Christine Anderson: Good morning, and welcome to our 2016 Second Quarter Earnings Call for the media. With me today is Tony James, Blackstone’s President and Chief Operating Officer; Michael Chae, our Chief Financial Officer; and Joan Solotar, Senior Managing Director and Head of Multi-Asset Investing and External Relations. As we do every quarter, Tony will summarize the highlights of the quarter, and then we will be happy to take your questions. Before I hand it over to Tony, I’ll remind you that we will refer to non-gap measures on this call. For reconciliations you should refer to the press release. There’s also an analyst call later today, at 11:00 AM. Dial in details are in the press release and on our website. I’d encourage you to listen to that, and if you do have questions after the call, feel free to give me a call. Take it away, Tony.

Tony James: Thanks Christine. And good morning everyone and thank you for tuning in this morning. From a broad market perspective, this past quarter again reflected the volatility and challenges that prevailed over the last three or four quarters. However, among the benefits of our ability to take the long view is being able to ride through periods like this, of sub-par pricing, without having to sell. And instead, to use those periods as buying opportunities. Overall, the firm is performing really well across the board, in terms of building long-term value. This translated, this quarter, into stable but not outsized earnings, as market conditions were not conducive to the large short-term mark ups that drive increases in quarterly performance fees.

Overall, revenues were about flat from last year’s second quarter. Disaggregating revenues a bit, our recurring fee related revenues jumped a robust 20% after adjusting for the spinoff of our advisory businesses. This jump was driven and it’s a sustainable level is driven by our AUM growth, where we had an impressive 21 billion dollars of gross inflows during the quarter, bringing AUM to an all-time record of 356 billion, up 7% year over year.

The strong growth and fee-related revenue was offset by a decline of 21% in performance fees, given the quarter’s market volatility mentioned above. Not surprisingly, Brexit had a brief but sizable impact on currencies and equity markets right at the end of the quarter. Ironically, that has all largely subsided since the quarter. It has certainly affected our marks right at the end.

We remain disciplined on expenses and on doing things to maximize efficiency. With good expense control, our ENI was actually up 2% for the quarter, to 520 million, a substantial sum that annualizes to over 2 billion dollars on an annual basis and was the best earnings quarter in over a year. All our major businesses had portfolio appreciation during the quarter. Private equity and real estate were each up 2 to 2.5% in the quarter. Hedge fund solutions was up 1.4% in the quarter, and our credit funds had a terrific quarter, with portfolio values jumping 7 to 10%.

Generally, this strong investment performance reflected solid operating results at the underlying portfolio company or asset level. Portfolio companies grew revenues and EBITDA in the low single digits, in contrast to earnings declines for the S&P 500. Rents and occupancies, our real estate assets, continued to rise across the board. And the rebound in oil and gas prices boosted both our debt and equity holdings in energy.
Rising EBITDA and positive cash flow is going to reduce portfolio company debt… mean we are continuing to build significant equity value every quarter for our investors. We don’t anticipate major changes in portfolio company operating trends, although the rate of growth we’re seeing continues to moderate, as it has been doing over the last year and a half. Realizations for the quarter remain strong at over 9 billion. The average realized multiple – our investors’ capital continues to be attractive, exceeding one and a half times their money in both real estate and private equity. With the good operating performance of our assets, and favorable market environments, we expect to be in an active disposition mode for the balance of this year. Deployments from our drawdown funds in the quarter were four billion dollars.

While asset values are generally full, events like Brexit always open new opportunities. More fundamentally, though, overall market averages, and economic trends, are not that relevant to our investment activities. We don’t have to buy portfolios of securities that reflect broader market conditions. In each business, we really only need to buy a few assets a year, and we can do so in any industrial sector, or in any region of the world. The performance of these few assets is idiosyncratic, as opposed to reflective of overall market trends. In addition, the assets we buy are ones where we can intervene materially in the operations and can therefore create our own futures. For these reasons, there are always good deals out there in our business. All we have to do is work hard enough to find them, and to execute well operationally once we own the asset. By doing that, we decouple our investment results from broad market averages. Despite record low interest rates today, we continue to underwrite our new deals with the same returns we have earned historically.

Good investment performance, of course, leads to strong fundraising. Growth inflows for the past 12 months were 70 billion dollars. Despite realizations of 34 billion over that period, AUM has risen from 333 billion to the 356 billion number I gave you before. It doesn’t hurt that it was negative real interest rates in virtually the entire global economy. Investors must have alternatives or alternative assets like we manage to earn anything like the returns they require to meet their future needs. Coupled with our strong, absolute returns, both across alternative asset classes and throughout economic and market cycles, it is easy to see why investors are eager to invest with us. Almost without exception in the last three years, all of our new funds have had an excess of investor demand and we’ve had to limit new capital raisings to the hard caps reflected in each fund. These robust inflows mean we have about 98 billion dollars of dry powder available for new investments, an all-time high. Given that this sits in new funds, with long remaining investment periods, we have plenty of time to put this capital to work productively.

A few highlights of our business are worth noting. In private equity, we committed over a billion dollars of equity right before energy prices began to move. We also raised nearly 5 billion for our new core private equity product and for a vehicle to hold nonresidential mortgage assets. In real estate, since the end of the first quarter, we assigned contracts for sales equaling 7 billion dollars in realizations. And this includes 4.7 billion just since Brexit. Market still is great for selling assets. In credit, turmoil in the European banking market has opened up lots of white space for us, culminating with the very large Polynt deal, over half a billion dollars… he largest European unitranche deal in 2016 by any lender.
Our credit investment returns of 7 to 10% in the second quarter speak for themselves. And in BAAM, despite industry headwinds, we continue to gain market share and picked up additional assets this year of 2.6 billion dollars after adjusting for termination of the Fidelity venture. In addition, we already have an additional one and a half billion of future commitments in hand. And BAAM recently won a hotly contested mandate for the initial foray into hedge funds by one of the top capital pools in the world. This LP could grow into one of our largest ever.

We continue to innovate with new investment strategies, new product structures, new distribution systems and access towards new investors. It is this constant innovation that has led to almost half our AUM being in product areas that are new to us in the last five years. Innovation continues to drive our strong secular growth and has built Blackstone into the only firm, the leading market positions, and leading investment performance across all significant alternative asset classes. With that, I’d be happy to answer any of your questions.

Operator: Ladies and gentlemen, if you’d like to ask a question, press star one. You’ll hear a tone indicating you’ve been placed in queue, and you may remove yourself from queue at any time by pressing the pound key. Once again, if you’d like to ask a question, press star one at this time. I’ll wait just a moment for questions to queue up. All right, we will begin with the line of Devin Banerjee with Bloomberg. Please go ahead.

Devin Banerjee: Thanks. Hi Tony. Thanks for your time. Beyond the short term market impact of Brexit that, as you said, has already sort of largely subsided, if and when the full Brexit does occur, what impact would that have on Blackstone investment strategy in the UK and investment professional headcount and fundraising and all of that?

Tony James: Okay, well, all of that’s a lot. So let me take pieces of that. First of all, the headcount… I don’t think it has any effect at all. We may be required to move certain legal entities from London, into what is at that time at least an EU country, but we already have offices in all those countries, so it’s just a matter of transferring a few people from one office to another. And I’m talking about very few people. So that’s on the headcount point. I think that one of the ironies about Brexit, for the UK, you can focus on the UK, is people are saying it will soften the economy and create some added friction costs. It probably will. On the other hand, the pound is down, making the UK more competitive for the next couple of years and they’re still in Brexit.

By the way, it’s not so clear to me, totally, that, what will happen with Brexit. So we continue to be pretty optimistic about the UK. I think the place we’re most worried is probably London office where, oriented towards financial services companies because there could be a lot of motion there, as people shift things around. But we’re fundamentally positive about the UK, frankly. In some ways, the UK faces fewer challenges than Europe as a whole. Europe – the remaining EU collectively has had slower growth, it’s got the weakness of some of the Southern European countries. It’s got the refugee problem. It’s got governance issues. It’s got worse demographics in terms of population growth in the UK. So the basic EU has some longer-term structural issues that haven’t been helped by this either. However, and of course, I think the basic EU has a weaker banking system, much weaker than both the US, but the basic EU has the weakest.
Now where there’s that kind of turmoil and that kind of weakness, it’s actually an opportunity for us. So, the irony of near-term Brexit has been it helps us both on the acquisition side and on the divestiture side, strangely. On the acquisition side, it’s created some pressure on institutions or at least desire on many institutions’ part to get liquid to sell assets. And so we’ve been the beneficiary of some of that. You’ve seen some of the funds, property funds, for example, talking about, selling assets to raise liquidity.

At the same time, the flight-to-quality has lowered interest rates for high quality assets. And so for some of our assets, and again, focusing on real estate for now, where we have very high quality properties, the cap rates have actually gone down, having a beneficial impact on prices, which is one of the reasons you’ve seen us sell several major transactions post-Brexit. Sorry for the long-winded answer, but it’s a bit of a complex topic.

**Devin Banerjee:** No, no, thank you. And one more if I may, Strategic Partners appears to be playing or maybe in just this quarter, did play a sizeable role in terms of realization. Was that sort of an opportunistic series of realizations? Or do you… or can we expect you know, that pace to continue going forward from Strategic Partners?

**Tony James:** Well, Strategic Partners is doing fantastically, but I don’t think they were a big piece of the realizations, frankly. I’m gonna turn this over to Michael.

**Michael Chae:** Yeah, Devin, I think you might be thinking in terms of fundraising. And on a fundraising basis, you know, they closed on a significant amount for both their seventh private equity fund and also their new real estate fund. That added over 4 billion dollars of fee earning AUM to the firm… and to the private equity segment. So I think it’s not a realization thing, it’s a fundraising.

**Tony James:** They did have good realized performance fees, but it’s… but the dollar realizations weren’t so huge. But their investment returns have been spectacular. So I don’t… I think it’s just kind of the ebb and flow of the business.

**Devin Banerjee:** On page 20 of the presentation, and that’s 428 million in realizations from Strategic Partners, is that not fairly sizable? I mean…

**Michael Chae:** Again as Tony said, Devin, there’s ebbs and flows to that business and so that’s… on a growth basis you’ll see that number move around. In terms of sort of net carry, it’s a less significant driver.

**Tony James:** It’s 428 out of 9 billion. 428 million out of 9 billion. So it’s whatever… 5%.

**Devin Banerjee:** Okay. Thanks a lot.

**Tony James:** We’re dealing with big numbers here. I’m not trying to say 428 million… this is a good level of activity, good for them. And but… but it’s not a big percentage of the total.

**Devin Banerjee:** Right, okay. Thanks.
Operator: Next we’ll go to the line of Matt Jarzemsky with Wall Street Journal. Please go ahead.

Matt Jarzemsky: Hey guys. So, you know, given kind of the rebound in equities and credit and other assets of late, you know, what are some themes going forward that you think you can put big chunks of money behind? I mean, understanding that a lot of what you do has just sort of, you know, looking at things that have idiosyncratic opportunity. You know, just kind of bigger picture, you know, what type of an investment deals have been topical?

Tony James: Sure, we still think there’ll be a ton of opportunity in the energy area. While prices have come up, it’s an industry that needs a lot of capital and a lot of the players are still pretty fully leveraged. The debt they issued at par that traded down many…and well below 50 cents on par is still less than par, so they can’t finance. And therefore, to, you know, but now that prices are up, they have prospects where they can drill wells or build pipelines or whatever, build power plants, all of which gets a nice, positive return on capital. So there’s tons of opportunity to put capital in the energy field, I think. I think that there’s a lot of opportunity, particularly in European real estate, where we’re seeing right now. In India, the office market is hot as a pistol, so there’s a lot of opportunity there. There’s some interesting…India is kind of doing quite well, actually, I mean by comparison to the turmoil around the rest of the world. There’s interesting opportunities in retail and in other things.

In credit, in Europe, with the banks pulling back and the turmoil, there’s just a lot of white space for our credit businesses to step in there. So, as I go around the world, I actually see a fair number of opportunities right now.

Matt Jarzemsky: Okay. Fair enough. And then in the buyouts business, specifically, you know, it seems generalist…you know, big generalist investors have been dealing with competition from strategic. You know, we often hear about Chinese financial investors, and strategics as well and some of these specialized PE firms spitting up assets in sectors like tech. So you know, what’s the competitive landscape been like, in processes where you guys have gotten involved on the PE side?

Tony James: Well, in general, in PE, while the stock market’s obviously high, our project list is as long as it’s been in quite a while. So we’re very, very active. Activity level has picked up. And it’s kind of a funny thing. Yes, there’s more competition but there’s a lot more for sale as well. And often when strategies are in there, buying things, they’re also rationalizing their business plan, their business mixes and selling things also. And so the activity level is up. I think there’s plenty of competition, there’s competition from other buyout firms, there’s competition from strategies… I don’t think strategies are bothering us any more than other private equity sponsors, if you will. But remember, what we try to do is we try to avoid competitive situations because we don’t…unless we have a significant angle, just because it’s, you know, it’s very hard to get real bargains there. So we focus much more on build ups and things…turnarounds, or we can go in and have a special advised management team that can do things. And things that are off the run. And there’s a fair amount out there right now. And for consolidation plays, particularly you get a great management team, and a platform company, it’s not a bad time in the
economic cycle, with the economy doing what it is. It’s not a bad time evaluation wise for entrepreneurs to decide it’s not a bad… it might be a good time to worry about their estate plan and sell their little company into a bigger company that we can then realize a lot of synergies and build a national champion. So that’s been a very active area for us.

**Matt Jarzemsky:** Okay. All right, thanks a lot Tony.

**Operator:** And next we’ll go to the line of G.Q. Koh with Reuters. Please go ahead.

**GQ Koh:** Hi Tony, good morning. You talked a bit about energy earlier, but can you leverage a bit more about where you see prices going? You know, whether you expect prices to retreat again and whether there’s specific areas within the energy sector that you like? Because I see that most of the funds for like the P2 and Energy Select has not been deployed. Thank you.

**Tony James:** Well, I’d have to say that our track record projecting energy prices has not been spectacular. I think we’ve done very well in energy, because we’ve been conservative. And I think we… we played the cycle pretty well. We bought into a lot of oil five years ago and then sold oil at some kind of peak, just because the values were high at that point. And we… and so we didn’t get hurt by the drop in commodity prices that many other people did. In the meantime, we’ve been building, we’ve been building a lot of energy assets around the world in the renewables area, and we picked up some traditional generation facilities at very low cents on the dollar of replacement cost and done very well with those. So all in all, I think we’ve been… done extremely well but not because we had a great idea of where energy prices are going.

In our models, we’re expecting energy prices, we’re kind of using this price as a normalize. We think there’s downside. So we kind of structure our deals to have survivability down to 30-dollar oil. And we premise our returns on something like the forward curve, which kind of gets oil into the 60s, out five years. And hopefully, you know, I actually expect it will be higher than that, truthfully, but if so, that’s icing on the cake. So we kind of used the pricing deck and we look at a lot of scenarios. There’s not any one scenario we look at. What do… I think energy is sort of in a reasonable equilibrium now. Where do we like energy? I think if you’re investing in oil and gas, you’ve gotta buy really prime properties that are economic at very low prices. And that’s where the action is. And everyone needs money, so we’re able to I think go and pick the best prospects and the best plays and that’s where we’re focusing our money. We’re not buying marginal properties that are only economic or marginally economic… only economic at higher prices, and marginally economic at these prices.

We’re buying into areas where… that were economic even at the lows, in terms of drilling new wells and finding hydrocarbons. And then we’re focusing a lot on picking up legacy assets at very cheap and building new things where – particularly in the renewables area, where we can get some nice returns.

**GQ Koh:** Okay, thank you.

**Operator:** Next we’ll go to the line of Mary Childs with the FT. Please go ahead.
Mary Childs: Hi, I was hoping to hear a little bit more about your hedge fund solutions. Just kind of the breakdown between seeking and Senfina and some of the other areas there.

Tony James: Okay. So, well, you know, our core business is the traditional business we’ve been in and accounts for a huge, the vast bulk of what we do. And then the numbers I gave you were in our flagship representative fund. So, Senfina is – has done about like, since inception, about like the S&P, honestly. Which in the contrast to many hedge funds… which underperform the S&P… is not bad performance. So we had a, we had a great… we had a great ’15. We had a challenging first quarter. We came back and made money in the second quarter. We expect that strategy to be a more volatile strategy, but we also expect it over time to put on higher returns and we’re still very optimistic about that business model.

In terms of our basic… in terms of our basic fund of funds aspect of that business, we continue to get assets. So there’s a lot of people that still want equity market exposure, but they like the idea of being able to earn returns comparable to that of the S&P but with lower volatility and lower risk. There’s nothing that’s better for our business than a lot of volatility in the market, but there’s investors who are uncomfortable with that. So if we can give them equity returns, with less volatility, they really like that.

In addition, because we’re the largest investor in hedge funds, we’ve been able to extract fee discounts from our managers that largely offset our own management fees. So they’re getting our expertise, with very, very low cost. And that’s been a pretty compelling pitch for people.

Mary Childs: And can you… that mandate, the hotly contested mandate that you guys won, is there any kind of… can you give us any color as to what business that went into more specifically?

Tony James: That’s going to be in a traditional… more in a traditional fund of funds side of that business.

Mary Childs: Okay, got it. Thank you.

Operator: Next we’ll go to the line of Megan Morris with PERE. Please go ahead.

Megan Morris: Good morning. Thanks for your color at the top with Devin’s question on Brexit. I wanted to drill into the details a little bit more on the real estate side and get some more color on what exactly those reductions in value for London office holdings are that are mentioned on page five? So I was wondering if you could tell me what portfolio those are in, and confirm that that’s Brexit related as well as give me the total reduction number?

Tony James: Well, we’re not going to go portfolio by portfolio.

Megan Morris: Sure.

Tony James: Or asset by asset. But it is Brexit related.
Megan Morris: Got it. And can you give me an idea of the overall reduction number?

Tony James: Overall reduction of…

Megan Morris: For the value of London office holdings?

Joan Solotar: Yeah, we don’t split out marks by portfolio or asset publicly.

Megan Morris: Got it, thanks.

Joan Solotar: Up or down.

Operator: All right, and our last question comes from the line of Steve Gelsi with Buyout Insider. Please go ahead.

Steve Gelsi: Yeah, hi, hello Tony, thanks for taking the call. Two quick questions. Can I get a little bit more color on the unitranche financing that you mentioned earlier on the call? I didn’t get… I didn’t catch the name of the deal. And if you could also, second question, could you also comment on demand from LPs for longer life funds and permanent capital vehicles, you know, as opposed to the traditional 10-year life of a private equity fund?

Tony James: Sure. I’ll get to that in just a minute, but I want to just say for Megan that the last question… just one other piece of color on that. The mark, while there were some mark downs in some assets, there were mark ups in others. On balance, there were mark ups. So just want… the portfolio increased in value. So, Brexit was net good to us, we think. So I just want to clarify that.

Okay, the name of the unitranche was Polynt and it’s a European chemical company – P-o-l-y-n-t. And in terms of demand for long-life vehicles, there’s definitely more demand for long-life vehicles than there used to be. And I think it’s a wise move on investors’ parts. They can’t necessarily, in their portfolio, get the very high compounding rates they used to. That is the very high IRR – it’s harder for most of our LPs and their portfolio, to find a lot of things where they can go get, say, 20% return. So what they’re doing instead is substituting high compounding rates for longer duration. So if they can’t get 20% over three years, they’re much happier to get 15% over five years, or 12% over 20 years. And if you think about the numbers, you get a lot richer, you get a lot richer, doing 12% over 20 years, than you do choosing around, finding a few investments where you get 20% for three years, then having to get that money back and you look for the next one and then you put it out, you get 20% for another three years.

So I think they’re very wise to do that. And a lot of the sort of very successful family offices and wealthy families over the years have had a strategy of investing into great assets, holding them a long time, but not necessarily getting the same IRR. But they get a lot richer over time. And I think a lot of the institutional investors we’re seeing are coming around and are seeing that, which is driving the growth of our Blackstone BPP – our core-plus real estate business, driving the growth of core private equity, and we’re reflecting that in other, long duration products. And there’s a fair amount of investor appetite for that.
**Steve Gelsi:** Okay. Yeah, but at the same time, I guess there’s a lot of public pension funds that probably want shorter life funds, because they need cash. You know, they’ve got unfunded liability. So maybe that’s kind of a push back via the way too, to have some shorter life products as well. Maybe that’s what’s getting those people into credit funds, because you do get a return, I guess. More of a constant return from credit funds. I just wanna share that thought with you.

**Tony James:** Yeah, okay, well, so – unfunded liabilities are not necessarily short-term outflows.

**Steve Gelsi:** Okay.

**Tony James:** But the unfunded liabilities are a huge – it’s the present value of the future obligation, which can go way, way out for a pension fund. So they have a lot of long-duration liabilities. Some pension funds certainly have near-term cash needs, and they like the current income as well, but they want a balance. In general, I would say, most pension funds and most investors across the board, have way more liquidity than they really need. And in this market, there’s a huge cost of liquidity. One of the ways we make premium returns is by being able to buy and hold illiquid assets. And for the same risk in every asset class, for the same risk your illiquid asset will give you much higher returns than a liquid asset with the same risk. So, I think investors are increasingly realizing that the cost of liquidity, of excess liquidity is high, which is why they’re moving more into alternatives.

**Steve Gelsi:** Okay, thank you very much.

**Operator:** All right, and now I’d like to turn the call back over to Christine for closing remarks.

**Christine Anderson:** Thanks everyone. We appreciate you calling in this morning. We look forward to hearing you on the – or at least having you join us on the analyst call and we’ll stand by and ready to take questions as you have them today. Thanks for joining.

**Operator:** Ladies and gentlemen, that does conclude our conference for today. Thank you for your participation. You may now disconnect.