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Saguaro Insights

Carlyle Group

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CARLYLE

Carlyle (CG)

We can't remember the first time we heard about the Carlyle Group. Perhaps for you, it was legends about private equity's heyday, an investor letter, or a TV show featuring David Rubenstein. Almost everyone seems to know of Carlyle, but at the same time know very little about Carlyle. We were no different until about four years ago. Though we have much experience investing in private equity (PE)[1] funds and are aware of private equity's role in the broader markets, we were dissuaded from a deep dive by two factors. First, it was privately held.[2] Second, even once public, it had an ownership structure disadvantageous to common stock investors relative to insiders. Recently it has converted to a standard and equal structure.[3] Since its conversion, so to speak, we have followed Carlyle religiously.

The story begins in 1987 with Edward J. Mathias, a director at T. Rowe Price who was determined to build a Merchant Banking division.[4] His vision was a team of five possessed with singular skills whose whole would be greater than the sum of its parts. To this end, he recruited David Rubenstein, William Conway Jr., Daniel D'Aniello, Stephen L. Norris, and Greg Rosenbaum. The idea of building a merchant bank excited the five, but the idea of working for T. Rowe Price did not. Running with Mathias's idea, the five set out on their own. They raised $5mn of capital from Alex Brown & Sons, First Interstate Equities, the Richard King Mellon family, and, amazingly enough, T. Rowe Price. All they needed was a name. Rubenstein and Norris had met at the Carlyle Hotel in New York to plan the company and thought the name Carlyle reminded them of the English banking houses of old. The Carlyle Group was born. A firm's identity, however, is more than just its name; it is bound up with its founders.

[1] We assume most of our readers know more about PE than us, but for those interns we force to read our letters, Private Equity (PE) refers to either an ownership stake in a private business or a company that takes ownership stakes in private businesses. It is considered a separate asset class from public equity which, of course, is ownership in businesses that trade publicly on a stock market.

[2] Blackstone went public in 2007, followed by KKR in 2010, Apollo in 2011, and finally Carlyle in 2012

[3] KKR converted to a C-corporation in 2018, followed by Blackstone and Apollo in 2019, and Carlyle in 2020.

[4] The term Private Equity hadn't been coined in 1987 and "Merchant Banking" was the respectable term for firms engaged in leveraged buyouts, hostile takeovers, and other highly profitable financial shenanigans powered by Drexel Burnham & Lambert junk bond debt.

Greg Rosenbaum is the least important, as he left during year one. His departure was ugly. He filed suit against the others for breach of contract and fraud. He wanted a cut of every deal, however, the others thought cuts should go with work. It speaks to the strength of the team that this early disruption didn't bring down the firm. A Harvard guy, Rosenbaum continued in the industry and is known today as a Minor League Baseball team owner.

Daniel D'Aniello was the oldest founder at 41. A Syracuse undergrad with an MBA from Harvard, he did stints at PepsiCo and TWA before joining Marriott as Vice President of Finance & Development. While at Marriott, he met and worked with Stephen Norris. Daniel was recruited as the deal expert. He is still active on Carlyle's board and is best known for philanthropy towards Syracuse and the American Enterprise Institute.

Stephen L. Norris is a favorite around Saguaro's office. An Alabama grad with legal degrees from NYU and Yale, Stephen was the tax expert. He spent eight years with Marriott before joining Carlyle. Over time, Stephen focused on advising one-off transactions and lost interest in managing funds. This led to Norris leaving in 1995 to start his own firm. He served on the Federal Retirement Thrift Board at the behest of George H. W. Bush and has run several subsequent firms, but none as successful as Carlyle.

William "Bill" Conway Jr. started his career at the First National Bank of Chicago and completed his MBA from Booth at night while working full days. He later moved to MCI Communications, rising the ranks to become CFO in 1984. Recruited as the balance sheet expert, Conway invested most of the early US and European PE funds with tremendous results. Loved by investors, Bill communicated his ideas in a simple way. Conway is active on the Board and currently serves as Interim CEO.

David Rubenstein is undoubtedly the most famous due to his TV shows, podcast, and prodigious writing. Born the son of a postal worker and a stay-at-home mom, David was a success the day he graduated Phi Beta Kappa from Duke. A law degree from the University of Chicago and a position as deputy domestic policy advisor in the Carter White House were beyond any of his parents' dreams. Recruited as a lawyer, David is a gifted storyteller who became the face of an industry.[5]

Their identity was clear: they were a "deal" team,[6] only raising their first fund in 1990 (with $100mn in investor commitments). They found ways to make money. They advised Japanese firms like SONY and Sumitomo on building Marriott hotels. They discovered a tax loophole whereby native Alaskans could sell tax losses to major US corporations, and they exploited it. They even advised Prince Al-

[5] On an error of omission side note, Rubenstein had the opportunity to invest in Facebook while Zuckerburg was still at Harvard. David considers passing on this to be his greatest investing regret. This despite also passing on an opportunity to buy 20% of Amazon in its early days, supposedly telling Jeff Bezos that "even if everything goes well, at most you'll be worth $300mn." May we all have such errors and still end up billionaires!

[6] In the early years Carlyle raised money by the deal. $5mn got them going, but the early backers had incredibly deep pockets for compelling deals. Capital was never a problem.

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Waleed bin Talal on his $500mn Citigroup investment.[7] Being based in Washington DC gave the impression that they knew government-based business. They embraced this new identity with zeal.

Throughout the 1990s, Carlyle invested in defense-related companies like GDE systems, Magnavox Electronic Systems, Vought Aircraft, and, most importantly, United Defense Industries. With financial success, it landed true DC insiders as advisors and partners: former defense secretary Frank Carlucci, former secretary of state James A. Baker III, former White House budget director Richard G. Darman, and even former President George H. W. Bush himself. This didn't hurt business inside the beltway.[8] The strategy was so successful that Carlyle also brought on former British Prime Minister John Major, former Philippines President Fidel Ramos, former SEC chairman Arthur Levitt, former FCC chairman William Kennard, and former World Bank chief investment officer Afsaneh Mashayekhi. The house of cards built on a DC address was now a castle standing on a foundation of political power.

All castles outlive their usefulness. On September 11, 2001, Carlyle held an investor meeting at the Ritz Carlton in DC. News of the World Trade Center interrupted the meeting. One of the investor attendees was the brother of a man made infamous that day: Osama Bin Laden. A few weeks later, the press reported that the Bin Laden family had been long-time investors in Carlyle's funds.[9] In October of that year, the position was liquidated as both Carlyle, and the Bin Laden family thought it best if they parted ways given the political situation. The firm, and its deep political connections, were suddenly placed under an intense microscope. The pressure led Rubenstein, Conway, and D'Aniello to decide it was time to grow beyond their political and governmental roots.

By 2003, Carlyle managed more than $13B in client money and had produced annualized returns since its founding north of 30%.[10] Despite the results, Carlyle was determined to change. The 2000s saw the firm actively shift its image away from government and defense. Move number one: it sold its defense businesses and reduced exposure by not buying others.[11] Move number two: it recruited Lou Gerstner, former Chairman, and CEO of IBM & Nabisco, to be Carlyle's new Chairman, replacing Frank Carlucci. Lou was its first Blue-Chip business hire and signaled the strategic shift. The shift succeeded, and over the decade, Carlyle's investment process proved successful, not just beyond government and defense but also beyond core PE. The company expanded to credit, real estate, real assets,[12] and many more.[13] Simultaneously, Carlyle centralized its fundraising, back-office,

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[7] It quickly became worth $2B, building Carlyle's reputation in the Middle East.

[8] The beltway is Interstate Highway 495 which circles Washington DC and its environs.

[9] They invested at least $2mn in the Carlyle Partners Fund II in 1995. This was an initial commitment, and the final amount could have been much higher.

[10] According to some media articles we found from this time period. While we can't confirm the data as Carlyle was not public, it is in line with data we've received from allocators about Private Equity returns in the late 1990s. Specific data is from: "Gerstner to Be Carlyle Group Chairman; Former IBM Chief Brings Long List of Contacts to Private Equity Firm". *The Washington Post*. November 22, 2002.

[11] PE firms naturally sell their portfolio companies over time. The real shift here was not re-deploying the capital into other defense firms. Any Carlyle material you can find from the 90's brands Carlyle as a "defense-focused" merchant bank or PE firm.

[12] Real assets include items such as dams, bridges, toll roads, etc.

[13] For the over-achievers: Carlyle does both direct and fund-of-fund investing. Its direct investing includes management-led buyouts, leveraged buyouts, privatizations, divestitures, strategic minority equity investments, structured credit, global distressed and corporate opportunities, small and middle market equity private placements, consolidations and buildups, senior debt, mezzanine and leveraged finance, venture and growth capital financings, seed/startup, early venture, emerging growth, turnaround, mid venture, late venture, and PIPEs. As for niches where they invest, they include: industrial, agribusiness, ecological, fintech, airports, parking, plastics, rubber, diversified natural resources, minerals, farming, aerospace, defense, automotive, consumer, retail, industrial, infrastructure, energy, power, healthcare, software, software-enabled services, semiconductors, communications

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and administration, boosting both efficiency and financial returns. This new model survived the financial crisis, caught the alternative investment tailwind, and grew into the Carlyle of today.

Today, Carlyle is one of the world's leading alternative investment management firms.[14] It currently manages just over $376B in assets, $259B of which are fee-paying,[15] for more than 2,500 clients from 95 countries. About half of these assets are public pensions, but the company also serves high-net-worth investors, sovereign wealth funds, insurance companies, and many others. This requires more than 1,800 employees serving in 26 offices on six continents—a far cry from five partners with five million dollars meeting in a hotel. Importantly, even after 35 years, the IPO, and the C-Corp conversion, Rubenstein, Conway, and D'Aniello are still on the board and remain the largest shareholders with about 9% ownership each. As mentioned, Conway also currently serves as the interim CEO. Carlyle has a strong business, culture, and history, but these qualities don't make it an SCM 100 business.

If, like most of our partners, you understand the quality of the major alternative investment managers, please skip this paragraph. However, if you are newer to the industry, it is important to understand what they do and how they make money.[16] First, PE firms raise money from investors to buy a business or some other asset, hoping to sell it later for a profit that they can share between the investors and themselves. Second, they charge a "management fee" for this work. Third, they typically raise investor money in a "fund," and said fund exists for 5-15 years. This fund will own 8-20 businesses over its life. Fourth, the investors don't contribute their money to the fund on day one; rather, their money is "called" over time when the fund has opportunities to buy a business. Funds thus have two types of capital: "committed capital" and "invested capital." Committed capital is the amount investors have committed or pledged to the fund, and invested capital is the amount that has been "called" and invested. **The key insight is that management fees are charged on committed capital, *not AUM.*** [17] When a manager raises a $2B fund, it locks in management fees for the full 5–15-year life of that fund. Additionally, when the businesses are sold, the fund closed, and the capital returned to investors, the firms keep a "performance fee" also called "carried interest" or just "carry" for short. Investors keep the first 6-8% of any return generated and then split everything else 80/20 between themselves and the manager.[18] In our opinion, this is a phenomenal and very lucrative business model, which is why so many have gravitated to it.

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infrastructure, financial technology, utilities, gaming, electronic systems, oil and gas, power generation assets, real estate, financial services, transportation, telecommunications, media, logistics, manufacturing, building products, packaging, chemicals, metals and mining, forestry and paper products, food and beverage, retail, restaurants, personal care products, direct marketing, education, and more.

[14] Alternative in this context really means "not traditional stocks and bonds".

[15] The discrepancy here is driven by investment gains. As management fees are paid on committed capital, not AUM, fees don't grow as assets do. Also, both Carlyle the company and Carlyle employees invest in its funds but do not pay fees, hence some of their assets are non-fee-paying. Also, some of its private equity funds which are past the "investment phase" of the fund, typically the first 4-5 years, will only charge fees on invested capital, no longer committed capital. Since committed capital could still theoretically be called, it is included in AUM leading to a further divergence between fee-paying and non-fee-paying AUM. Please see the Carlyle 2021 10-K, pg. 5 for more info.

[16] We will oversimplify here for brevity and understanding (It took Carlyle 26 pages to explain) but are happy to write a white paper on our valuation methodology for alternative investment management firms if there is interest. We'd also recommend Carlyle's April 2012 presentation on "Understanding Carlyle's Financial Statements" for further information.

[17] This is an oversimplification as some funds charge management fees on invested capital or in rare instances on "fair value" once the fund is past the investment phase. This is a subtle distinction as most management fees are in essence calculated on a fixed and not a floating asset base.

[18] Another oversimplification as performance fees are as varied as wildflowers in Spring, but we are attempting to discuss the business model in general and not carried interest in specific.

In both private equity specifically and alternative investments more broadly, the barriers to entry are low, but the barriers to success are high.[19] Carlyle is one of the largest alternative asset managers in the world and has the talent, scale, product diversity, and global network required for success over the next decade. Most private equity assets are institutional, and these large investors (i.e., public and corporate pensions, endowments, foundations, etc.) are trying to limit the number of firms they invest with. The costs of due diligence on a new firm are very high, so once an alternatives manager is selected, they are likely to win repeat business.[20] This is evidenced by Carlyle's book. **75% of its AUM is from investors with allocations to 5 or more of its funds,** and 94% of its AUM is from investors with allocations to more than one fund. These investors are very likely to continue "re-upping" into new funds when their current funds mature. This is good news for KKR, Blackstone, Apollo, and Carlyle but a challenge for nascent private equity firms. Even tougher for small firms, almost 80% of investment returns are earned by operational improvements,[21] not financial engineering.[22] Carlyle retains a group of 50+ world-class operating executives who work as advisors and independent consultants to its various portfolio companies.[23] As a group, its portfolio companies have grown their top-line by double digits for years. The large firms hire only the best and, as such, are truly ahead of the game. Carlyle has been carbon neutral since 2017. 50% of Carlyle's AUM is female managed. 60% of 2020 hires were either female or minorities. They have been active in the ESG-financing space for years, issuing debt that includes ESG goals and hence commands a lower rate. The leading companies of the alternative space have developed truly imposing moats around their businesses and easily qualify for inclusion on the SCM 100.

Still, no company is perfect, including Carlyle. Some of its investments have failed. In 2004, it purchased Hawaii Telecom from Verizon for $1.6B. Hawaiian regulators immediately delayed the deal and placed onerous requirements on the business, leading to severe billing and customer service issues. Carlyle failed to build back-end systems that could meet these requirements and delight customers. The company was forced into bankruptcy, and Carlyle's investors lost the full $425mn of equity they invested. Carlyle's deal for Acosta was even worse. Based in Jacksonville, FL, Acosta was once the nation's largest food broker. For decades it helped companies like Proctor & Gamble, Kellogg, and Clorox secure shelf space in America's supermarkets. After a few years of Private Equity musical chairs (described more fully below), Carlyle and its investors bought a majority stake in Acosta for $4.4B in 2014; $1.1B in equity from Carlyle, $300mn in equity from CalPERS[24] and $3B in High Yield debt which went on Acosta's Balance Sheet. Unfortunately, Acosta had no online business and focused almost entirely on traditional canned and dry goods. Despite its history of free cash flow, consumers now wanted organic, fresh, healthy, and online. Acosta's clients also had a zero-based budgeting phase,[25] and many took Acosta's services in-house. These headwinds, combined with the $3B in high-yield debt, caused a turbulent death spiral from which Acosta couldn't recover. The

[19] And they are growing higher with every passing year.
[20] In Moat parlance, the switching costs are very high. This is doubly the case when you consider that most of the funds lock assets up anywhere from 8-15 years.
[21] This specific number comes from pg. 146 of Carlyle's 2021 Investor Day, but we've seen & heard similar comments from their peers.
[22] Debt representing 95% of the purchase price of a business was not atypical in the 1980s. The equity component (the capital invested by KKR) in the most famous deal of all (RJR Nabisco) was a mere $1.5B of the total $26.08B purchase price. Today, equity percentages are often in the 30-50% range of the purchase price.
[23] Most of them are former C-Suite executives.
[24] California Public Employees' Retirement System is the largest public pension fund in the United States with almost a half-trillion under management.
[25] Led by Buffett's 3G partners of Heinz fame.

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company ultimately defaulted, and Carlyle's investors lost the full $1.1B. The fund model, however, is resilient, and the fund that owned Acosta still generated a double-digit net return for its investors. From the beginning, resiliency has been one of Carlyle's defining characteristics.

All founder-led firms must eventually transition leadership to the next generation. Rubenstein, Conway, and D'Aniello believe Carlyle's collegial culture is a byproduct of their relationship and desire a shared CEO role for the next generation. The transition occurred in 2017 with new co-CEOs: Glenn Youngkin & Kewsong Lee. For three years, they expanded the credit business, shrank their underperforming hedge funds, and grew their fund of funds and secondary offerings. Youngkin, who joined the firm in 1995, eventually felt tension with Lee and stepped down in 2020. **Today Youngkin is Governor of Virginia.** Kewsong joined Carlyle in 2013 after a 20-year career at Warburg Pincus. Initially serving as the Deputy CIO for corporate private equity, he began leading Global Credit in 2016 as well before ascending to co-CEO. Insiders suggest Lee maneuvered Youngkin out and thereafter moved to consolidate control. Lee asked the founders to step back so the next generation could lead. He rebuffed their offers to help with fundraising or other efforts around the firm. Perhaps Lee's ideas were "right," but unfortunately, his attitude was "wrong" in the eyes of triumvirate founders who successfully shared power for 30 years. Things came to a head this year while negotiating a new 5-year deal for Kewsong. He sought a pay package in the realm of $60mn per year, higher than the past but in-line with peers. The board declined this package and voted not to renew Kewsong's contract. Officially, they "lost confidence" in his leadership[26]. Kewsong opted to step down immediately on August 7th. Conway stepped in as interim CEO, reaffirmed all guidance, and expressed full confidence in the firm. We are unaware of further departures. Even though this first attempt at leadership transition failed, Carlyle's resiliency again shines through. We believe the firm unimpaired.

Carlyle's financial and investment success paint these shortcomings as road bumps, not material threats. So why is the stock down 55% from its peak? As children playing Clue,[27] we learned it's only by other people (or data) proving you wrong that you can discover the truth. At Saguaro, we refine our investment theses by looking for data that will prove us wrong, not confirm what we already believe. Only in this way can we inch ever closer to reality and the truth.[28] With Carlyle, we actively sought out people, data, and ideas that would argue for the company's exclusion from our SCM 100 list. In our opinion, the following are the five most compelling arguments we have found to date,[29] along with some associated data:

1. **Too much money invested in Private Equity chasing a scarcity of opportunities.** Future returns won't match historical, and investors will allocate money to other asset classes. We asked allocators their opinion. The few considering or reducing their PE weight had no plans to take from the big four but rather from smaller firms. Industry sources suggest/predict the alternative investment industry to double in size over the next five years,[30] driven by the

[26] Our read is that they made their decision a while ago but viewed this opportunity as the best way to replace Kewsong and try again with the least drama possible.
[27] Learn about Clue here.
[28] Also called the "Scientific Method," this is humanity's most powerful tool in the pursuit of truth.
[29] More than one of these ideas was suggested by external friends and partners to whom we are grateful. Please note that we view nothing we write as "the final word," but rather "the current step" on our journey of discovery. The best partners will be those who help us see the world a little bit more clearly.
[30] Prequin, KKR, Carlyle, Apollo, Blackstone, BlackRock, and more.

"retailization" of the asset-class with large in-flows from the private wealth space. Even without this retailization, the number of public US companies has declined by half since the mid-90s. However, the total number of businesses in the US has continued to grow by about 2% per annum.[31] This growth and the decline in public equities has been captured by private equity, and the opportunity continues to grow. Private equity net returns for the past decade have outpaced its public peers by more than 400 bps annually.[32] This spread will narrow but should exist for some time. While the data does not confirm the big idea, even if it were true, only about one-third of Carlyle's AUM is core PE, and the other two-thirds of its business should prosper if allocators seek yield elsewhere, especially in credit.

2. **Private Equity is a Ponzi-scheme and regulation is coming.** Let's revisit our Acosta example to explain.

   - **— 2003** Boston-based Berkshire Partners buys a minority stake in Acosta
   - **— 2006** AEA Investors buys this stake for an undisclosed sum
   - **— 2011** Thomas H. Lee Partners buys this stake for $2B
   - **— 2014** Carlyle buys a majority stake for $4B

   Many PE deals today trade companies back and forth between firms. If the deal price steadily rises, every PE firm reports good returns and collects lucrative bonuses from happy clients. This incentivizes AEA to pay slightly more for Acosta than they should because next time, Berkshire Partners may buy from them. The final firm takes the company public. But with Acosta, Carlyle unfortunately held the potato when the music stopped. Society does not benefit when a company is purchased, traded between owners for lucrative fees, and then floated to the public with an unwieldy amount of debt.[33] Regulation, reduced access to capital, or falling deal prices could end this cycle. The data is clear. This risk is real and has forced the big four to change their model towards operational improvements and away from financial engineering. They can purchase, improve, and take any portfolio company public on their own. A culling of competition will mean more opportunity.

3. **Death by a thousand hikes.** This idea is irrefutable and needs no further data. Like Newton's law, when interest rates go up, investment returns must come down. Private Equity is not an exception. However, this is also true for *every* asset class. The early history of PE suggests that money can be made in a higher-rate world.[34] Higher rates and tighter access to credit may disrupt the cycle described in the second idea, but this is not existential for the big four. As long as alternative returns outperform their public counterparts, as evidenced above, people will continue to allocate here.

[31] Office of Advocacy – sba.gov

[32] Cambridge Associate, Buyout & Growth Equity Index and Selected Benchmark Statistics from March 31, 2020. Actual 10yr performance was 12.1% for PE and 7.4% for the public index. 20yr data was even more disparate with 11.4% returns for PE vs. 4.7% returns for the public index.

[33] See KKR's debacle with Toy's R Us for more insight.

[34] In fact, a lot more money was made with higher rates, higher amounts of debt, and less competition than we see today.

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4. **Fee Compression.** The trend of fee compression has strengthened over the last decade. BlackRock's push into alternatives will turbocharge this trend.[35] Here is the effective management fee rate for Carlyle over the last ten years (2012-2021):

2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
0.79%	0.78%	0.88%	0.91%	0.89%	0.90%	0.96%	0.98%	0.94%	0.93%

   According to Carlyle, it is not seeing fee pressure. Many of its newer non-PE funds have lower fees, so the effective rate may come down. Despite the explosion of PE capital in the last decade, current data does not support the fee compression thesis. This risk, however, cannot be dismissed and would become acute if Carlyle began to underperform relative to peers.

5. **Bear Markets eat performance fees for breakfast.** The lower the stock market, the lower the price at which Carlyle will be able to sell its investments, whether via IPO or to another firm. Historically, when markets are down, PE firms delay sales of their portfolio companies and wait for stronger markets. This means delayed performance fees and delayed cash flows. It can even mean lower rates of return and lower performance fees. Thirty-five years of private equity industry data confirm this idea. It also shows that most funds from the public players ultimately earn a performance fee.

No data we've found suggests an existential threat to the large alternative asset managers. It does, however, suggest lower valuations than we've seen recently.

As mentioned, alternative investment firms collect two fee types: management fees and performance fees. The market doesn't care about the fees per se but rather "net" fees (fees – cost of fees). The industry term for net management fee is "Fee Related Earnings," or FRE for short. Net performance fees are termed "Net Performance Fees". Management fees are worth more than performance fees because they are low-risk and stable from year to year. The market has historically valued FRE at 25x.[36] To buy a company with $100mn of FRE, you would have to pay $2.5B. Likewise, Net Performance Fees are valued closer to 10x[37]: $100mn of Net Performance Fees would cost $1B. Carlyle should generate about $700mn in FRE[38] and about $1B in Net Performance Fees over the next year.[39] This methodology values Carlyle at $28.5B, or $78 per share, accounting for $1B in Balance Sheet net cash. The same numbers from one year ago valued Carlyle at about $60 per share, a price at which the stock traded in November 2021. Due to the fears above, general macroeconomic sentiment, and Kewsong's sudden departure, Carlyle currently trades at about $26 per share or $9.4B for the full company. This is either the lowest or on par with the lowest valuation

[35] BlackRock's alternative AUM is $313B with Fee-Paying AUM of $276B. (As of Sep. 30, 2022) Slightly larger than Carlyle. We are also happy to own BlackRock.

[36] Apollo Investor Day 2021 (23-27x), Brookfield Asset Management Investor Day 2022 (25-35x), Blackstone 2018 Investor Day (23-26x), KKR 2018 Investor Day (22-24x),

[37] Similar data to note 76.

[38] For simplicity's sake, we've removed $200mn in stock comp for FRE though this may over-penalize the value.

[39] This is a normalized next-twelve-month (NTM) number. Performance fees vary from year to year and will likely be down this year due to the market level but should average about $1B over the next five years.

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we've seen for Carlyle.[40] **To justify this valuation, you must assume that Carlyle will *never* again receive a Net Performance Fee**,[41] and that the guaranteed FRE is worth only 12.5x or half what FRE was valued at just one year ago. By our math, 12.5x implies growth of about 3%. Carlyle grew FRE 9% annually from 2010 through 2019 or 11% annually from 2010 through 2021 if we include the pandemic.[42] Again, industry experts predict 15-16% growth over the next five years due to "retailization," and Carlyle believes that 10-15% FRE growth is sustainable. If this isn't interesting enough, we note that cash flow positive Carlyle has a book value of $16.50 per share.[43] We leave it to you to determine if the market priced Carlyle correctly last November, today, or somewhere in between.

As for Saguaro, Carlyle has hurt our numbers due to its 15% weight in both our Smid-Cap and All-Cap portfolios. Like the market, we failed to predict Kewsong Lee's exit. Unlike the market, after a thorough review and a discussion with the company, we do not believe Carlyle's competitive positioning, business quality, or long-term prospects are impaired. Our view is that Carlyle's value has grown with AUM, not declined with its stock price. We believed Carlyle a strong value in April, and though its value has declined some with rising rates and a slowing economy, that decline is far less than that of its stock. Like the other major PE firms, Carlyle is sitting on a record amount of dry powder, has diversified into Credit and Infrastructure, and still views the fundraising environment as positive.[44] We envy having billions of dollars to deploy in today's market environment. As you should expect from Saguaro, we have added to our Carlyle position with every inflow from April 1st until today and will continue to do so should current trends hold.

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[40] Carlyle's valuation was more challenging prior to the C-Corp conversion, so we tread lightly, but the point stands.
[41] Given that Carlyle has more than $4.2B of net accrued performance fees on its Balance Sheet we think this is a poor assumption.
[42] We would look for data through the financial crisis, but Carlyle was private at that time and has not disclosed those numbers.
[43] It is extremely rare for cash flow positive companies to trade below book value.
[44] Given that four of us have, and one of us still sits in an allocator's seat reviewing PE firms for investment, we agree with this sentiment.

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