BLACKSTONE First Quarter 2019 Earnings Investor Call
April 18, 2019 at 9:00am ET

Weston Tucker: Good morning and welcome to Blackstone's first quarter conference call. Joining today's call are: Steve Schwarzman, chairman and CEO; Jon Gray, president and chief operating officer; Tony James, executive vice chairman; Michael Chae, chief financial officer; and Joan Solotar, head of private wealth solutions and external relations.

Earlier this morning we issued a press release and slide presentation along with a supplemental presentation which are available on our website. We expect to file our 10Q report next month. 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 do not undertake any duty to update these statements, and for a discussion of some of the risks that could affect results please see the risk factor section of our 10(k).

We'll also refer to non-GAAP measures and you'll find reconciliations in the press release on the shareholder's page of our website. Also not that nothing on this call constitutes an offer to sell or a solicitation of an offer to purchase an interest in any Blackstone fund. This audio cast is copyrighted material of Blackstone and may not be duplicated without consent.

So a quick recap of our results. We reported GAAP net income of $1.1 billion for the first quarter. Distributable earnings were $538 million, or 44 cents per common share, up seven percent from the prior year. We declared a distribution of 37 cents, to be paid to holders of record as of April 29th.

We also announced that Blackstone will convert from a partnership to a corporation, which is expected to be effective July 1st, 2019. We posted a short video to our website this morning, along with the supplemental slide presentation that I mentioned, walking through the details of the conversion which we encourage you to watch.

With that I'll now turn the call over to Steve.

Steve Schwarzman: Thanks, Weston, and good morning and thank you for joining our call. Today we're pleased to announce a compelling next step in Blackstone's evolution as a public company: our conversion to a C-corporation.

This is a journey that began in 2007 with our IPO. Since that time we've not only advanced our position as the clear leader in our industry, growing AUM six-times over that period to $512 billion, but we've also established ourselves as one of the leading public companies in the world. For example, our financial performance over the past decade ranks Blackstone among the highest of the largest 150 U.S. public companies. We've grown revenue and earnings at more than double the median growth rate of this group, while our profit margins are more than triple, as is our dividend yield. On a composite of these four metrics Blackstone ranks number one among the largest companies in the United States.

In addition to our financial performance Blackstone is widely regarded as one of the best franchises. Morgan Stanley recently named Blackstone as one of the 30 best stocks for a long-term investment based on its review of business quality and competitive positioning. We were the only asset manager on a list that includes highly-recognized companies such as Amazon, Alphabet, Costco, Visa and a lot of other household names, if you will, in finance.

Like these firms, we have a real moat around our franchise. By delivering differentiated investment performance to our customers over decades, with minimal loss of capital, we've created a deep bond of trust resulting in a very significant percentage of repeat business.

Blackstone is the reference institution in the fast-growing alternatives industry, and that growth is widely expected to continue. Morgan Stanley also predicted that management fees for our industry would grow to $70 billion annually within five years, up from $45 billion currently. We are extraordinarily well-positioned to benefit against this backdrop as the largest and most diverse firm with the strongest brand among both institutions and retail investors.

Blackstone's stock, however, has not matched the trajectory of our business. Even though the stock has performed in line with the S&P, since our IPO – which most people don't recognize because a lot of it comes from dividend flow – that actually makes little sense for us to be at the S&P, given that our business has dramatically outperformed the market on most metrics.

On the list of 30 top companies that I referenced we have the highest dividend yield but the third lowest earnings multiple. Why does this discount persist?

In analyzing this disconnect we've spent considerable time speaking with our investors around the world. Consistent theme has been that our public-traded partnership structure simply makes the stock too difficult to own. We determined that over 60 percent of long-only index and ETF investors in the United States, representing $7.5 trillion of capital are materially restricted in their ability to own PTPs, and they actually typically don't. Add to that trillions of dollars more of non-U.S. and retail capital that is challenged in owning PTPs, and the cause of our valuation disconnect comes into better focus.

Earlier last year, following the passage of tax reform, we told you that we would carefully study the possibility of changing our structure. We also had the benefit of being able to analyze the experience of two of our peers that converted. What we learned is that since these firms' respective conversion announcements they had the best-performing stocks among our peers other than Blackstone itself, which at that point had not converted.

Ownership by long-only and index funds for these other firms doubled, and liquidity dramatically increased with their trading volumes almost doubling, on average. Time will tell what impact conversion will have on Blackstone's stock. But we know this: conversion will make it vastly easier to own our stock. Michael will discuss these statistics in more detail, but we estimate conversion will initially remove restrictions on at least $4.5 trillion of investor capital in the U.S., as well as trillions of dollars more institutionally. If we continue to grow as the reference institution in our industry, and now have access to trillions of dollars more of buying power, I think it's reasonable to assume we should substantially close the gap between our valuation and that of other top companies. We believe the action we're announcing today is a very significant step forward in driving this type of outcome.

I'd like to thank the investor and analyst community for encouraging us to look at this, and we greatly appreciate your patience as we went through a very thorough analysis. We are enthusiastically making this change because we think it will unlock substantial value for all of our current and future shareholders.

In closing – although our corporate structure is changing – everything else at Blackstone remains the same. We will continue to operate as the same integrated firm, preserving the unique culture that has driven our success for 33 years, characterized by meritocracy, entrepreneurialism and excellence in all we do. Our core mission remains unchanged, which is to drive outstanding long-term performance for our investors.

Thank you for joining our call today and with that I'll turn things over to Jon.

Jon Gray: Thanks Steve, and good morning everyone. I share Steve's optimism on driving greater value for our shareholders under the new structure. But importantly, Steve said the foundation of our firm is not changing. We remain totally focused on delivering great returns which builds trust and allows us to continue raising capital and innovating on behalf of our investors.

At our Investor Day last September we outlined a path for how this virtuous cycle would drive a meaningful step up in the growth and quality of our earnings. As today's results illustrate, the two major pillars underlying our targets, first – a raising and launching of four major flagship funds, and secondly – the trajectory of our real estate core-plus platform, are both advancing better than initial expectations.

We now expect the four flagship funds, corporate private equity, global and European real estate, and our PE secondaries fund to reach approximately $65 billion collectively, or 30 percent more than their prior vintages. We've already closed on 70 percent of those commitments, with three of the four funds substantially completed, including a $22 billion first close for our corporate private equity fund, which we expect to be the largest PE fund ever raised. For the fourth flagship fund, European real estate, we expect the vast majority of its approximately $10 billion to be raised in the coming weeks.

The ability to raise record-setting funds on close to a one and done basis speaks to the strength of the global franchise. In total, across the firm, gross inflows were just over $100 billion for each of 2017 and 2018, a pace we expect to meaningfully exceed in 2019.

Our real estate core-plus platform has also continued to display the momentum we talked about at Investor Day, growing to $36 billion in a little over five years – up 22 percent year-on-year. This includes our non-traded REIT, B-REIT, which continues to power forward, raising nearly $600 million in the most recent month as we further expand distribution internationally and in the IBD channel. B-REIT has already grown to $6 billion in two years, a remarkable endorsement of the power of the Blackstone brand in the retail channel.

We now manage $76 billion of perpetual capital AUM in total across 13 funds. These vehicles will drive greater predictability of the firm's earnings, given their enduring nature and the fact that performance revenues occur on a known time table without requiring asset sales.

The power of our franchise allows us to rapidly expand new businesses to global scale. We've been talking about a push into faster growth areas like life sciences and growth equity. We now expect to begin fundraising for a dedicated Blackstone vehicle in life sciences in the current quarter and growth equity later this year. Our Tactical Opportunities business which started as $5 billion first fund in 2012 is now a $30 billion platform.

In our secondaries area our current fund will be over $10 billion, or more than four times larger than when we acquired the business five-and-a-half years ago. And in GSO the rebuilding of our U.S. direct lending strategy is progressing well, and we expect it to exceed $12 billion later this year.

Of course this always ties back to the investment performance of our funds: 15 percent net returns annually in both our opportunistic real estate and corporate private equity businesses for 30 years. In the first quarter all of our flagship strategies again delivered healthy appreciation, driving strong growth in our balance sheet receivable. Michael will discuss our returns in more detail, but overall the portfolio companies are reporting steady performance.

Our public holdings also benefited from the stock market rally in the first quarter. The Fed pausing its tightening cycle, combined with greater optimism on China trade and growth were major factors in the rebound. Strong markets helped us launch two highly-successful IPOs in the past few weeks. We listed the embassy REIT in India, the country's first, and the culmination of eight years of building one of the largest office portfolios in India, which continues to benefit from some of the strongest fundamentals in the world. In addition we bought Tradeweb public, a division of Refinitiv; the offering was upsized twice and 17 times oversubscribed, and the stock has traded up 40 percent since its debut.

The biggest challenge today globally in making investments is a lack of distress and high multiples in many sectors. When valuations are rich we stay disciplined. We're never buying the market and we use our scale and global reach to win deals others cannot. We committed to three large opportunistic deals in the quarter, including a creatively-structured midstream investment and the privatizations of two technology businesses, Ultimate Software, which represents the largest PE software deal in history, and Scout24, the leading German online classifieds business. We were also active in our real estate core-plus, PE core, and secondaries businesses.

In total we invested $12 billion in the quarter and committed $8 billion to deals not yet closed. We have record capital on the ground today and record capital to deploy with $133 billion of dry powder. We have very long investment periods and can be patient for the right opportunities.

In closing: the firm continues to deliver strong performance for both our limited partners and our shareholders in all respects. Over the past year we've made several changes to drive even greater value for our shareholders. Last April we announced a $1 billion stock buyback program. More recently we simplified our financial metrics to make them easier to understand, focusing on distributable earnings. And today we are announcing our conversion to a C-corp, so a much larger universe of investors can buy the stock.

And with that I turn things over to Michael.

Michael Chae: Thanks, Jon, and good morning. I'll begin my remarks with the details around the conversion and will refer to the pages in the supplemental presentation. I'll then review first quarter results and the outlook.

Starting on page one of the supplement with the mechanics of the conversion. We expect an effective date of July 1st, as Weston stated. Existing unit holders will receive their final Schedule K1 for the period January 1 through June 30, 2019. After this date all shareholders will receive a Form 1099 with respect to qualified dividends instead of a K1.

Moving to page two, which summarizes the rationale for conversion. The takeaway here is that we view BX as a must-own stock that has been under-owned historically, due to our PTP structure. Why must own? The firm has an exceptional business model and financial profile. Page 3 illustrates the comparison of Blackstone to the largest 150 U.S. public companies as Steve summarized. On all four of these key metrics – revenue and earnings growth, pre-tax margin and dividend yield – we are in the first or second decile, and on an equal-weighted composite Blackstone ranks number one among the largest 150 public companies in the U.S.

Despite this compelling position among the leading public companies our structure has meaningfully limited the market for our shares. Page 4 illustrates the extent of those restrictions. As you can see nearly 100 percent of index funds and ETFs are off limits to

PTPs, along with a substantial portion of long-only funds, together representing $7.5 trillion of capital, as Steve said.

As a result, as shown on the right side of this page, these investors only hold 21 percent of BX float, well below the 60 percent average ownership of C-corp alts, reference financials and the largest U.S. companies.

As shown on page 5 by converting we effectively double the unrestricted domestic long-only and index ETF market to $9 trillion. We eliminate the K1, making the stock eligible for 100 percent of long-only funds. We also eliminate such problematic pass-through income as UBTI, state-sourced income, and of importance to non-U.S. investors: ECI.

The stock becomes eligible for the benchmark indices underlying an estimated 40 percent of index funds and ETFs, namely CRSP, MSCI, and certain total market indices. And we're hopeful that eligibility will further increase over time. We were encouraged by MSCI's recent decision following an 18-month review to continue including dual share class securities in its primary indices and to create an additional index family for single share class securities. We believe this was a thoughtful and well-structured model for the future.

Finally and importantly, as shown on page 6, we are able to access the significant benefits of conversion at a modest additional tax cost. To unpack that, our fee-related earnings are already largely taxed at the corporate rate today, and as outlined previously, the firm's earnings mix continue to shift toward a higher percentage of FRE over time. Our net realization income is mostly pass-through income which will become taxable at the corporate level upon conversion.

By electing a tax basis step-up we will mitigate dilution resulting in a negligible total impact toward distributable earnings from conversion in the near-term and approximately two to five percent annually on average over the next five years. Looking beyond five years longer-term we ultimately expect tax dilution in the 12 to 13 percent range annually at the corporate level.

Finally I would note at the shareholder level for a taxable U.S. shareholder the impact is even lower due to the tax treatment of qualified dividend income as a C-corp versus the various individual tax rates applied to pass-through income as a partnership.

In summary: following significant reflection over the past year and a half we find the cost-benefit analysis of conversion highly compelling. We're exciting to be making this change today, with success to be measured over the long term.

Now moving to a discussion of our first quarter results. The firm's strong momentum continued in the quarter highlighted by robust inflows and the march toward our Investor Day targets, as well as attractive investor performance and a growing store of value. Total AUM rose 14 percent year over year to a record $512 billion through the combination of

$126 billion of gross inflows, an industry record, and $20 billion of market depreciation despite $36 billion of realizations.

To address a point of confusion recently in the press, our total AUM metric includes the underlying equity value of our funds but not third-party leverage on our investments. This is consistent with how the other public alternative firms report, except for one – Brookfield, which is an outstanding firm, includes leverage in its reported AUM. Measured on the same basis Blackstone's total AUM would be approximately $804 billion.

Management fee revenue in the quarter increased 11 percent year over year to $814 million also a record for the firm. Fee-related earnings rose 11 percent to $374 million, notwithstanding the sale of our prior direct-lending business last year, and our forward momentum is strong. I'll discuss the outlook more specifically in a moment.

Distributable earnings were $538 million for the quarter, or 44 cents per share, up seven percent from the prior year and underpinned by the strong growth in FRE. And fourth quarter market turbulence had the effect of reducing the realization pipeline entering the year. That said, we did complete the sales of a number of private holdings, primarily in private equity, and as markets recovered we executed several public sales in real estate and private equity.

Turning to investment performance, where we saw broad-based strength across the firm in the quarter. In real estate the opportunistic funds appreciated 4.7 percent while core-plus rose 2.7 percent. In private equity the corporate PE funds appreciated 4.6 percent, Strategic Partners also 4.6 percent, and Tac Opps 2.8 percent. In both private equity and real estate returns benefited from a sharp rebound in our publics as well as continued steady appreciation in our private holdings. In credit the performing credit funds delivered a 4.1 percent growth return in the quarter, while the distress funds were up 3.7 percent gross. And in hedge fund solutions BAAM’s composite rose 3.4 percent gross.

Strong fund performance powered $540 million of net accrued performance revenues in the quarter, lifting the balance sheet receivable to $3.9 billion, up 10 percent from year end. Fund appreciation, combined with our active investment pace, including $12 billion deployed in the quarter, and $46 billion over the last 12 months, drove performance revenue AUM in the ground to a record $211 billion, up 13 percent year over year. Taken together these are positive indicators for future value realization.

Moving to the FRE outlook: as Jon referenced, we continue to advance on the path outlined at Investor Day. Of the major flagship funds underpinning that view, our new PE secondaries fund launched its investment period in the first quarter and is generating full fees. The other three funds: corporate private equity, global real estate, and European real estate, are expected to launch investment periods throughout the second half of this year and into early 2020 and are then subject to four-month fee holidays for first closers.

At Investor Day last September, we outlined a path of 50 percent or better growth in 2020 FRE which implied better than $1.70 per share. Given our fundraising success to date, and our continued progress overall, we now have even better visibility and more confidence in that view. And importantly we remain confident in our path to $2 per share.

Finally, in terms of returning capital to shareholders: we've purchased nearly 18 million shares in the open market over the past year under our buyback program resulting in a flat share count despite the firm's continued robust growth and business line expansion. Combined with our cash distributions we returned $3.3 billion to shareholders over the last 12 months. We remain extraordinarily focused on delivering attractive value to our shareholders and our conversion announcement today is another major step in support of that commitment.

With that we thank you for joining the call and would like to open it up now for questions.

Operator: Thank you. Your question and answer session will now begin.

The first question comes from the line of Bill Katz of Citi. Your line is now open, please go ahead.

Bill Katz: Okay, thank you very much for taking the questions and congrats on the conversion. I agree with your assessment.

So just on the conversion itself, maybe a couple of just sort of tactical questions. Michael, I was wondering if you could talk about just some of the tax-related savings in the first few years and how you're accomplishing that. And then – maybe it was in your prepared commentary about the thoughtfulness of MSCI – but how is the dialog with both the S&P and Russell about the dual class structure as well.

Michael Chae: Bill, thank you. On the first question, as part of our conversion we will be making section 754 elections – section 754 – which will create a step up in assets that'll be utilized as those assets are sold in addition to creating intangibles that'll be amortized over 15 years. So that is obviously one of the, but not the only, factor around what we view as modest dilution in addition to the continued mix shift around FRE, which as you know is already taxed largely at the corporate rate and so forth. So that is some color on that.

And in terms of the latter question Jon do you want to comment?

Jon Gray: Sure, I'd just say, Bill, we haven't obviously gone out because we weren't eligible for any indices as a publicly-traded partnership. So we haven't had dialog directly for some time on this topic. But we do look forward – as Michael noted in his remarks, MSCI studied this pretty carefully and concluded that it was okay to leave dual class shares in their indices. We think that's the right conclusion because when you look at performance – and we've studied this – in the S&P 500 over the last ten years the companies with dual class shares have doubled the performance of the overall index, and in many cases they're founder-led companies. So you have companies like Berkshire and Google and Nike, and those founders and what they've done to drive those businesses, has led to great creation of shareholder value.

So we're hopeful that the index managers will be open to this dialog. As we've noted a number of indices will include us and that should happen when we convert here in the next couple months but over time we'd love to convince folks that this is the right way to give shareholders access to great companies like Blackstone.

Bill Katz: Thank you.

Operator: The next question comes from the line of Craig Siegenthaler of Credit Suisse. Your line's open; please go ahead.

Craig Siegenthaler: Thanks. Good morning everyone and congrats on the C-corp conversion too. So I know that you haven't changed your dividend policy today, but now that you will be paying taxes – or the owners will be paying taxes – on the actual dividends and not the underlying income, how do you evaluate buying back your stock at this compelling valuation versus returning capital, via dividends, which now are taxed at the dividend level?

Michael Chae: What I would say, Craig, overall – thanks for the question – we don't have plans to change either our dividend policy or our zero dilution purchase program at this point, which together we think of made for a very shareholder-friendly capital return policy. As you know, our business model is such that we can grow, as we have and will do, at very high rates, without essentially requiring much capital, which is pretty extraordinary. And our capital return policy reflects and takes advantage of that to the great benefit of our shareholders. So as you note, obviously conversion enables a qualified dividend treatment and that creates even more flexibility. But we're going to maintain the approach, and, on repurchases, as I said we're committed to zero dilution. We are open to the possibility at times to be opportunistic and we will certainly reserve that right and look at it through the lens of creating long-term shareholder value for our investors.

Craig Siegenthaler: Great. Thanks, Michael.

Operator: The next question is from the line of Michael Cyprys of Morgan Stanley. Your line's open. Please go ahead.

Michael Cyprys: Good morning. Just to follow up on the payout policy on the dividend what would lead you to change your dividend policy. To what extent is that something that you're evaluating? 85 percent payout for a C-corp does seem a bit high? Are there others out there that you see that have been successful with such a high dividend payout policy?

Jon Gray: We've obviously made some significant changes, as you guys noted over the last year, in terms of moving to a share buyback program, simplifying the financials and obviously the big announcement today on C-corp conversion. We're very focused on delivering for shareholders, as Michael noted. And what we've seen from our investors is they like these healthy dividends. And we think the market, particularly in this more liquid form of C-corp, will react positively.

Obviously over time, if things are not positively received, we can evaluate. But we really like this; we think shareholders like the idea that we're big returners of capital and we pay out healthy dividends.

Tony James: I'd just like to jump in, Mike. The key thing about our business that's better than any other corporation out there is we don't need capital to grow. We can grow at high double digits without having to reinvest and fix plant equipment as so many other businesses need. It's one of the great things about Blackstone.

Operator: The next question is from the line of Robert Lee of KBW. Your line's open please go ahead.

Robert Lee: Great, thank you, and congratulations on pulling the trigger on conversion. I guess my question may be moving away from the conversion a little bit to the high net worth and retail market. I know, Jon, you talked a little bit about some of the success you're having there, and expanding it out globally. But I'm just curious more specifically, for a bunch of years now, a lot of people in the industry have looked at the big pool of retirement assets, 401(k) assets, as this kind of Holy Grail. And for any number of reasons, the liquidity of your strategy, on certain terms over litigation, whatever it may be, any – and maybe this is a question for Joan – but any sense that you're starting to see some light at the end of the tunnel? That some of these hurdles maybe be overcome the next couple years and you can actually start accessing that pool of capital?

Jon Gray: That's a very good question. We, I think like many others, recognize that increasingly in private sector we've gone from defined benefits to defined contributions. Individual investors don't have access to the returns we generate in private markets. And so if you think about a young person in their early 20s contributing to a 401(k), and yet the requirement today is for daily liquidity, it's really a regulatory requirement that has made it very difficult to give our products to the retail world and the 401(k) retirement world, it's not super logical that they shouldn't have some portion of their portfolio available for alternatives.

We have been working sort of in Washington, talking to various folks, we and others in the industry, about the idea of opening up the retirement community. Tony specifically has spent some time on this as well, John Finley, our general counsel, Wayne Berman on government relations. We think that this is an area where it makes a lot of sense for these long-term pools of capital for individual investors to have access to alternatives. And our suspicion is over time these markets will open up. I think regulators rightly will want to make sure that the folks who do this are highly experienced, that the fees that are charged are reasonable. There have been abuses in the past with alternative products in retail hands. And so we think the collaborative approach with regulators could lead to a very good outcome for individual investors in their retirement accounts, and obviously for money managers like us.

Tony James: I would just like to point out the statistics. The average 401(k) returns 3-4 percent; the average pension returns 7-8 percent. The big difference is the pension plans allocate to alternatives.

Robert Lee: Great. Thank you for taking my question.

Operator: The next question is from the line of Ken Worthington of J.P. Morgan. Your line is open, please go ahead.

Ken Worthington: Hi, good morning. Thanks for taking my questions. I guess in terms of dilution from the conversion, is the tax blocker you're creating with the conversion essentially the sole driver of the difference between the near-term two to five and the long-term 12 to 13? Is there a difference between the cash taxes from this blocker and reported? And then maybe lastly I assume that management will continue to own a different class of shares here; to what extent does that dual ownership structure have any positive impact on this dilution of the C-corp shares?

Michael Chae: Ken, you're referring to a blocker – I mentioned in my remarks, it's an asset step-up in tax basis, so a different term of art. In terms of the cash versus reported taxes those will be aligned, and that's a factor. I also mentioned the evolution of our earnings mix, will continue as we talked about in Investor Day towards FRE within DE, which already currently, as you know, is largely taxed at the corporate rate. So those are, I think, a couple perspectives on your first question.

And as for your second question, that's not a driver. The effective tax rates and the dilution I alluded to are on the common. Those refer to DE per common dilution numbers.

Ken Worthington: Great. Thank you.

Operator: Next question is from the line of Alex Blostein of Goldman Sachs.

Alex Blostein: Thanks guys. Another one on taxes. So I guess as we think about the run rate tax rate going forward starting the second half of 2019 into 2020, what should we be thinking about in terms of the rate? And then is it expected to gradually increase over the five-year period and then normalize in the low '20s? Or stays low and takes a step up once you get to the five-year period?

Michael Chae: Alex, it sounds like you've more or less got your fingers on it. Under our current partnership structure we estimate our effective tax rate on DE per common would have been in the range of around 11 to 13 percent going forward.

As a corporation we expect that to be at or maybe just above the high end of that range on average over the next five years, and longer-term we expect the rate to trend to the low 20s. And so, within the next five years, what you're getting at in terms of the shape of that, it obviously depends on the activity and income mix in terms of what we sell and when we sell it. We expect pretty negligible change in the next few years, relative to the current rate, while in the latter part of the five years we should begin to trend towards that longer-term rate.

Alex Blostein: Got it. Thanks.

Operator: The next question is from the line of Michael Carrier of Bank of America Merrill Lynch.

Michael Carrier: Thanks everyone and good morning. Michael, you gave a pretty good pathway on the FRE. I know the realized income is tougher to predict and the whole industry had a little bit of a pause given the fourth quarter volatility. But just wanted to get your sense when you look at the performance of the portfolio across the different segments, some of the IPOs that you guys have launched, and then what maybe secondaries are out there, just how we should be thinking about the realized performance fees in this environment.

Michael Chae: Sure Michael. As you point out the portfolio is performing. We're pleased with that, as you saw in the investment performance. You know, as I mentioned in my remarks, the first quarter obviously saw the impact of the significant market dislocation of the fourth quarter. It's still early in this quarter and in the year, but the markets and market conditions have obviously materially improved, asset prices have recovered, and some measures of that are we've replenished the net accrued performance revenue balance in a really significant way. That ten percent quarter-over-quarter growth in the first quarter was actually the largest sequential increase we've had since the second quarter of 2014, both on a dollars and percentage increase basis.

And you alluded to this: our public portfolio between appreciation and new IPO activity, our liquid public holdings, are up about 25 percent in size today versus the beginning of the year. So the value in the ground continues to grow, the pipeline's rebuilding. We have some substantial things sort of in motion in the hopper. Those will play out according to their own timetables, but we feel good about our position as we go forward through the year.

Michael Carrier: Okay, thanks a lot.

Operator: The next question is from the line of Glen Shore of Evercore ISI. Your line's open. Please go ahead.

Kaimon Chung: Hi, this is Kaimon Chung in for Glen Shore. Many of the asset managers have been getting a little more vocal on the prospects of China being a big growth market for them. I'm not sure anyone has better insights than you, and Steve specifically, but can you talk about your views on that market opening up and how Blackstone is positioning for that? And anything on timing would be great. Thanks.

Steve Schwarzman: Sure. China's going to be opening a variety of areas in finance – the banks, insurance companies and also in the brokerage area. And they'll first go to a majority permitted by foreigners. And then they'll be able, after a few years, to take 100 percent. And so obviously they have existing regulations and then it should be some modifications of those. This is an area where I think the Chinese will be very cautious in terms of the quality of companies that they 'green light'. And I think this is an area of long-term interest for any firm such as ours.

There are particular areas where China has a lot of assets, like real estate – a big source of where they put their savings. Stock market is much less important in China, as you know. And people save and they invest in real estate as their primary drivers. We happen to be unusually capable in that area compared to competitors around the world, and longer term, this is something, along with our other business lines, that I think that we would be interested in.

This is all evolving now; people are negotiating some of these elements. It's an area where the Chinese want to have much more engagement with the outside world, and so things hopefully will line up at some future time. We're not involved in any negotiations at the moment with them. But things are going to change, I think, after the agreement which everybody anticipates will be done, you know, within the next six weeks or so. Could be the wrong timing, could be another week or two either way, but that's the current thinking of where things should shake out.

Kaimon Chung: Thank you.

Operator: The next question is from the line of Chris Kotowski of Oppenheimer & Co. Your line's open. Please go ahead.

Chris Kotowski: Good morning. Question for Jon Gray, I suppose. I'm curious about your approach on investing BREP 9. Historically I always thought of Blackstone's opportunistic real estate, that you try to buy properties below cost then you buy it, fix it, sell it. I also thought a big portion of the funds would be invested in small, mid-rise suburban office buildings that might be $20 or $30 million tickets. But now, with an $18 billion fund, it seems like you're being more reliant on bigger deals like the Sears Tower and things like that. But every city you go to there's massive construction, construction seems to be booming. So the current environment just doesn't seem that in sync with your historical style, so can you talk about your approach to investing BREP 9?

Jon Gray: Sure. I guess I'd say a few things. The challenge today in investing is opportunistically in the United States is a reflection of the fact that there is not a lot of distress and prices are relatively full. And so on that point, it is not an environment where you back up the truck and buy everything, let's say, as it was back seven or eight years ago.

That being said, what I would differ on is the way we've run the business. It has not generally been small deals, it's been a scale business. If you went back to the pre-crisis era, the way we were able to really dodge some of the big challenges – we did two very large deals in the EOP and Hilton which we ended up making more than $20 billion on – when most investments in real estate of that vintage turned out to be substantial losses. And we've continued on that in housing and our GE real estate deals.

So I think the business model is very much staying the same. I think at some point here the opportunities – remember, we get this capital for a long period of time, so if there's not a lot to do we can sort of leave the bat on our shoulder. But then what happens is the U.S. economy here, with potentially U.S.-China trade resolve, with the Fed on hold, we can see potentially are acceleration, rates could move back up a bit, stocks could trade down – that could create a new investable universe for us. Things tend to change over time.

In addition, beyond the U.S., of course, our global fund participates along with our Europe and Asia fund around the world, where actually there's a bit of a better opportunistic real estate investing environment. So the scale of what we do, the time, the patience, and our ability to look across the universe to all different asset class give us a lot of flexibility, and I have a lot of confidence in our real estate team and what we see out there.

So overall it's certainly a tougher environment to invest but I feel very good that we'll continue to do a great job for investors as we've done for 30 years.

Chris Kotowski: Okay, thank you.

Operator: The next question is from the line of Brian Bedell of Deutsche Bank. Your line's open. Please go ahead.

Brian Bedell: Great thanks. Good morning folks and congrats on the C-corp also. Maybe a couple questions along that line, if we did get into an environment where realizations can slow down significantly such as in a difficult prolonged market environment, would that elevate the tax rate closer to that FRE tax rate on the corporate level? So something well above the 13 percent and closing in on 20s.

And then just second, separately: is there any change in compensation plans for the employees of Blackstone as a result of the C-corp conversion, both for employees across the board and then also the investment teams?

Michael Chae: Sure, Brian. On the first one, it's I think it might be inverted from your question – which is, from a dilution standpoint from conversion, the more performance fees there are the more at the margin dilution there'd be. And the lower the level of performance fees the less dilution, because obviously the biggest change in terms of tax rate as a C-corp will be on the performance fees.

Jon Gray: And then on the employee side, investment side, non-investment side, no change in any compensation policy.

Brian Bedell: Okay thank you.

Operator: The next question is from the line of Gerald O'Hara of Jeffries. Your line's open. Please go ahead.

Gerald O'Hara: Great, thanks. Just picking up on Jon's comments on the lack of distress and higher multiples in the current environment, and I suspect some of those same commentary from the real estate side will apply hear, but perhaps you can speak to how you get comfortable with the sizing of the latest vintage private equity fund and why I guess $24 billion or more is the right number for that vehicle. Thank you.

Jon Gray: What's interesting in private equity is, if you look at the data and you went back to, say, 2006, now 13 years ago, and the number of large buyout funds, call it $15 billion or more, I think that number is unchanged. And yet during that time the global market cap has more than doubled.

So what we've seen is lots of capital move into the middle market private equity area, and a lot less capital move into these larger transactions. And so we think having the ability to have big-scale capital and do larger transactions like Refinitiv and a number of the corporate carveouts we've done and things we're looking at, we think that's a big competitive advantage.

And again, it's a large world; we invest not only in the U.S. but in Europe and Asia, both places we've been quite active. And we continue to see a pretty good pipeline of deals. I mean in the first quarter large transactions with Ultimate Software, with Scout24, both companies that we think are terrific. And having the ability to write large checks, billion dollar plus, $2 billion checks, really makes a difference. So we like the large end of the market and we certainly don't feel like we have too much capital. But as Steve commented on publicly on some of his TV appearances earlier, we cap our funds. We're very mindful of not having too much capital. And so if you look at our funds – go back to the real estate comment earlier or here in private equity – our funds have been growing 20-30 percent, but that's of course five or six years from the previous fund. So if you look at that on an annual basis we've actually been pretty modest in how much we've allowed these funds to grow. The growth of the firm has been the expansion of our capabilities by product type and geographically.

And the firm sits in a really unique spot today, which is almost everything we move into, if we have a team, there's a compelling market opportunity, we go see our investors, they will give us capital. And we're really the governors of how much capital we'll take for a strategy, and we really focus on long-term delivery and returns. If we don't do a good job, if we take excess money, if we deploy the capital in the wrong way, that's how we damage this franchise. And our focus, number one focus, our investment committee process, everything we do is on delivering great returns to investors.

Operator: The next question is from the line Patrick Davitt of Autonomous Research. Your line is open. Please go ahead.

Patrick Davitt: Hey thanks for taking the question. I want to go back to the retirement question. The commissioner of the SEC said that he was actually big about putting alternatives into retirement. I'm sure some of you had a part of that. How does that actually happen? What is the probability that it happens? And what are the wrappers that you put around it to make it work?

Jon Gray: I think it's too early to say. Obviously regulators are going to have to decide. I'm sure there'll be a long-term process here to go through. It's hard to say how quickly this will happen, what the process will be. I just think back to Tony's earlier comment is there's a big differential between what pension funds have been able to achieve and what individuals have been able to achieve in their 401(k)s – and regulators see that. So I think there'll be a lot of discussion and focus. The way forward, I think that's hard to predict. I don't know if you want to put some more meat on that.

Tony James: Yeah, Patrick I might say that it probably won't be a million little investors picking Blackstone Private Equity or Blackstone Real Estate. You'll probably see this come in the form that our alternative products will be included in target date funds. So an investor will pick a target date fund which will be relatively more allocated towards capital gain products in the early stage of the fund and as he or she gets near retirement become more income oriented. So it'll probably be embedded in other products as a start.

Patrick Davitt: Do you think the probability is going up that it'll happen?

Tony James: Yes.

Jon Gray: And I do think – I would just say generally, when you look at the long-term positives in our business – Steve touched on the China retail opportunity, here we just talked about retirement savings, we've talked in the past about insurance. There are a number of large markets where we see a lot of white space to go.

Operator: The next question is from the line Bill Katz of Citi. Your line's open. Please go ahead.

Bill Katz: Thanks for taking the follow-up question. Just coming back to fee paying AUM for a moment. It seems like – I appreciate the observations for, the outlook for, the next couple years in terms of FRE. Could you maybe provide a bit of a pathway of how you see the more recent capital-raising feeding into fee-paying AUM? And how that schedule may look over the next six to twelve months, number one?

And then number two I guess you mentioned sort of you're in the market now for life sciences and ultimately the growth equity. Is there a way to sort of broadly frame your expectations around initial fund closure sizes?

Michael Chae: Hey Bill, welcome back. On the first part, obviously the gap today that you see between AUM and fee-paying AUM growth are these large funds we've raised that are yet to be lit up. So as you see the BCP fund, the BREP Global Fund, BREP Europe, etc. light up as I mentioned in the course of the second half of the year into early next year, you'll see those align. There'll obviously be other things going on that may lead to diversions or conversions but that's really the big drivers. You need to wait for those things to happen.

Jon Gray: I think it's a little early on growth equity and life sciences. What I can say is Clarius' earlier vintage fund was a billion dollars. I think we're pretty confident it'll be multiples of that, given the scale of the opportunity we see in that marketplace and the team they've got there. And they have really been constrained, not by opportunities but by access to capital, and becoming part of Blackstone I think will help them write much larger checks because we'll be able to raise capital, and some of the deal flow has picked up a bit. I think in both of these areas there's an opportunity to grow certainly early funds of a certain size but even much larger over time.

Operator: The next question is from the line of Brian Bedell of Deutsche Bank. Your line's open. Please go ahead.

Brian Bedell: That was actually my question but maybe just a follow-up on that, Michael, to get to the $1.70 for 2020. Is that your assessment of what you have raised that's not yet fee-paying and what you have in the pipeline that you know of right now that you think you will be raising to get to that? And does that $1.70 include the expectations for the life sciences and growth equity?

Michael Chae: So the better than $1.70 that I mentioned was, as I said, really a reaffirmation of the same target that we articulated on Investor Day last September, and with the passage of six or seven months and the fundraising progress, our message is our confidence is even higher and our visibility is higher. So that takes into account the views on fundraising where we see the rest of our business, including life sciences, going. But obviously we can – visibility and even greater weight is placed on things that are more or less in the bag like the fundraising that's already occurred.

Brian Bedell: Great. That's clear. Thank you.

Operator: The last question is from the line of Devin Ryan of JMP. Your line's open. Please go ahead.

Devin Ryan: Good morning. Getting in a little late here but just wanted to follow up with one on the conversion. I think the dilution was a little bit less than some people were thinking – it's good to see there. I know there are a lot of considerations to the decision.

But I'm curious how the political backdrop played in, it at all, meaning if the corporate rates were to, at some point in the future, move higher under a particular administration – and hopefully that doesn't happen – but at what point, statutory rates, was this the right decision or would this have been the right decision. And just thinking about, to the extent that scenario ever happened, kind of what grandfathered benefits you gave up and if it would ever make sense to go back. Don't want to go there, but just curious since it's on the other side of a lot of questioning.

Michael Chae: Devin, I think it's pretty simple for us. We manage for the long term, and this is definitely the right long-term decision for our shareholders in our view, and it's one that stands up in different scenarios – political and otherwise. Even at higher corporate rates that are talked about or have been contemplated – and obviously that requires a particular political scenario to happen or not happen – it's still the right decision.

So let's say at a 25 to 28 percent range of corporate rates versus the current 21, the additional dilution, certainly over the medium term, is only about 1 or 2 percent per year versus what we said. And in that scenario – not to get too far ahead of ourselves – a lot of people would say higher individual taxes are likely to accompany higher corporate rates, which cuts the opposite way, and could in fact offset the dilutive impact on an after-tax basis at the shareholder level for, say, U.S. taxable shareholders. But the bottom line is we feel great about this and we're committed to the decision.

Devin Ryan: Great. Thank you and congratulations.

Michael Chae: Thank you.

Operator: And now I hand it over to Weston Tucker for closing remarks.

Weston Tucker: Great. Thanks everyone for joining us this morning, and please follow up after the call with any questions.

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