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OAK - Q3 2015 Oaktree Capital Group LLC Earnings Call

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## PRESENTATION

**Operator**

Welcome and thank you for joining the Oaktree Capital Group third quarter 2015 conference call. Today's conference call is being recorded. (Operator Instructions).

Now I would like to introduce Andrea Williams, Oaktree's Head of Corporate Communications and Investor Relations, who will host today's conference call. Ms. Williams, you may begin.

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**Andrea Williams** - *Oaktree Capital Group LLC - Head of Corporate Communications and IR*

Thank you, Rhea. Welcome to all of you who have joined us for today's call to discuss Oaktree's third quarter 2015 financial results. Our earnings results and release issued this morning may be accessed through the Unitholders section of our website.

Our speakers today are Oaktree's Chief Executive Officer, Jay Wintrob; Co-Chairman and Chief Investment Officer, Bruce Karsh; and Chief Financial Officer, David Kirchheimer. We will be happy to take your questions following their prepared remarks.

Before we begin, I want to remind you our comments today will include forward-looking statements reflecting our current views with respect to, among other things, our operations and financial performance. Important factors could cause actual results to differ, possibly materially, from those indicated in these statements. Please refer to our SEC filings for a discussion of these factors. We undertake no duty to update or revise any forward-looking statements.

I would also like to remind you that nothing on this call constitutes an offer to sell or a solicitation of an offer to purchase any interest in any Oaktree fund. Investors and others should note that Oaktree uses the Unitholders section of its corporate website to announce material information. Accordingly, Oaktree encourages investors, the media and others to review the information that it shares on its corporate website at IR.Oaktreecapital.com.

During our call today we will be making reference to certain non-GAAP financial measures which exclude our consolidated funds. For a reconciliation of each non-GAAP financial measure to its most directly comparable GAAP financial measure, please refer to our earnings press release which was furnished to the SEC today on Form 8-K and may be accessed through the Unitholders section of our website.

Today we announced a quarterly distribution of $0.40 per Class A unit payable on November 12 to holders of record as of the close of business on November 9. Finally, we plan to issue our third quarter Form 10-Q next week.

With that, I would like to turn the call over to Jay.

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**Jay Wintrob** - *Oaktree Capital Group LLC - CEO*

Thanks, Andrea, and good morning, everyone. The third quarter was challenging for almost all asset classes and in many respects a challenging quarter for Oaktree. For certain key financial metrics such as management fee revenues and fee-related earnings, we believe the quarter's results were at or near a cyclical low. With respect to incentive income and investment income, as investors, we are keenly aware that we are not immune to weaker market conditions such as those experienced in the third quarter. However, our long-term view of the potential of our investments and of our ability to generate attractive levels of incentive income remains positive.

Getting more specific, the third quarter generated divergent investment performance similar to the prior two quarters with some strategies doing well and others not, and with European-based assets generally outperforming the US markets. The aggregate gross return of our closed-end funds was negative 3% in Q3 and positive 1.5% for the last 12 months. Excluding the results in distressed debt which were negative, the aggregate closed-end fund gross return was positive 1% for the quarter and positive 13% for the last 12 months.

The strong performance continued in real estate and European principal funds with aggregate gross returns for the last 12 months at 21% and 24%, respectively.

Declines in a number of public equity holdings have continued to weigh on distressed debt returns with such holdings now comprising approximately $4 billion of the $13 billion of current distressed debt assets.

Now despite the difficult market conditions, we continued to show a healthy pace of fundraising. Total funds raised in the quarter were $2.7 billion bringing our 12-month total gross capital raised to $22.6 billion. Importantly, $16.8 billion of this $22.6 billion was for closed-end funds with relatively higher management fee rates and potential for incentive income.

The largest amounts of closed-end capital raised in the third quarter were an additional $400 million for Opportunities Funds Xa and Xb bringing total commitments in those funds to approximately $9.9 billion, an additional $300 million for Real Estate Opportunities Fund VII bringing total commitments for that fund to $1.6 billion, and $600 million for Senior Loan products, the new Enhanced Income Fund and CLOs, bringing total AUM across all of our Senior Loan products, open-end and closed, to $12 billion.

So halfway through the 18-month $20 billion targeted closed-end fundraising program we announced last year-end, we are well over $15 billion. The funds I just mentioned will have further close activity in the next few months in addition to our first infrastructure fund. So all in all we remain confident of achieving our $20 billion target.

Now outside of the funds included in this target, we are focused on the new European funds I mentioned last quarter, European Capital Solutions and European Principal Fund IV.

The impact of this strong fundraising has yet to be seen in our financials. We believe the prudence and patience that we apply to the sizing of our funds, our decision on when to begin fund investment periods and most importantly, when and how to deploy capital, reflects our primary focus on our clients and the long-term risk-adjusted investment performance we seek to achieve for them.

To repeat my comment from last quarter, Oaktree is very well-positioned to convert our growing balance of dry powder into management fee-generating AUM over time. It is not a matter of if but when, and David will comment further on timing in his remarks.

Now of course we have, and will continue to have, a very strong franchise and long-term investment track record in distressed investing. The peak net asset value for our Opportunities Funds was about $25 billion at year-end 2010 post the last financial crisis. Since that time, we have distributed about $30 billion from these funds and since inception achieved a strategy gross IRR of 22%. And with Opportunities Funds Xa and Xb currently sized at about $10 billion, almost all of which is still dry powder, we expect to further enhance this franchise in the years ahead.

But at the same time, it is important to keep in perspective how Oaktree has grown and diversified since that peak in 2010. As of September 30, distressed debt represented only 16% of our NAV, down from 36% at year-end 2010. Additionally at year-end 2010, distressed debt represented 73% of our net accrued incentives balance. But as of 9-30 that percentage was 44%, with real estate funds comprising 23% and control investing funds, namely Global Principal, European Principal and Power Funds, now representing 31%.

Finally, we have raised $17 billion in AUM for products that didn't even exist at year-end 2010 including Strategic Credit, Enhanced Income, Emerging Markets debt and equity products, Real Estate Ddebt and European Private Debt. We consider this diversification of investment strategies, AUM and potential for incentive income generation both prudent and positive for Oaktree.

Yes, we will maintain and enhance our expertise in distressed and opportunistic investing and our ability to deploy large amounts of capital during periods of market dislocation.

Concurrently, we will continue executing our strategy to grow and diversify and do so in a manner that is consistent with Oaktree's long-held investment philosophy and business principles including emphasizing the primacy of risk control, consistency, proprietary in-depth research, a preference for step-out strategies and a keen focus on acting with integrity and treating our clients fairly in all respects.

Coming up on my one-year anniversary as the CEO of Oaktree, I will conclude by saying that my enthusiasm about the strength and quality of our business and the possibilities that lie ahead has only grown this past year. Having now met with many of our clients, unitholders, rating agencies, bankers and many of you on this call, my view that our reputation and relationships are strong and that we are on the right long-term path of prudent and profitable growth and diversification has been reinforced.

The opportunity to interact with more and more Oaktree colleagues around the globe has confirmed my confidence that we have and can attract immensely talented professionals of extraordinary character. Working together, we will continue building a more diversified, growing and enduring Oaktree all while remaining true to our core values and our mission to deliver superior investment performance with risk under control.

With those comments, I will turn it over to Bruce to discuss how we are navigating the investment landscape.

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**Bruce Karsh** - *Oaktree Capital Group LLC - Co-Chairman and CIO*

Thanks, Jay, and hello, everyone. The third quarter was one in which risk-bearing was penalized, not rewarded, as events unfolded that left investors at best uncertain and at worst fearful of their impact on global growth, interest rates, commodities, foreign currencies and the direction of the US economy. Throughout the quarter, unexpected events in China fed concern that its economy was slowing faster than expected, which would further harm emerging markets and commodities that are dependent on its growth. China's devaluation spurred a sharp drop in commodities in oil, with US crude oil prices declining 24% in the quarter and hitting a six-year low of $38 in August.

As you might expect, CCC-rated high-yield bonds came under significant selling pressure in this challenging period. In the third quarter, the bottom tier declined a whopping 8%, its worst quarterly result since the European debt crisis in 2011. The higher rate at non-investment grade categories that we emphasize weren't much better, however. BB-rated bonds were off 4% while B-rated bonds dropped 6%.

Though the selloff rippled across multiple sectors, the major carnage occurred in the energy and metals and mining sectors. In a meltdown reminiscent of the telecom debacle in the early 2000s, in high-yield the oil and gas producers declined an extraordinary 22%. The metals and mining sector, which had suffered five consecutive quarters of negative returns, lost over 15%. The oil equipment providers rounded out the bottom three industries falling more than 14%.

The leverage loan market also experienced significant weakness in July and August. Continued negative investor sentiment in September led to a relatively large price decline in the quarter. Generally we see this environment as creating opportunities that Oaktree is well-equipped to capitalize on. For example, as E&P companies face borrowing base redeterminations in the next several months, we expect many of these companies to experience a reduction in their bank credit lines and potentially a need for quick liquidity solutions.

We continue to opportunistically look for investments in liquid securities, asset base purchases and structured loans. For Opportunities Fund Xa, which is about one quarter invested or committed at this point, we continue to find attractive opportunities in Europe particularly with European loan portfolio investments where we have recently purchased pools from German and Spanish banks.

In Real Estate Fund VII, the pipeline is diverse across both commercial and residential real estate in the United States as well as commercial properties in Europe.

Our focus remains on increasing value through active asset management and by injecting new capital to fund targeted renovations to help reposition assets.

As we begin the fourth quarter, the global macroeconomic picture remains uncertain with a slowing Chinese economy and depressed commodity prices weighing on global growth. In this unsettled environment, the high-yield bond market has become more volatile due in part to the growth in ETFs and the impact of strict capital requirements at the banks which has hampered their ability to maintain liquid trading markets.

In view of the larger cracks in market sentiment that was evident in the third quarter, we continue to believe the next big opportunity to deploy capital for our distress-related funds is getting closer and closer. We are glad to have the flexibility afforded by large amounts of uncalled capital and we continue to be humbled by our client's trust in us to deploy it judiciously.

I look forward to answering your questions but now I'm delighted to turn the call over to David to discuss the financials.

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**David Kirchheimer** - *Oaktree Capital Group LLC - CFO*

Thank you, Bruce, and thanks to all of you for joining today's call.

Jay mentioned our patience in starting investment periods of new closed-end funds. How patient are we? Of the $16.8 billion of closed-end fund capital that we raised over the past 12 months, only about 10% had generated any management fees through September 30. Thus, fee-related earnings fell to $48 million in the third quarter. Together with a drop in incentive income and a net investment loss stemming from the quarter's weak financial results, the decline in FRE caused adjusted net income and distributable earnings to fall on both a sequential and year-over-year basis.

The quarter's fee-related earnings illustrated anew that our reported FRE meaningfully understates our recurring cash flow because it excludes all of our investment income proceeds. These receipts arise from our $1.5 billion of fund investments and our 20% equity stake in DoubleLine Capital. Our fund investments benefit from Oaktree's credit orientation and extensive fund diversification. Our DoubleLine investment allows us to participate in the industry's most successful start-up through earnings that have all the same characteristics as fee-related earnings.

On the last call I noted that our aggregate fund and DoubleLine investment income proceeds had topped $25 million for the 14th consecutive quarter. It is now 15 straight quarters because the third quarter came in at $43 million. The combination of that cash flow and fee-related earnings has totaled about $90 million in each of this year's first three quarters.

Looking ahead, revenues will soon benefit from four of the new closed-end funds starting their investment periods and thus generating management fees based on full LP committed capital. Specifically, we anticipate that Power Fund IV and Global Principal Fund VI will commence their investment periods in November. Between them, they account for about an aggregate $2 billion of incremental management fee-generating AUM as compared to the September 30 balance.

Then in the first quarter of 2016, we expect that Opps Xa and Real Estate Fund VII will start their investment periods. Their aggregate current LP commitments represent a total of about $4 billion of incremental management fee-generating AUM relative to the September 30 balance.

With respect to the fourth quarter, our known fund-related investment income proceeds and net incentive income are about $7 million and $6 million, respectively. Additionally in the fourth quarter and/or the first quarter of 2016, there is a good chance that we will incur placement fee expense of single-digit millions of dollars that would compare to about $700,000 of such expense in the third quarter.

Recall that placement expenses are immediately taken as a charge against income even though the related management fees are recognized into the future.

Finally, looking a bit further ahead, we would like to preview two plan changes regarding employee equity ownership for which our goals are to further align the interest of our employees with those of our public unitholders and increase the perceived value of equity that is owned and will be granted to our employees as an important component of compensation. These enhancements pertain to our existing internal or so-called OCGH units and to restricted units that we issue as part of our annual compensation program.

The first action would result in the exchange of approximately 13 million existing OCGH units into an equivalent number of Class A units. The exchanged Class A units will be subject to a lockup to be released in 12 equal quarterly allotments over three years starting after our fourth quarter 2015 earnings announcement. This would result in about 1 million units becoming newly tradable each quarter.

By way of comparison, over the past three years, we have averaged nearly 6 million units a year in secondary equity offerings.

We have always taken a constructive approach to facilitating gradual liquidity for internal unitholders while growing our public float to the intended benefit of all unitholders. We believe this action continues that.

The second action involves annual employee compensation. Historically our employee restricted unit grants have been in the form of private OCGH units, not public Class A units. We have decided to join our industry peers by using Class A units instead of OCGH units as a general matter for employee grants starting with 2015 annual compensation. We believe that this action will help reinforce the alignment of interest as between all of us and all of you and thus serve to enhance the prospects for further value creation in the years ahead.

With that, we are delighted to take your questions. So Rhea, please open up the lines.

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions). Mike Carrier, Bank of America Merrill Lynch.

**Mike Carrier** - *BofA Merrill Lynch - Analyst*

Bruce, maybe first a question for you. Just on the distressed side you gave kind of an update on what you guys are seeing. Just wanted to get a sense since it has been a little while since we have been getting close to an environment like this. One is when you size the funds based on the opportunity, has anything changed in terms of the potential opportunity that you see out in the market?

And then from a deployment standpoint -- and I know each cycle can be different -- but what is the typical pace of deployment once you are in that distressed environment to actually put the capital to work?

**Bruce Karsh** - *Oaktree Capital Group LLC - Co-Chairman and CIO*

You probably know, Mike, that we do have roughly $10 billion in our Opps Funds Xa and Xb, approximately $3 billion in A and $7 billion in the reserve fund B. We talked about the deployment of A which is roughly 25% invested or committed and that has been deployed over the last year or so. It has been at a very measured pace I would say. We were encouraged in the third quarter with what we saw in terms of the potential for expanded opportunities in the distressed world but our pace of investment didn't change materially. We continue to be cautious and selective and disciplined albeit encouraged that down the road that pace would accelerate materially.

When the opportunity really strikes, which we expect will happen over the next year or so, couple years, that is when you will see very, very significant deployments of capital.

It is hard for me to tell you exactly on a quarterly basis how much that would be but it would be multiples more on the distressed side than we are currently deploying.

**Mike Carrier** - *BofA Merrill Lynch - Analyst*

Okay, that is helpful. And then, David, just two things that kind of stuck out on the financials. Just on the incentive income, it seemed like there was a little bit more on the tax side or that is related to the tax distributions. I'm just wanting to get an update on the outlook and I am sure it is not that transparent but any color you can provide.

And then the other would just be on the overall tax rate, just seemed like a little bit lower and so anything on the outlook for that and again I know it can be pretty volatile.

**David Kirchheimer** - *Oaktree Capital Group LLC - CFO*

Yes. Thanks, Mike. So first off, it was unusual as I am sure you noted to have tax-related incentive distributions in a quarter other than the first quarter. This was something true-up -- as we finished all the tax returns for 2014 and realized that there was some more taxable income that we hadn't already picked up earlier in the year. So you should not expect that kind of event in the future, though I wouldn't preclude it.

You are right about the timing. If I could interpret your question about the outlook as broader for incentive income than just tax-related distributions, because yes, it is famously unpredictable in terms of what we would expect to see in the first quarter of 2016 so I won't venture a guess. And as far as the timing on incentive income, I would note that of the nearly $900 million of accrued debt incentives as of September 30, a little over $300 million of that was in funds currently paying incentives, most of that in Opps VIIb and Opps VI, and both of those funds obviously are towards the end of their liquidation period and getting to a point where the distributions are going to be episodic and therefore the incentive income is going to be lumpy and inherently unpredictable.

But I would also note that we have another over $300 million from closed-end funds that are in their liquidation period. And so all in all, almost $700 million of that $890 million balance is in closed-end funds that are in their liquidation period so they are certainly motivated to sell, but it is very, very difficult to try to predict when that might be realized.

In terms of these filing on the tax rate question, we made less money. Fee-related earnings came down and also with the lower incentive income, that all drove the tax rate to be lower. As we disclosed in the earnings release, you should expect the tax rate, certainly the part applicable to FRE, to increase as FRE increases when these new management fees come online.

**Mike Carrier** - *BofA Merrill Lynch - Analyst*

Okay, that is helpful. Thanks.

**Operator**

Brian Bedell, Deutsche Bank.

**Brian Bedell** - *Deutsche Bank - Analyst*

Good morning, folks. Maybe to start out, Bruce, in the deployment opportunities obviously extremely tough to tell on the timing of that. But just from a big picture perspective and how you see the credit markets developing, what are some things that you think could accelerate the pace of deterioration in the credit markets that would accelerate the pace of your deployment and what type of environment do you think would substantially postpone that beyond the one and two years or do you think that is really kind of inevitable over the next one to two years?

**Bruce Karsh** - *Oaktree Capital Group LLC - Co-Chairman and CIO*

Deployment and the credit markets. You probably know we think we are in the later stages of this credit cycle. What could accelerate that and move us into the final, final inning? Certainly exogenous events, something happening either in connection with China slowing and the impact that that may have, the secondary or tertiary impacts that may have around the world. It could be interest rates going up, it could be the psychology changing. It could be some defaults coming because default rates have been relatively low and may remain low for awhile. But as that starts to change, and it ultimately should and will I think, that in and of itself could weigh on investor psychology.

What you saw in the third quarter of this year could well have been a harbinger of things to come over the next year or two. Now obviously we can't predict timing and we can't really predict events, but it could be something totally unforeseen that happens that kicks off the next big opportunity for us.

Our sense is there is a lot of debt out there and if and when it does happen, the opportunity will be extremely large and that is why we raised as much capital as we have. Now much of it, most of it, almost all of it currently is dry powder and we have been very patient.

Even in the third quarter, we started looking at a lot more opportunities and a lot more situations but we didn't really dive in at that point. But it encouraged us and we could see that down the road the opportunity will expand and expand significantly.

**Brian Bedell** - *Deutsche Bank - Analyst*

And what do you think would potentially postpone that? Is it the very rough one- to two-year timeframe that you mentioned, is there a possibility that you don't see those opportunities over the next couple of years or do you think it is sort of inevitable that you will?

**Bruce Karsh** - *Oaktree Capital Group LLC - Co-Chairman and CIO*

At Oaktree we believe in cycles and I think it is inevitable that ultimately we will have another cycle. Could it be postponed? Sure. Would it be on account of a Goldilocks scenario where the central banks around the world are able to continue to keep things moving in the direction currently where it is moving? Possibly. But ultimately we believe in cycles.

**Brian Bedell** - *Deutsche Bank - Analyst*

That is great color. And then, David, thanks very much for the timing of the $2 billion and the $4 million moving into fee-paying AUM. Too early to say I guess what the other $6 billion of that $12 billion in terms of timing to move into fee-paying AUM?

**David Kirchheimer** - *Oaktree Capital Group LLC - CFO*

Yes, there is something like $7 billion in Opps Xb and certainly wouldn't expect that to start its investment period or for that matter start generating any management fees for some time. So yes, it is too early to predict.

There is $3 billion of the shadow AUM which I think was about $17 billion as of September 30. About $3 billion is in funds that have fees based on drawn capital and so that will occur in a gradual way already started as of September 30. But the biggest part is Xb.

Now I would also note that of course we are frequently in fundraising, or we are always in fundraising mode, and periodically have additional closings, so that would increase the future fee-generating AUM but at the same time we've got funds in liquidation that reduce the fees arising from closed-end funds.

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**Brian Bedell** - *Deutsche Bank - Analyst*

Great. Then just a clarification, I think Jay, you mentioned a little over $15 billion of the $20 billion target and then I think there was another comment about $16.8 billion of the $22.6 billion. I just want to get a sense of relative to the $20 billion target ROE more like $3 billion away from that or closer to $5 billion away from that?

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**Jay Wintrob** - *Oaktree Capital Group LLC - CEO*

We are over $15 billion, probably closer to $16 billion. So as to the $20 billion target, a little over $4 billion away. But as I mentioned also, we are very much focused on the two European fundraises which are both closed-end fundraises which are outside of that initial target.

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**Brian Bedell** - *Deutsche Bank - Analyst*

Great. Great. Thanks very much.

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**Operator**

Craig Siegenthaler, Credit Suisse.

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**Craig Siegenthaler** - *Credit Suisse - Analyst*

I wanted to get an update on the M&A front now that Highstar is in the rearview mirror here. What is your appetite across asset classes? And there is some fairly cheap BDC asset managers and hedge funds out there and also I am thinking longer-term it seems like Jay's background is a pretty good fit for a life insurance balance sheet that could provide access to long-duration liabilities. Maybe just an update on the M&A front here.

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**Jay Wintrob** - *Oaktree Capital Group LLC - CEO*

Sure, Craig. First of all, obviously not comfortable commenting on anything specifically and also just a reminder that our preference at Oaktree for growth is principally through step-out strategies, and in many respects Highstar was an example of that although in the form of an acquisition. So that is the premise.

Look, I think our appetite is there for opportunities that fit Oaktree. So we do have a desire to grow but we want to do so consistently with our philosophy of investing and our business principles. And I think you can see the track record for that growth over many, many years. I had mentioned that just in strategies that didn't exist since 2010, we have raised about $17 billion, $18 billion since then. I listed some of those.

I should also comment that there are many opportunities out there that generally aren't of interest to Oaktree either because the investment strategies themselves are not consistent with our desire to focus mainly on inefficient markets, create alpha, achieve consistency, strategies that are driven by fundamental securities research versus market timing or macro forecasting and the like.

So all of the areas you mentioned are certainly on the radar screen, along with many others; don't want to get into any specifics. But we are going to be focused on opportunities that are consistent with how we like to invest in terms of philosophy, and we would like to stay pretty complementary to what we are doing for a number of reasons.

It has been a formula that has worked well and helped sustain the culture. We are much more familiar with the resources we have than the resources we could acquire. But from time to time, whether it is Highstar or bringing in people from other funds with an extensive background as we have done recently, for example, with the emerging market debt would be an example; I could name others. It is a balancing act between all of those opportunities that are out there and sticking with what we are comfortable with.

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**Craig Siegenthaler** - *Credit Suisse - Analyst*

Thank you. Just as my follow-up on monetizations; if you look at closed-end fund distributions, the third quarter I think was one of your lightest quarters since becoming public. Can you provide -- and we know why; it was sort of a difficult macro backdrop -- but can you provide any color in terms of how monetizations, distributions, and the closed-end fund segment are looking into the fourth quarter?

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**David Kirchheimer** - *Oaktree Capital Group LLC - CFO*

Sure. Look, they are episodic, and in terms of commenting on the specific pace in the fourth quarter, if there was anything particularly meaningful right now that is known, I would make a comment in the context of investment income proceeds and/or incentive income. But it is still early in the quarter, so I'm not going to get over my skis, Craig, in terms of predicting this quarter.

All I can tell you is that with the number of closed-end funds in their liquidation, there is a lot of activity going on on the monetization front. It is unknowable as to how much of that falls to the fourth quarter versus early 2016, through 2016, but rest assured that there is a lot going on on that front.

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**Craig Siegenthaler** - *Credit Suisse - Analyst*

Got it. Thanks for taking my questions.

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**Operator**

Robert Lee, KBW.

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**Robert Lee** - *Keefe, Bruyette & Woods - Analyst*

Just want to confirm a couple of things. So the two Euro funds, the infrastructure fund, those three fund strategies of fundraising that's outside the 20, but could you remind us kind of roughly speaking what the targeted size is of those strategies?

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**Jay Wintrob** - *Oaktree Capital Group LLC - CEO*

Rob, a couple of comments. First of all, the infrastructure fund is in the 20 just to clarify. The two European funds, we have not announced a target publicly but I will refer you to their predecessor fund. So the European Capital Solutions, which is our direct lending platform in Europe, the predecessor fund which was called the European Dislocation Fund was EUR675 million and for EPF IV, European Principal Fund IV, the predecessor fund EPF III was EUR3.2 billion respectively. And obviously that weighs into what we are targeting but we haven't come out yet, still pretty early in the fundraising process. Should have more news on that over the next quarter or two and obviously we will update you as closings in progress take place.

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**Robert Lee** - *Keefe, Bruyette & Woods - Analyst*

Thanks. I was curious on the Strategic Credit, which I guess was in the evergreen funds, I mean that was a newer strategy a couple of years ago, got off the ground raising several billion of assets. Could you maybe update us on your thoughts with capital formation there? I mean are you seeing good demand or are you holding off on adding more assets given capacity constraints? Just trying to think of the growth prospects of that relatively new strategy?

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**Bruce Karsh** - *Oaktree Capital Group LLC - Co-Chairman and CIO*

Sure. Okay, Rob. It is Bruce. Currently we've got about $3 billion of AUM in Strategic Credit but a lot of dry powder there. And even though we deployed probably close to $0.5 billion in that strategy during the third quarter, we still have quite a bit of uncalled capital. It is an area that we are excited about. We think there is growth potential there and continued interest among our clients who like that strategy. But it may be a little bit before we incrementally add a great deal of capital there.

Not to say that we won't and haven't recently added some and will continue to add some, but to take it to a next couple billion dollar level, we want to see the dry powder work down a little bit more.

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**Robert Lee** - *Keefe, Bruyette & Woods - Analyst*

Okay and maybe this is a follow-up. We focus a lot understandably on the $14.5 billion of capital commitments that haven't started to earn fees on the closed-end fund side. But if I'm not mistaken, I think it is in your release, you still have about another $3 billion of commitments, and maybe a lot of that is in Strategic Credit, that also is not earning management fees because it is just not drawn down yet. So is it really maybe closer to $17 billion?

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**David Kirchheimer** - *Oaktree Capital Group LLC - CFO*

Right, that is part of the $3 billion that I mentioned earlier is in shadow AUM that isn't going to pay fees until drawn so that's Strategic Credit. It is Mezzanine IV. It is Real Estate Debt, those kind of strategies. You are absolutely right. So that will take time but we have no reason to believe that it won't be drawn in coming quarters.

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**Robert Lee** - *Keefe, Bruyette & Woods - Analyst*

I appreciate that. Maybe one last question on kind of new product development. I know you guys always have a lot of things in the hopper but stepping back if I think of some of your competitors across the industry, several of them have put a lot of emphasis and focus on building permanent capital vehicles, for lack of a better -- one way of putting it. And it is not a direction you guys have gone in as of yet.

Can you maybe just update us and give us your thoughts around opportunities you see within your franchise of building similar types of products or do you feel like maybe there is something culturally within what you do that makes that more difficult or just your thoughts around that?

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**Jay Wintrob** - *Oaktree Capital Group LLC - CEO*

I'm going to share a couple of thoughts. I think David will correct me if I am wrong -- just again context. I think roughly 60% of our AUM is in closed-end fund structures and about 40% in either evergreen or open-end. So I just want to start with that background.

Secondly, my view is pretty straightforward here, which is we want to find the right investing opportunities and investment strategies much more so than we want to find the right vehicles to create permanent locked up capital.

Now if we can combine both of them obviously that is a good mix, but the first instinct isn't how to get permanent capital and then we will figure out how to invest it later. The first instinct is to focus on what are the investing opportunities that are consistent again with our philosophy, with our resources, our people most importantly. So that is what really drives a lot of our decision-making as well as what we are looking at. We are not at all opposed to increasing permanent capital, however defined, whether it is the long-term closed-end fee structure or things like BDCs and other long-term or locked up permanent vehicles subject to the management contracts obviously. A lot of interesting developments going on in that field.

But again, I think the focus needs to be on the investment opportunities and strategies first and then different ways to attract capital, be it open-end funds, evergreen funds, the traditional closed-end strategy or BDCs. I should just say we are looking at opportunities -- it ties to the prior question -- that do involve what you are referring as permanent capital vehicles, but it is really looking at the investment opportunities first, not the structure.

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**Operator**

Chris Harris, Wells Fargo.

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**Chris Harris** - *Wells Fargo Securities - Analyst*

Thanks, guys. So you highlighted the performance or the weak performance of metals, mining and energy, the sector more broadly. Can you guys give us an update on Oaktree's exposure there? I think we have talked about energy in the past but I don't believe metals and mining.

And then the follow-up to that, did that exposure account for some of the performance we saw in a few of the funds and I'm specifically looking at Opps Fund IX, which I think went from a 3.5% return to sort of flat quarter on quarter.

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**Bruce Karsh** - *Oaktree Capital Group LLC - Co-Chairman and CIO*

We do have exposure in energy. It is not highly substantial or significant but we have been -- this is now I'm talking about the closed-end vehicles. Of course the open-end funds, high-yield for example, has exposure to energy probably under-weighted relative to the benchmarks which is probably one reason why high-yield has done fairly well this year, beating their benchmark year-to-date, certainly on the US side.

On the closed-end side, you referenced specifically Opps Fund IX and Opps Fund IX had exposure to energy, again not significant, but enough that it did contribute to the decline in value as well as a few other sectors such as commodities generally and our dry bulk shipping. But also metals and mining to some small extent.

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**Chris Harris** - *Wells Fargo Securities - Analyst*

Okay. My one follow-up is sort of a similar question about performance -- just the numbers excluding distressed debt, 1% you talked about in the prepared remarks. That is a really good outcome in what was obviously a very challenging quarter. Any detail you can provide on how you guys were positioned this quarter that drove such a strong number?

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**Bruce Karsh** - *Oaktree Capital Group LLC - Co-Chairman and CIO*

Let me start by saying there were two areas that performed well for us, the real estate related investments we made and also many of our European investments and that has been the case for most of this year and it was certainly the case in the third quarter.

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**Chris Harris** - *Wells Fargo Securities - Analyst*

Okay, thank you.

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**Operator**

Alex Blostein, Goldman Sachs.

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**Alex Blostein** - *Goldman Sachs - Analyst*

Good morning, everybody. Bruce, I want to get your thoughts on some of the technical and market structure related challenges we have observed in the credit space over the last couple of months. And more importantly, how does that inform your decision about capital deployment? Is the business nimble enough to take advantage of those type of opportunities? More importantly, when we take a step back and knowing kind of what we have learned over the course of the third quarter, is the opportunity set better, same, worse relative to where you were a quarter ago? Thanks.

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**Bruce Karsh** - *Oaktree Capital Group LLC - Co-Chairman and CIO*

Right. Look, the third quarter was very interesting in a lot of respects. We saw the psychology beginning to really roll over and change and people starting to get fearful and we didn't see substantial distribution take place which is when we would deploy a lot of capital. But we started to see a lot of cracks and we started to see companies that started trading at levels that got us very busy in terms of looking at opportunities.

Obviously October has been a sea change in terms of certainly equity performance. The high-yield market has snapped back to some extent. The leveraged loan market interestingly has not. It is still weakish and we continue to think that there is going to be a real chance to deploy substantial capital. And what we focus on is obviously bottoms-up, fundamental analysis and in particular we will deploy a lot more capital when we see a lot of distribution taking place and a lot of selling and more selling.

One of the attractive things from our perspective is that there isn't a lot of trading capital devoted to maintaining orderly markets by the banks. And so one of the things we saw to some extent certainly in the energy sector in metals and mining is that when there was weakness, the opportunity was very interesting. And one of the things that we are looking for obviously apart from -- when I say distribution of course what I mean is a lot of selling that takes place -- but we are also looking for dislocation of industries, etc.

So I think that is sort of where we are at right now. We continue to think that what we are seeing in October, we don't know what the future is going to hold, but there has certainly been a change in the markets that should ardor well for us down the road.

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**Alex Blostein** - *Goldman Sachs - Analyst*

Got it. And then another follow-up question around the open-end channel. I'm not sure if this was already asked but when we look at the outflows this quarter, I guess not particularly surprising given what has been going on in the broader space, but just curious if you could give a little bit more context around the top strategies, high-yield, EM -- where the bulk of the outflows came from?

And then maybe overall just a reminder on what is kind of the firm's overall exposure to sovereign wealth funds in the more liquid space where there seems to be some continued redemption returns. Thanks.

**David Kirchheimer** - *Oaktree Capital Group LLC - CFO*

Thanks, Alex. I will kick it off with the first part of your question about open-end flows. You are right, there were some headwinds first off in high-yield bonds counterintuitively as prices become more attractive, people sort of flee. There is always some of that noise inevitably. And also convertible securities as a source of outflows understandably because of the headwind to the equity markets and just the shrinking nature for now of that market.

You saw a bit of a leveling off. We had had big growth in Emerging Market Equities as that strategy ramped up from its launch back in the summer of 2011 and so there is inevitably going to be a pause in that. All that said, if you look at the last 12 months, net inflows among open-end funds have been slightly positive and thanks to the downturn in the high-yield market in the third quarter I think we are seeing a lot of interest there. So you should expect that area to sort of bounce around a little bit.

We are going to be handicapped until rates start picking up and presumably that triggers a resurgence of growth in the convertibles market which has been very stagnant, really shrinking to a certain extent, since the crisis. That is not going to be a source of growth for us but the other areas, Senior Loans, Emerging Market Equities, High-Yield Bonds continue to be very fertile. Jay, do you want to talk about sovereign wealth funds?

**Jay Wintrob** - *Oaktree Capital Group LLC - CEO*

Yes, just before I get to that just a couple of additions, David, to what you commented on. I should say though we didn't see big outflows, obviously third quarter was also a challenge industry-wide for flows into emerging market equity funds as that whole sector was hit pretty hard in the third quarter.

And then further, we watch the flows very carefully and with respect to some of the outflows we have seen in high-yield and converts, the main event we have observed are clients who have chosen to allocate entirely out of those strategies which is relevant to us. It is not necessarily moving from us to another manager as opposed to somebody making an asset allocation decision. And David is correct, I think there is still a lot -- I know there is a lot of opportunity up ahead in several of our open-end strategies.

You asked about sovereign wealth funds. I guess a couple of comments there. They are an important part of Oaktree but probably fair to say not really a vital part. Around 9% of our AUM, a little shy of $8.5 billion, are from sovereign wealth funds. That has been steady for really the last five years. It has been about the same percentage.

Interestingly despite the falling sovereign wealth fund assets globally in 2015 as we understand it, we have seen sovereign wealth fund inflows at Oaktree. The two largest sovereign wealth fund clients we are fortunate enough to have have made new commitments to Oaktree funds this year. In fact in total, five sovereign wealth funds have made commitments and one of our largest clients has actually helped us seed a new strategy this year.

We think there is still further opportunity up ahead. Some of the bigger challenges are probably focused in the Gulf-based sovereign wealth funds but for the most part, for Oaktree, most of our SWF assets are in our closed-end fund structures, I believe, much more than the open-end. We have not seen any pressure really and in fact have seen inflows, but we watch the situation closely. We are cognizant of what is going on especially in the Gulf and we will see how that develops.

**David Kirchheimer** - *Oaktree Capital Group LLC - CFO*

Also it doesn't seem like it was that long ago that we were talking about just becoming double-digit in terms of the number of sovereign wealth fund clients, and I noted just in preparing for today's call that we are up to 16 now, so the diversification across that important LP group continues.

**Alex Blostein** - *Goldman Sachs - Analyst*

Thanks for the details.

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**Operator**

Michael Kim, Sandler O'Neill.

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**Michael Kim** - *Sandler O'Neill & Partners - Analyst*

Thanks for allowing me to ask questions. So in terms of your capital management approach, any thoughts on retaining more of your earnings to maybe invest more alongside your funds, maybe seed new strategies or capitalize on M&A opportunities to further enhance the earnings power of the firm and potentially ultimately get a better valuation for the stock?

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**David Kirchheimer** - *Oaktree Capital Group LLC - CFO*

Well, first, we are all about getting a higher price that better matches our valuation just to pick up on the final comment, Michael. But I am assuming that you are alluding to the KKR announcement of earlier this week. Is that a fair assumption?

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**Michael Kim** - *Sandler O'Neill & Partners - Analyst*

That would be correct, yes.

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**David Kirchheimer** - *Oaktree Capital Group LLC - CFO*

Okay. So look, I'm going to limit my comments to us but I would be remiss if at the outset I didn't observe that there are some meaningful differences regarding business models, product mix and for that matter a lot of other characteristics between us and them, and for that matter all the public Alts.

So I would just observe that the capital management policy that may work best for any one of us may be suboptimal for the others. They, as you know, have a very large balance sheet and have had that from the outset. We, along with many others, have taken a different approach at Oaktree. We have developed, we have refined our capital management policy over our 20 years through several market cycles and plus just over the past year we have formed a capital and risk management committee that meets quarterly to consider topics such as this. And I would boil it down to this, the key tenets of our capital management policy are along the lines of what you were sort of questioning. It has long been and it is going to remain for the foreseeable future one, most importantly, we have always grown. We are focused on growing a strong, highly-rated balance sheet with ample liquidity that allows us to fund growth in our current investment strategies along with strategic opportunistic initiatives, M&A, what have you.

Number two is to distribute to unitholders any cash that isn't needed to achieve number one. And third, it is to consider opportunistic, not formulaic, purchases of our stock as we did just a few months after our IPO when the first lockup came up. But always in the context of a long-term goal of growing the public float.

That has been our plan for two decades, it has worked quite well and we believe the best way of increasing the value and ultimately the price of our stock is just to focus on our mission of achieving superior risk-adjusted returns with the utmost integrity. We are confident that the rest will take care of itself.

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**Michael Kim** - *Sandler O'Neill & Partners - Analyst*

Okay. And then separately, just given the level of capital you continue to raise, can you talk about maybe how you are thinking about balancing taking advantage of maybe a wider investment opportunity set on the one hand versus staying selective or disciplined on pricing particularly with where we are in the cycle? And I know every strategy is different but just any broader comments might be helpful.

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**Bruce Karsh** - *Oaktree Capital Group LLC - Co-Chairman and CIO*

Michael, we are going to stay selective, patient and cautious given where we are in the credit cycle. That is our view. One of the things we did in the Opportunities Fund as Jay alluded to in his opening remarks, we have materially reduced the assets under management from a high of over $25 billion to almost half, down to $13 billion or so, distributing $30 billion of capital in the process. We've got dry capital almost as much as assets in the ground in the Opportunities Fund.

So we are geared up, we are ready, but we are not going to panic. We are going to be patient and we are going to wait until we see forced selling out there where people are really motivated and fearful and that is the time when we materially increase our pace of purchasing.

We are not going to hesitate to deploy billions of dollars in a short period of time at the right time. But it doesn't feel to us given where we are in the cycle and where prices are and the level of forced selling that we see which isn't hugely significant, although we saw it in the third quarter to some small extent, we are not yet ready to go all out but we will know it when we see it and we think we are getting closer.

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**Jay Wintrob** - *Oaktree Capital Group LLC - CEO*

If I could just add one thing to that, Bruce, and I fully agree with what Bruce mentioned in my prepared remarks about the distressed debt franchise not only remains intact but incredibly well positioned. But we do have roughly 25 investment strategies at Oaktree and several of them have been quite active in their own space and aren't as subject to all the factors Bruce was just alluding to regarding distressed. So our European Principal Group remains very active, the real estate group, which is a global platform, very active deploying. We have been very active in our Enhanced Income Fund and really the CLO space, which as I mentioned now is roughly a $12 billion platform for Oaktree.

And the Global Principal Group was extremely busy in the third quarter. So the diversification is not only prudent, I think it has got a long-term positive, but it is also material and it is relevant. And I hope that will continue to be the case going forward. And so those strategies are not in exactly the same place as maybe distressed debt or as Bruce talked about Strategic Credit, nor should they be. That is the whole point of the diversification.

So I just want to mention the whole firm is not in the exact same space. Each of our investment strategies acts more or less independently. That is how the firm was established and some of the strategies are much more pro-cyclical than others, and so I would encourage you also to focus on where we are deploying capital.

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**Bruce Karsh** - *Oaktree Capital Group LLC - Co-Chairman and CIO*

We did deploy $2.5 billion away from Strategic Credit so if you add Strategic Credit to the closed-end vehicles, we deployed $3 billion last quarter.

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**Michael Kim** - *Sandler O'Neill & Partners - Analyst*

Understood, okay. Thanks for taking my questions.

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**Operator**

Ken Hill, Barclays.

**Ken Hill** - *Barclays Capital - Analyst*

Thanks for squeezing me in there. Just a quick one from me on the fee rates, it looked like they moved lower across the board within those specific asset classes even though I know the overall mix shift was favorable which drove that a little bit higher. But as we think about that longer-term, understanding that the mix shift is going to be positive, more of the closed-end funds come online, what is really driving the fee rates lower in the open-end and the evergreen funds? Was that competitive dynamics or is that just some of the newer funds that have lower rates? Is there anything there you can point to?

**Jay Wintrob** - *Oaktree Capital Group LLC - CEO*

I think it is a good observation. The overall mix is what generally has modestly improved the overall fee rate. But within some of the open-end strategies, there continues to be fee pressure and some of it is our own desire to work with clients that have become quite large and we are always balancing the trade-off between focusing more on larger clients and the obvious benefits of that versus the modestly lower notional fee rates.

I would say you are exactly right in some of the open-end strategies, that is where you see some of the greater fee pressure and again some of it is our decision on a case-by-case basis to work more closely with certain large clients.

**Ken Hill** - *Barclays Capital - Analyst*

So the trend there still being I guess moving lower, nothing that would really right the ship there? Within open=end and evergreen specifically.

**Jay Wintrob** - *Oaktree Capital Group LLC - CEO*

I think that is fair. I think that is probably a high=level broad trend but you don't see it equally across all the strategies or across all the different client-size markets. So it is really again a balancing act of how you are going to approach the market, where you are going to focus your marketing and sales efforts and of course wanting to work with, especially take care, of our long-term loyal dedicated Oaktree clients.

**Ken Hill** - *Barclays Capital - Analyst*

Got it. Thanks for taking my question there.

**Operator**

We have no further questions. Ms. Williams?

**Andrea Williams** - *Oaktree Capital Group LLC - Head of Corporate Communications and IR*

Thank you everyone for joining us for this conference call. A replay of the conference call will be unavailable for 30 days on Oaktree's website in the Unitholders section by dialing 800-677-1575 in the US or 1-402-998-0907 outside of the US. That broadcast will begin approximately one hour from now.

**Jay Wintrob** - *Oaktree Capital Group LLC - CEO*

Thank you.

**Operator**

That concludes today's call. Thank you for your participation. You may now disconnect.