about a third of that decline was just from realizations and of the remainder, to your latter question about half of that decline has now been on a mark-to-market basis been made up by the rally in the publics in the last two weeks.

So, without maybe directly answering your question about what I think of the deep meaning of this metric, because I think it is an interesting metric, maybe what I just described could give you a sense of how you have to put it in context.
Coordinator: Our next question comes from the line of Michael Kim with Sandler O’Neill. Please proceed.

Michael Kim: Good morning. Maybe more of a conceptual question, just given the more recent underperformance of the stock and the alternative asset managers more broadly, just curious if you’re thinking on the PTP structure has evolved at all and then related to that, any sense that the chatter around potential tax changes for publicly-traded partnerships has maybe started to pick up a bit more these days?

Steve Schwarzman: I think it’s political season and there used to be 19 candidates on the Republican side and I guess I watched four or five of them on the Democratic side. Everybody has got a point of view and you have to distinguish yourself in a crowd and there are a lot of different ways to do it. And one of the ways is, obviously, to look at different kinds of businesses, asset classes, tax approaches and so forth.

We see the same stuff you see and we also see sort of a very complex Congressional array and some people don’t want to do anything under any circumstances and some people who will do almost anything to anybody at any time. And so, I think we’re just sort of cautious, interested observers and I don’t know that there is any way that you could sort of handicap what’s going on.

It’s very difficult, so we’ll see what happens. It runs the gamut from overall tax reform, which could take a whole variety of different things to targeted things against our industry, which some people are in favor of and this has only been going on now for eight years. So I think we just take an active watching posture.

America has become an unbelievably complicated place with a variety of different positions, some of which haven’t existed in my lifetime, certainly, and society will figure out what it wants to do and, hopefully, it’ll really do a good tax reform thing. It’s very simple and treats people without enormous preferences and has very low rates and this is my personal view, not a Blackstone view, and that would be great for society.

I don’t even know if anything like that is even vaguely possible. I think it’s the right thing to do, but with different people in Congress opposed to this, that and so forth it’s sort of tough.

Coordinator: Our next question comes from the line of Ken Hill with Barclays. Please proceed.

Ken Hill: Hi, everyone. You’ve recently raised a significant amount of capital through some of the flagship funds like BCP VII, BREP VIII. Do you anticipate any sort of stepdown after such a robust period and how do you think about fundraising moving forward in general? Any key funds you think, in particular, that are going to drive some inflows over 2016?

Tony James: Our fundraising is episodic, so yes, it’s lumpy. Those are big funds and they all came in the beginning of the year and it’s going to be hard to keep that pace. However, core-plus real estate, we talked about, has huge potential and we’re just beginning on that.

In addition we’ve got tremendous potential with different kinds of retail products that we’re just beginning on. I think those are two big areas where you can see a lot of assets. In real estate, we’re coming to the end of a couple of funds that are chunky funds, so BREP Europe at some point will be in the market and we’ve got other real estate funds.
It’s not going to fall off a cliff by any means, but it’s going to be hard to equal the pace the first half of this year.

**Weston Tucker:** It’s also the third real estate mez fund that’s going to be in the market later this year and the secondaries buyout fund is launching this year.

**Joan Solotar:** And then there are other perpetual hedge fund products, like the long only, etc., that are on the platforms.

**Michael Chae:** I’d add in, we’re all chiming in here, that GSO – some of their major drawdown funds will have fund raises over the next year or two. Then stepping back I’d say if one could sort of time one’s life in business perfectly, obviously, we feel great about the timing of our flagship fundraises for real estate and private equity and are excited to have that capital in this environment.

**Joan Solotar:** And just to go back to Michaels’ earlier comments, if you recall, a lot of that money hasn’t even been turned on, so to speak, from a fee perspective, so we raised a large private equity fund, but it’s not even in its investment period yet, so it’s not in our fee earning AUM.

**Coordinator:** And our next question comes from the line of Devin Ryan with JMP Securities. Please proceed.

**Devin Ryan:** Thanks, good morning. Just want to come back to the question on potential tax changes on carried interest. I think we’re clear on where you guys stand. I know that you also prepare for a number of scenarios. In that scenario where distributions experience higher taxes, does that change your view on capital allocation and maybe make buying back stock become more attractive as an alternative? And then, kind of on the same theme, the stocks bounce around a bit here. It’s recovered from the low, but is there a price or point where you say there is really no better opportunity than buying back your own stock?

**Michael Chae:** We’re not contingency planning in that regard and I’m not sure in that scenario those are the contingencies we would consider strategically. What you’re hearing in this room is it’s just not something we’re focused on at this point in terms of those kinds of plans.

**Tony James:** Let me jump in on this. We’re a business – because we pay out all of our earnings, we don’t generate a lot of capital. As far as we can see we’ve got double-digit growth ahead of us with AUM and that’s going to require, given the way we structure our funds and the way LPs want us to have skin in the game, it’s going to require us to keep putting money up.

Those underlying properties, those underlying investments have very high returns, so the combination of the returns on the underlying capital and then the carries and the fees and all that that’s generated for the firm means that the return on our money, if it’s key to raising more capital, is extremely high. And our view is we’re going to have to keep growing and we’re going to need to husband our capital to keep supporting that growth.

I don’t see near-term buy-ins, I really don’t. And, if anything, as you’ve seen over the last few years, we’ve raised additional external capital through the debt markets. I think that tells
you kind of where we are. We’re not running out of growth. If we go ex-growth, it might be a different discussion.

**Michael Chae:** And just to put it simply really on the first part of your question, we’ve said it before and we say it every time and it’s true, which is we manage and run our business the way we always have, which is to generate the highest returns over the long term for our LPs. Period. Whatever regulatory changes may come or other exogenous factors, that won’t change it.

**Coordinator:** Our next question comes from the line of Eric Berg with RBC. Please proceed.

**Eric Berg:** Thank you. Good afternoon. [Audio disruption.]

**Tony James:** Eric, can you either dial back in –

**Joan:** I can answer the question. The question was basically the publics were down. What does it imply for the private mark? And what does it imply about the performance of the underlying portfolio?

And I would say, generally, the underlying portfolios are outperforming what you would see in the market and, as you know, we’re very careful about choosing sectors and companies so we saw positive performance in both private equity and real estate, and so, the privates actually were up.

**Coordinator:** Our final question comes from the line of Bill Katz with Citigroup. Please proceed.

**Bill Katz:** Thank you very much. I just want to come back to this notion of capital allocations that I think is a sticking point on the sector. I think one of the issues for this group overall is relevancy relative to attritional managers. You’ve often compared yourself to BlackRock and they have a higher multiple than you and yield and half the growth rate you did this quarter-on-quarter.

So if I look at your stock price when you went public it was 31 and you add back the dividends you’ve compounded growth of the stock by about 3.5% and yet the underlying fundamentals – it’s hard to argue that you’ve out-executed everybody. So, how do you help the shareholders get comfort that this is a good stock at this point in time? The age old question is do you invest in Blackstone the funds or Blackstone the stock and what I hear you saying now is there is no interest in buyback, but why not?

I just don’t understand why you can’t possibly lower the payout ratio. You’re not getting credit for the carry anyway and then buy back some stock and maybe a little bit more forceful statement of confidence relative to some of your peers who do buy back a lot of stock in the traditional space. A convoluted question, but I’m still curious.

**Steve Schwarzman:** One of the advantages that long-only managers have is they don’t have to invest one dime in what they do, and so they can do anything they want with their cash flow. If they want to buy in some stock at a high price and look not so smart or at a low price and look smarter, they can do that.
What happens with our business is sometimes we have unbelievable opportunities when markets go down and for us to raise money we must invest large amounts of money alongside our limited partners.

And as the world gets worse they want you to put up more and more money because they think perhaps it’s not such a wonderful idea. And that is the most wonderful time to be investing. And we can do nothing that inhibits that.

And, by the way, when times are terrible we can’t sell stock to replenish. We can’t even sometimes go to banks because banks freak out and regulators freak out. And so, just when we need money to grow and make great investments you would have us be out of money and, frankly, that’s – doesn’t work.

If we’re trying to service our customers, have great products, we have to not just look at the world as it is today, we have to plan on all the different types of contingencies and one of those contingencies is always be liquid, don’t run out of money, have amazing products and grow your business.

We are a great example of that and the fact that the people don’t still sort of buy into what we’re doing, didn’t somebody say on this call we had a 9% yield? I guess that’s a bad idea. Why would we want to do that? That’s like a bad idea.

And we will have very strong cash generation and growth over a very long period of time. I think Joan has explained repeatedly what we see as the bands for growth with a ten-year model, with a stock price somewhere around, in terms of assumptions that we’ve used, $85 stock price with another $25 to $30 of cash income.

If that is not good enough for you, then I can’t help you. I just can’t help you. I think we can easily do that. That’s my personal opinion. Go out and buy something else and the people who believe what we’re doing only because we’ve been doing it for 30 years, we’ve had the same basic rates of return on what we do and we’re getting better and better at what we’re doing.

I get a little sort of frustrated, but I know in the end those kinds of returns will be terrific for investors. They’re terrific in our funds and they’ll be terrific for public investors. I realize I sound a little adversarial. I’m not really adversarial. I’m frustrated because we can demonstrate all these things, but it’s hard to deal with fear.

And so, maybe we have to go through another cycle or something and you come out, we earn this huge amount of money and that will be perceived as an accident. These aren’t accidents.

**Joan Solotar:** Just to correct something, being a little picky here, but the return is actually a little higher than you alluded to, so we returned over $10 in cash. You also have to include the PJT spinout, what shareholders got and when you do the compound growth rate from the IPO until now, it’s actually closer to the 5%.

Now, that’s well below how the firm has grown, assets – how the firm has grown earnings and we’re triple the size that we were at the time of the IPO and, as Steve said, the earnings power is meaningfully greater than what the market is giving us credit for. So, we agree with your frustration, but the structure of the firm is that we get taxed on the full amount of earnings regardless of what we distribute, and so, retaining capital is just not as efficient for those receiving the distributions.
Steve Schwarzman: Also, one other thing I would say, my own people around the table are telling me to say nothing, but we went public at a time of sort of very high valuation. It was really the top of the cycle, somewhere between two and three weeks after we went public there was the start of the most massive credit crisis that we had since the Depression.

It drove our stock down to $3.55. If you had bought at $3.55 you wouldn’t have the same mediocre return you were talking about, and so, we can’t control what the market was like the day we went public. But we sure as heck can control the growth of our business and what we’ve paid out and all of those types of things.

I think the analysis has a bit of a false premise, which is that we went public at an absolute market peak and you’re measuring us off of that. I wish the multiples were all the same because then that would be the performance that will drive it that much higher, but multiples changed and they changed for almost all financials and our performance against all financials is actually, I think, quite good.

But something happened to the overall marketplace and we’re sort of, we’re out there right at the top. I think if you want to measure against the top, then you can generate numbers that are somewhat like you were saying. If we went public in a more normalized environment it would have been much different.

Tony James: If Bill can get into our funds, I’d love to have him.

Bill Katz: I don’t think I’m down that low in the minimals, but thank you.

Joan Solotar: Thanks, everyone. And we’re here, of course, this afternoon to answer any other questions that you have. Thanks for joining.

Coordinator: Ladies and gentlemen, that concludes today’s conference. Thank you for your participation. You may now disconnect. To you all, have a great day.