Carlyle Group [NASDAQ: CG]

Initiate at BUY | PT: $38.28

October 20, 2022

CIMG Investment Research

Carlyle Group: Give Credit Where Credit is Due

The Financials committee is recommending a buy of the Carlyle Group at a 5% weight. CIMG has the opportunity to invest in an alternative asset manager at a discount to their intrinsic value because of the overreaction of fundraising concerns in the industry and the recent departure of its CEO. The diversification of their portfolio with their global credit segment is underappreciated and has runway for growth.

Investment Thesis

Alternative asset management is the place to be in the long term. The AUM in the private markets has grown from $6 trillion in 2018 to $10 trillion in 2021 and is expected to grow to $23 trillion by 2026. Carlyle has been focused on developing its strategies in secondaries, private credit, and infrastructure which are poised for the most growth in the private markets with CAGRs of 18%, 17%, and 17% respectively. LPs are attracted to alternative asset managers because of the outperformance the investments have compared to the public markets. For the past 10 years, private equity has provided a 16.8% return outperforming the public market equivalent by 2.6%. The entire space is derated because of the competitive fundraising environment along with higher interest rates. Carlyle has consistently beaten their fundraising targets since going public and are on track to reach their $130 billion target for 2021-2022. Rising interest rates will have a varied impact on different vehicles and overall will not impact investment performance.

Carlyle has been focused on building increasingly sustainable earnings mix by growing its global credit segment. Its global credit segment has more than doubled its impact from 2016 to 2022 by going from 18% to 38% of its AUM. They have made acquisitions to add to their portfolio, one being CBAM which has allowed Carlyle to become the world's largest CLO manager. Carlyle's private credit segment has delivered strong results and has continued runway for growth as the number of traditional U.S. lenders decreases. This diversification of their platform has driven FRE to go from $192 billion in 2017 to $746 billion for LTM 2Q 2022.

Carlyle is trading even lower than its competitors within the industry. This is because Carlyle is the lowest AUM amongst KKR, Apollo, and Blackstone. This is evident in their FRE margins also being the smallest; however, as Carlyle grows its AUM they will realize an improvement in their FRE margins. Furthermore, the recent departure of their CEO Kewsong Lee has investors worried about management uncertainty. William Conway is the interim CEO who is also one of the co-founders of the Carlyle Group and is committed to having Carlyle execute their plans enhance scale, speed, and performance to deliver sustainable results which gives us a compelling entry point.

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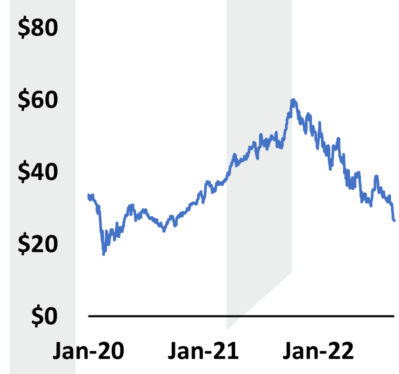
Figure 1: LTM Stock Chart & Volume



Price	$25.90
Dividend Yield	4.44%
PT	$38.28
Upside	48%
52-Week Range	$60.62 – $24.59
Dil Shrs Outstand	366mm
Mkt Cap	$9.36bn
Ent Value	$16.83bn
NTM P/E	4.72x
NTM EV/EBITDA	9.30x
FY 2021 Revenue	$6.27bn

Valuation

We arrive at a $38.28 price target for Carlyle Group, implying an upside of 48% from the closing price on 10/19/2022 of $25.90. We arrived at this price target by using a sum of the parts valuation, applying a 12x FRE multiple on 2024E fee-related earnings and a 3x multiple on 2024E normalized net realized performance fees. We believe that these multiples provide a margin of safety based on the nature of FRE and CG's flexibility in accruing carry on longer dated carry funds FRE was projected based on growth of fee-earning AUM, particularly in the Global Credit segment as demand for private credit products continues to accelerate. Growth in FEAUM within GPE and Solutions is also projected, as the private markets continue to see growing demand and LPs seek portfolio solutions. We see margins expanding in the credit segment and the credit segment becoming a larger driver of CG's total FRE as the segment scales, through commitments raised for carry funds as well as perpetual capital inflows.

Company Overview

Carlyle was founded in 1987 as a boutique investment bank in Washington, D.C. It later entered the private equity space and grew its AUM as it raised funds and grew a global platform. In 2012 Carlyle went public and focused on increasing their fee earnings AUM to drive an increase in fee related earnings in the interest of shareholders. Carlyle has grown to now having $376 billion assets under management. They primarily earn revenue through the management and performance fees earned on their carry funds along with their growing perpetual capital. Clients for the carry funds are Limits Partners (LPs) such as institutional investors, pension funds, and high net worth individuals through retail. The carry funds are operated within their global private equity, global credit, and global investment solutions platforms. The global private equity segment makes up 54% of total AUM and advises buyout, growth, real estate, and natural resources funds. Global credit is 24% of AUM and pursues investment strategies across credit assets. Further, Carlyle recently completed an acquisition of Fortitude Reinsurance which allowed Carlyle to add an additional $50 billion in perpetual capital, which has a higher incremental FRE margin. The global investment solutions segment uses the AlpInvest platform to provide comprehensive investment opportunities for clients to build a private equity portfolio, purchase secondary investments in existing portfolios, and manage co-investment programs.

Industry Overview

The macroeconomic uncertainty, rising interest rates, and higher inflation have triggered derating in alternatives. These fundraising concerns will be offset by the market share gains for large managers. This is because firms are seeing the largest LPs are wanting to consolidate their investments to fewer GPs (general partners such as Carlyle, KKR, Apollo, and Blackstone).

The alternative asset management industry has historically been viewed to benefit from a low-interest rate environment by being able to recognize higher NPV of exiting investments, higher NPV of dry powder, lower financing costs, and improved fundraising prospects. However, this view has been outdated because the largest fund managers have a strong mix of AUM relying less on private equity.