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## OAK - Q1 2016 Oaktree Capital Group LLC Earnings Call

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## CORPORATE PARTICIPANTS

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

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

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

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

## CONFERENCE CALL PARTICIPANTS

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

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

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

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

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

**Patrick Davitt** *Autonomous Research LLP - Analyst*

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

**Michael Cyprys** *Morgan Stanley - Analyst*

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

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

## PRESENTATION

**Operator**

Welcome and thank you for joining the Oaktree Capital Group first quarter 2016 conference call. Today's call will be recorded. (Operator Instructions) Now I would like to introduce Andrea Williams, Oaktree Capital Group'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 - Managing Director, Head of Corporate Communications and IR*

Thank you, Bob. Welcome to all of you who have joined us for today's call to discuss Oaktree Capital Group's first quarter 2016 financial results. Our earnings release issued this morning detailing these results 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 that 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 the 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. For a reconciliation of each non-GAAP financial measure to the most directly comparable GAAP financial measure, please refer to our earnings press release that was furnished to the SEC today on Form 8-K and may be accessed through the Unitholders section of our website at www.oaktreecapital.com.

Today we announced a quarterly distribution of $0.55 per Class A unit payable on May 13 to holders of record as of the close of business on May 9.

Finally, we plan to issue our first quarter Form 10-Q also the week of May 9.

With that, I will now turn the call over to Jay.

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

Thank you Andrea, and good morning to everyone. Taking some literary license from Charles Dickens, the first quarter of 2016 was a "tale of two markets."

As we entered the new year, there was a continuation of the pervasive negativity and angst of late 2015. Suddenly in mid-February, the markets took an abrupt and perhaps unexpected turn. The fear present in January and February dissipated and prices reversed.

Had you been asleep for the quarter and awakened on March 31, you would be excused if you thought it had been a relatively boring 91 days. In this volatile environment, we had a good beginning to 2016, highlighted by growing management fees and fee-related earnings, as well as our ability to harvest investments in the form of significant realization activity by our distressed debt, real estate and other closed-end funds.

Management fee-generating AUM increased to $80 billion as of March 31, and management fees rose 6% year over year, driving 25% growth in fee-related earnings to $62.4 million. The growth in quarterly fee-related earnings is important to highlight as we began to benefit from the start of the investment periods for closed-end funds that we raised in the last year and a half, namely Opportunities Fund Xa, Power Fund IV, Principal Fund VI, and Real Estate Opportunities Fund VII.

As mentioned last quarter, we anticipated that the cyclical trough for management fee revenue and earnings occurred in 2015 and we are now experiencing the benefits of a strong closed-end fundraising cycle, and greater cost consciousness across Oaktree.

In terms of closed-end fundraising, in the first quarter we closed on an additional $500 million for Opps Xa and Xb. And we are continuing to make steady progress on a number of important closed-end fundraises. Over the next three quarters, we expect additional closes for Opps Xb, Real Estate Opportunities Fund VII, and European Capital Solutions. We expect a first close for European Principal Opportunities Fund IV and Infrastructure Fund I, and we anticipate first closes for Real Estate Debt Fund II and new separate accounts for our debut Real Estate Value-Add strategy.

All in all, it is shaping up to be another good year for fundraising for a number of our established fund strategies, as well as for newer Oaktree funds in their first or second generation.

We also remain quite active fundraising for our open-end funds, especially given the challenging net flow environment. Following $4 billion of net inflows for the year ended March 31, 2015, we've now experienced roughly $3.7 billion in net outflows from our open-end funds for the year ended March 31, 2016, the majority of which has been in Convertibles and US Senior Loans. Leveraged-loan markets have been volatile during the period, and some clients have reduced their exposure to the asset class due to reduced expectations of short-term interest rate increases that would increase the yield on these floating-rate assets.

In convertibles, a shrinking market size due to lack of new issuance during this prolonged low interest rate environment has been a headwind. As a reference point, we look at US mutual fund flow data for these two asset classes, where we also see net outflows.

On the positive side, our recent marketing efforts for high yield bonds and European senior loans have been productive, as we believe our clients see both the relative value of these asset classes and the ability of our experienced investment teams to capture that value. In the aggregate, these strategies represent two-thirds of our open-end AUM. Our benchmark outperformance over the last 12 months in all three of our high yield bond strategies, as well as European senior loans, is testament to our adherence to disciplined risk management in our portfolios, and our ability to meet client expectations to outperform down or volatile markets.

Moving on to investment performance for our closed-end funds, the first quarter's gross fund return was a blended 2%. Distressed debt also had a 2% gross return, driven by solid performance of real estate-related holdings and some public equities. Our Real Estate Opportunities and Real Estate Debt funds continued to perform well, with gross returns of 3% and 6%, respectively, in the quarter. And our strongest quarterly gross returns were in the smaller strategies, such as 6% in Power Opportunities, and 15% in Emerging Markets Opportunities.

Despite the volatility and V-shaped nature of the first quarter's markets, our investment teams are finding attractive new deployment opportunities while taking advantage of opportunities to realize seasoned investments in their portfolios. The first quarter's deployment activity was centered mostly in distressed-oriented strategies, such as Distressed Debt, Global Principal Group, and Strategic Credit.

At the same time, we are remaining disciplined, given near-record high US equity markets and the low interest rate environment we see globally. Bruce will elaborate on all of this in a moment.

Finally, I will close with a recap of one of the most positive events of the first quarter, our client conference that we held here in Los Angeles in March. The conference featured two full days of panel discussions led by our senior executives and portfolio managers, as well as breakout sessions for Oaktree investment strategies. We had the highest attendance ever at almost 500 clients, and featured the largest number of Oaktree professionals ever in that forum. Several longtime clients of the firm commented to me that it was the best Oaktree conference they had ever attended.

Together with our fundraising success, our 2016 client conference generated momentum for our business and was the latest validation of Oaktree's enduring business principles. Specifically, putting our 2,200 clients' interests first and serving their needs by engaging in transparent and candid communications.

And with that, I will hand it over to Bruce to cover the investment landscape.

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

Thanks, Jay, and hello, everyone. As Jay noted, the first quarter began under the same veil of investor pessimism that ended the fourth quarter.

Serious concerns abounded regarding US economic growth. Fears of a continued sharp decline in China's growth rate and further yuan devaluation dovetailed with worries that commodity deflation would metastasize throughout global financial markets.

Compounding the situation was concern over a weakening global economy, prospective interest rate hikes by the Federal Reserve, and the potential impact of them on the strong US dollar. Yet midway through the quarter, the sell-off reversed course.

This turn-about seemed to be prompted by signs the Federal Reserve would be less aggressive about raising interest rates and by actions of other central banks around the world to further ease credit conditions. Additionally, stimulation by China addressed concerns over its weakening economy, and triggered a rise in commodity prices.

Taken together, these developments played a major role in alleviating investor anxiety.

Before this reversal of sentiment, Oaktree funds capitalized on the meaningful buying opportunity in the first six weeks of 2016. Specifically, in our distressed debt funds we invested in a diversified set of high-quality public debt opportunities in such sectors as telecom, media, chemicals, E&P, midstream MLPs, metals and mining. In March, the prices of many of these public securities snapped back with our public energy and commodity names appreciating the most, some by as much as 20 to 30 points.

We took advantage of this market strength to realize a few holdings and recycle proceeds. It is not exactly our standard game plan, but as always, we try to be opportunistic.

While it has proved to be a fleeting bargain buying opportunity, the credit markets' panic attack from January through mid-February reminds us that market psychology is fragile. Liquidity can suddenly become scarce and capital markets can quickly shut. Moreover, we believe it signals that an upswing in defaults has finally started and that we are a big step closer to the next expanded distressed debt opportunity.

As you may know, the percentage of the high yield bond index that is trading at yield spreads greater than 1,000 basis points over Treasurys has historically been a reliable leading indicator of default rates. That is, when there is a greater supply of such securities, more defaults are expected to occur.

By the end of January, the percentage of the high yield index trading at such high spreads had increased to 19%. Since mid-February, prices have snapped back and yield spreads have narrowed considerably. Nonetheless, a number of stressed securities are still trading at spreads over 1,000 basis points and not just in energy- and commodity-related industries.

On the realization front, in the first quarter, we fully exited one of Oaktree's largest positions for a substantial gain. STORE Capital is a specialty net-lease REIT that our funds created in 2011 in partnership with an excellent management team.

Through our Real Estate and Distressed Debt Opportunities Funds, we invested just under $1 billion in the platform in two equity tranches in 2011 and 2013. STORE successfully invested in middle-market, single-tenant operational real estate in a broad range of retail, service and distribution facilities. After taking the company public in November 2014, we completed four follow-on offerings both primary and secondary. In March 2016, we sold our remaining 33 million shares at a slight discount to the stock's then all-time high price, producing a $1 billion profit for our funds and a 26% IRR for the investment.

STORE Capital has the hallmarks of some of our most successful investments. First, building a platform by partnering with an excellent management team to purchase assets in out-of-favor markets during a trough. Second, leveraging our strong relationships and access to debt providers who improve the platform's flexibility and competitiveness. And third, helping to grow the business with a significant Board presence of our investment professionals with an eye, of course, to a successful exit. Plus, in this case, I'm particularly gratified by the terrific collaboration between members of our real estate and distressed debt teams.

I look forward to answering your questions, but now I am delighted to turn the call over to David.

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

Thank you, Bruce, and good morning, everybody. The new year began where the old one left off with 2015's closed-end capital raised of $18 billion beginning to benefit management fees and fee-related earnings. Management fees grew for the second straight quarter, while fee-related earnings increased for the fourth consecutive quarter. Adjusted net income declined from a year ago to $0.49 from $0.81 per Class A unit on lower incentive and investment income, and a higher tax rate.

First quarter management fees totaled a record $201 million, up over 5% sequentially and year-over-year, as we benefited from the investment period commencing for two of the closed-end funds we raised last year, Opportunities Fund Xa and Real Estate Fund VII. The growth in management fees drove an increase in fee-related earnings to $62 million, up 3% sequentially and 25% over the year earlier's $50 million. That growth could well take a pause until other new closed-end funds start generating meaningful management fees which we do not currently expect will occur in the second quarter.

Incentive income, net of compensation expense in the first quarter, amounted to $47 million, of which annual tax-related distributions accounted for $35 million. Investment income fell to $15 million from $53 million a year ago. The biggest reason for the drop was energy-related holdings in certain of our CLOs, underlying a $23 million impairment charge we took on our CLO stakes in the first quarter.

Investment income also includes our 20% ownership stake in DoubleLine Capital. In the first quarter, DoubleLine continued its remarkable growth, ranking among the top three in terms of net flows among all mutual fund families according to Morningstar, not too bad for a firm that started managing assets just six years ago this month. As of March 31, DoubleLine's AUM stood at about $95 billion, up 11% for the quarter and almost double the level of $49 billion two years ago. Our share of DoubleLine's income was $15 million for the first quarter and $55 million for the past 12 months.

Finally, a couple of updates pertaining to the current second quarter. First, as we announced two weeks ago, we capitalized on the slide in interest rates to price $100 million of 15-year privately placed notes at 3.69%. We intend to use the proceeds when received upon closing in July to pay down our term loan so total debt will not increase. Coupled with the recent renewal of our five-year bank credit facility, we're quite pleased with the liquidity capacity, ladder of maturities, and mix of attractively priced floating- and fixed-rate debt this gives us.

Second, so far in the second quarter, known incentive income, net of compensation expense and fund-related investment income proceeds are estimated to be roughly $45 million and $9 million, respectively. From where I sit today, even with the realization momentum across our closed-end funds, I do not currently expect any additional incentive income of consequence in the current second quarter.

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

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) Alex Blostein, Goldman Sachs.

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

First question, I guess the only question, on the fund-raising front, so Jay, you outlined a bunch of funds as you did last quarter. And just kind of wondering the appetite from the market relative to your target across those funds, and just to maybe help us summarize in addition to the $12 billion of AUM that is not generating management fees for you guys yet, how much do you guys anticipate in these new strategies, both with kind of whatever is left on Xa and Xb, plus some of the new funds.

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

Focusing on the closed-end funds, we have got a number of things in process. Bruce may want to comment. But we are still marketing Opps Xb and that technically goes through this year. We are making good progress in Real Estate Opportunities Fund VII. That fund is going to end up being north of $3 billion. European Capital Solutions has had a close, and has more closes in the offing. That follows up on its predecessor fund, EDF, which was a EUR650 million fund, I think, and this fund will be larger than that. European Principal Fund IV and Infrastructure Fund I will both have their first closes almost certainly in this quarter. The prior European Principal Fund was a little over EUR3 billion, and of course, Infrastructure Fund I is a new strategy for Oaktree.

We are now in the market with our second Real Estate Debt Fund. The first Real Estate Debt Fund, I think, was a little over $800 million. I will check that number real quickly. (multiple speakers) I'm sorry, $1.1 billion in the first Real Estate Debt Fund, excuse me.

And then, as I mentioned, we do expect during the course of this year to launch our Real Estate Value-Add strategy in the form of one or more separate accounts.

We feel good about the pipeline. We feel good about the activity, and we just need to continue steady on the course, and focus on getting these things completed or further along over the course of the year.

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

Thanks, I will jump back in the queue.

**Operator**

Craig Siegenthaler, Credit Suisse.

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

Thanks. I just wanted to circle back on the investment environment and your bullish commentary on the deployment front. 1Q wasn't that high, so maybe some color there would be helpful. But it sounds like we should see a healthy increase in investment activity in 2Q and 3Q, given you are increasingly optimistic. So, any color there would be helpful.

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

Q1 was relatively high. You said it wasn't relatively high, given the funds that were currently being invested. I think in the aggregate, the closed-end funds put to work were roughly $2 billion. With respect specifically to Opps Xa, we invested roughly 15%, so we felt like we had put a decent amount of money to work. The window closed relatively quickly, and we did not get all that we had wanted when we were in the market looking for opportunities. But we felt that we did a reasonable job of putting money to work in Q1.

And with respect to the rest of the year, it is really going to be a function of what the environment is. We still think we are going to continue to deploy, although what we were doing in Q1 is probably not as much of what we are going to do in Q2 and beyond. We see some other opportunities outside of public US corporate debt that looks interesting to us, and of course the energy sector is still interesting.

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

And Craig, recognize, too, that in addition to Bruce's funds, and who else has sought, Emerging Markets Opportunities, Principal Fund VI also capitalizing on the brief but severe market downturn early in the year, that some of the strategies actually need slightly more positive market backdrop to help their deployment. So, mezzanine for example, was relatively quiet in that six-week downdraft.

So it is another example of the benefit of a nice mix of pro- and counter-cyclical strategies across Oaktree.

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

Thank you.

**Operator**

Michael Kim, Sandler O'Neill.

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

Looks like you had a nice step-up in the percentage of incentive-creating AUM that are generating incentives. First, did that just relate to Real Estate IV and Power III crossing over? And then just going forward, maybe if you could provide some thoughts on some of the other funds that might be in a position to crossover at some point.

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

In terms of the percentage of the incentive-creating AUM generating incentives, it is I think like 53% or so, a little above 50%; Real Estate Fund IV, Principal Fund III have been generating incentives at the fund level for some time.

I will get back to the point of your question, but I would use your mention of Real Estate Fund IV as an opportunity to point out as, when you have a chance to look at the fund table, that that fund is among many that, thanks to the very strong realization activity in the first quarter that spilled over into the second, we're very close to and I think actually as of this week will be at the point of having made distributions to where, on a cash basis, it will have reached crossover so that future distributions from Real Estate Fund IV will generate incentive income.

But, back to the point of your question, which is on the creation of incentives, not the receipt of them, that there are about a handful of funds such as Opportunities Funds, Opps VII, VIIIb, and IX; Principal Fund V, European Principal Fund II, as you can see in the fund table, all those five are funds that are not at the level of returns sufficient or necessary to generate incentives at the fund level, and while it is way too early to predict the ultimate outcome, that those funds just between them represent about 30 percentage points of additional incentive-creating AUM.

And so, that would take the amount generating incentives from about 52% to over 80%, and I am certainly not predicting that that is going to happen for all of those funds. But if past is prologue, it certainly will for some. And to put that in perspective, as of March 31, those five funds between them, if they were to go through their so-called catch-up layer on a book basis, that would aggregate approximately $700 million of additional net accrued incentives, or about equal to what we had, which is about $747 million, I think, as of March 31.

So your question is a really good one and we remain excited about the prospects for those funds and the funds already in incentive-creating mode to create further accrued incentives in the future.

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

Got it, that's helpful. Okay, thanks for taking my question.

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**Operator**

Mike Carrier, Bank of America.

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

Bruce, maybe first question for you. Just in the first quarter you mentioned kind of dynamics in the market and how active you guys were, at least in the first six weeks. Just kind of wanted to get your view on when you look at what happens with the valuations in the market versus the fundamentals. So when you look at some of these companies, and you are looking at the revenue growth and the EBITDA growth trends, when debt is coming due, are there still concerns out there from a distressed standpoint, meaning new opportunities will eventually come just given where we are in the cycle?

And then David, just a quick one on the tax rate. If you can hit on why it was at the elevated level.

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

I will start, Mike. With respect to the value that we saw in the first six weeks, we thought there was a lot of value. One of the hallmarks of the capital markets today is that there just isn't a lot of liquidity. And when the sellers emerge, prices drop, in many cases well below fundamental value.

And we were excited to buy and, as I mentioned earlier, across a wide range of industries and companies that we thought were trading effectively well below intrinsic value. In some cases, we were stymied because there wasn't as much supply as we would have liked of the companies that we found attractive. But we bought all we could.

Then, when the recovery came, again some of these securities traded up 20 or 30 points, again because of the lack of liquidity. So, when the buyer showed up, there wasn't as much supply as I had mentioned, and they drove prices up a lot. And we took the opportunity to sell.

So, it was an unusual period where, for a short window, we were able to really enjoy the bargains we saw. And then very quickly, we saw prices go up to levels that we thought fundamentally overvalued some of these companies. And thus we sold.

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

For the tax rate question, Mike, ANI tax rate increased to 28% for the quarter because of the large amount of the incentive income that is so-called blocked, or where the tax is paid at the corporate level. That is the main driver.

Secondarily, as we've often talked about as fee-related earnings and income from DoubleLine increase, all things being equal, that also puts upward pressure on the tax rate. All that said, I would point out that under the approach that we all take to calculating these tax rates, that for the quarter the ANI tax rate was 20%. But as you can see in the earnings release, the predicted or forecasted full-year estimated tax rate for 2016 is 23%. I will spare everyone the details as to why that is the case, but the expected rate right now, for what it's worth, is a lower. That is probably going to bounce around as we go through the year. It always does. Does that help you?

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

Yes, that's good. Thanks a lot.

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**Operator**

Brian Bedell, Deutsche Bank.

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

Just a quick question for Bruce. Given what we have seen in the dislocation in markets, the temporary dislocation in the distressed markets in January and February, and we saw obviously some of this back in August and September, are you thinking for this next -- let's say, I'm going to call it -- a credit cycle even though that may not be the proper word for it? But does this change your strategy into more of an opportunistic and short-term strategy across your closed-end funds so that we could think of your investment cycle horizon is actually speeding up, and giving you the capability to generate higher IRRs?

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

Well, I don't know exactly what the future holds and I don't know what kind of opportunities and the duration of those buying opportunities will be. We have seen this before and I have seen this before in my history, where there are these brief windows. But over time, they lengthen and, at a point in time, the best point in time, it is reasonably prolonged. So we will have an opportunity to deploy a whole lot of the capital that we have raised.

That is still our base case expectation. We think it is still going to happen. In the interim, sure, it creates some high IRRs when you buy something and then a month or two later, you sell it very quickly. That is not what we are hoping for. What we are hoping for is a longer, prolonged buying opportunity that will give us the chance to put meaningful dollars to work. And we still believe that is coming.

These are just cracks along the way that are getting a little bit bigger each time, and hopefully down the road, we will see something that will enable us to meaningfully deploy a lot of the Xa and Xb capital that we've raised.

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

And I guess the question would be around, sort of, is the illiquidity of the markets, the state of that versus prior cycles, such that you might see more of these cracks along the way and sort of extending that long-term cycle? But giving you more opportunities than you had in prior cycles in the short-term?

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

It is possible, but I don't know exactly what the future holds, and I think in this particular case, there were reasons that I cited in my remarks about why sentiment changed. And at some point, if those things don't occur and sentiment doesn't change, the buying opportunity will accelerate and the liquidity will ultimately be there. People will continue to redeem from mutual funds, hedge funds will sell and accelerate their selling, and there will be plenty of supply, but not if sentiment changes on a dime, which it did in the first quarter of this year.

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

Great, that's great color. Thank you.

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**Operator**

Patrick Davitt, Autonomous.

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**Patrick Davitt** - *Autonomous Research LLP - Analyst*

Do you know if the word impairment, I guess, with the CLO change suggests some permanence? Is that fair? And could you mainly walk through if that is the case, what kind of credits they were on the energy side that caused that impairment?

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

Sure, I think we had a lot of company this first quarter with persisting headwinds in the energy and related sector. And it's those credits which accounted for the vast majority of the $23 million impairment charge.

To your question about permanence, most of that charge related to credits that, in fact, have not yet defaulted, but where they are distressed priced. So the market is basically predicting for most or all of those at some point they very well could default. And so it is just prudent for us to take the impairment charge.

But we remain quite optimistic about those credits in particular, but the entire CLOs to underscore that, the performance on an unlevered basis for each of those CLOs, there are several that are of the vintage where they had a higher concentration of energy and related credits than on average for all of our CLOs. And their performance since inception, last year, this year to date, etc., unlevered, is in all cases above the benchmark.

So our holdings of those industry credits based on our performance, based on their current prices for that matter, are better than the benchmark average, and our returns going forward from those CLOs are expected to be positive now that we've taken the impairment charge in particular, and they have traded up a little bit since the March 31 date. So, it is a long way of saying that this reflects that basket of securities when you have levered vehicles such as CLOs are, that tends to magnify the charge. The carrying value of the three CLOs which contain those credits are now below $60 million. I think it was $59 million or so as of March 31, out of our total exposure to carrying value of CLOs of $144 million.

So there are a lot of CLOs that have absolutely zero impairment or any expectation, no defaults or anything like that. And I would also note, at the risk of perhaps sounding a little bit Pollyanna-ish, but at Oaktree again, as I have learned over the years, wherever there is a ray of sun, sometimes there's a cloud and vice versa.

And this is the latter, where indisputably it is a negative, Patrick, to have the impairment charge. But I would observe that the credit weakness that underlies the reason for the charge portends the type of investment opportunity that Bruce has described. So, we are somewhat diversified in that respect.

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**Patrick Davitt** - *Autonomous Research LLP - Analyst*

That makes sense, thank you.

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**Operator**

Ken Hill, Barclays.

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

I just wanted to follow up on the balance sheet side. It looks like that took a step down during the quarter. I was wondering if any of that was strategic, or are you guys just realizing some positions alongside your funds, and kind of how you are thinking about that level over time.

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

Yes, you are talking about balance sheet, right?

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

I think the investments in funds.

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

Right, yes, exactly. I wouldn't say it's that strategic, it just sort of reflects the ebb and flow of our investments as general partner. We had nice distributions from funds. And so that causes the GP balance to come down and also these new funds, many cases have not had a chance yet to draw down large amounts of general partner capital yet, and so you have not seen the increase.

So no, I would not say that is strategic at all. That is just natural, again, ups and downs in the general partner balance on average. And it also is a chance for me to just remind everyone that our investment in DoubleLine, which is part of that, is carried at original cost, which is very small. It's something like $20 million or so and is not carried at fair value.

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

Thanks for the color there.

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**Operator**

Michael Cyprys, Morgan Stanley.

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**Michael Cyprys** - *Morgan Stanley - Analyst*

Just wanted to follow up on the fundraising side. You gave some helpful color on the closed-end funds that you expect to raise over the next 12 months or so, but just curious looking out a little bit beyond that over the next, call it three years, certainly the fundraising has been very healthy over the past two years, and unlikely this year.

But looking out next -- sort of beyond the next 12 months -- three years forward or so, what sort of funds can we expect to come back or new strategies come in for fundraising on the closed-end side? And if you could also touch upon some of the weakness that we've seen on the open-end side, what is driving that and what it will take to drive the open-end side back to organic growth there.

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

Sure. Thank you, Michael. On the closed-end fund side, I think the most logical thing to assess is that as our existing funds deploy and get towards full deployment of their funds, they are by far the most likely closed-end funds to be back in the market, assuming the deployment opportunities and the outlook is sufficient.

So for example, as we work through the current -- for Oaktree, relatively small -- principal fund, Principal Fund VI, which I think is now roughly 50% deployed, that is a possible candidate. And you can really go down the line looking at which funds are moving further through their deployment cycle. We are really just sort of at the back end of a very bullish cycle for closed-end fundraising, and so there is still a lot of capital to be deployed. We are at near record levels of dry powder, shadow AUM.

I think you'll also see, assuming success with our separate account raised for our value-add strategy that, at some point, that may develop into a co-mingled fund. So that's possible, the real estate platform, looking out in the time period you mentioned, will grow. But I think those areas, but the biggest driver is going to be getting through the current funds and the market environment. That will be the biggest driver.

You asked about open-end flows. And as I mentioned in my prepared remarks, the most challenged areas we think there were some sound reasons for what we observed, that being senior loans and convertibles. The convertibles market, I think we have talked about it now on two or three of these calls, it is just a very tough situation when the overall market is shrinking, principally driven, I think, by the prolonged low interest rate environment. And that has been as much of a challenge as anything for us.

Also we continue to look at how we are allocated between convertible bonds versus a growing part of the benchmark there, which is convertible preferred securities, which tend to capture more of the upside but also more the downside. We have generally been under-allocated convertible preferred, over-allocated convertible bonds. We will continue to look there.

But open-end funds for Oaktree that represent over two-thirds of our open-end funds, mainly high yield and European senior loans, all outperform their benchmarks. And we continue to see pretty good visibility in terms of our fundraising efforts through the rest of the year. But a lot of that is going to be driven by the markets and by prolonged low interest rates in the case of convertibles.

Flipside is on the loans. Again, as I mentioned in my remarks, I think when expectations for short-term interest rates rising were muted mid-first quarter, I don't think that was positive also for that asset class in general, because a number of the purchasers there are looking at the senior loan asset class as a means of capturing higher yields, assuming higher interest rates, since that is a floating rate asset class. So there are different factors impacting different parts of the open-end asset classes that we participate in.

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**Michael Cyprys** - *Morgan Stanley - Analyst*

Okay, great, thank you.

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**Operator**

Robert Lee, KBW.

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

Just curious actually and wanted to focus a little bit on the Evergreen funds. It looks like you drew down some capital this last quarter. Could you maybe update us on where you see the incremental fundraising opportunity for strategic credit and, I guess, Value Opportunities are the two main products there? And if you have seen similar to what you have seen in distressed and other strategies, that maybe the opportunity set to put money and strategic credit to work has been increasing as well?

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

Let me just comment on strategic credit, Bruce, and then maybe you can comment on Value Opps. So it's a good observation. I think we are at our all-time high AUM for the strategic credit asset class at March 31, and that group has been quite active in the first quarter, and continues to see opportunities across that spectrum basically between high yield on the one hand and Opps on the other hand. And we see good growth opportunities there. Again very opportunistic, subject to market conditions, but we have ambitions to continue to grow that Evergreen category and possibly expand a bit into some related areas of focus for the portfolio manager there.

Bruce, you are probably best to comment on Value Opps.

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

Sure. Value Opps is our open-end alternative to the closed-end Opportunities funds. It focuses much more on liquid public securities because of the fact that it is open-end. And we have chosen to really focus our fundraising efforts on the closed-end side, so we have really not done much in terms of attempting to add to Value Opps at this point.

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

Okay, great. Maybe just a follow-up on marketing and distribution. Can you talk a little bit about where you are seeing the biggest opportunity to expand your LP base? I mean with 2,200 LP, it is pretty broad now, but maybe update us on where some of the key initiatives are on the distribution front, and whether it is regionally or investor segment.

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

Absolutely. This may sound -- I think David used the word Pollyanna-ish -- but I really don't think there is any sector that there isn't more opportunity. We have everything from -- if you take on a regional basis, we continue to expand our efforts outside of the United States. I think a little over 29% of our AUM by client location is from clients based outside the US.

We have ambitions to try to increase that. We are adding to resources based outside the United States for marketing, in particular in Asia, and I think that will bear fruit over time.

At the same time, we continue to expand with our core institutional clients, public and corporate pensions, large endowments in particular, insurance companies, sub-advisory arrangements which now I think represent roughly about 8% of AUM and have grown fairly dramatically over the last three years.

So I wish I could tell you that we all sit down as a group and say, okay, which of these client sectors that I just mentioned should be de-emphasized so we can refocus on certain other client sectors. I can't tell you that there is really any that fall into the category. We continue to pursue carefully high-net-worth individuals through intermediaries.

So I don't think, whether it is by geography or by client type, there's any particular area that we are overemphasizing at the expense of another. We continue to see good relationships with and opportunities with sovereign wealth fund clients.

So again, we are pretty constructive as all of these areas continue to allocate to alternative investments against a backdrop of a very low interest rate environment and, in some cases, liabilities that require higher returns to have a chance to meet those liabilities over the long term.

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

Great, and if I can maybe just indulge one more, and I apologize if you mentioned this earlier, but just in terms of fundraising, I know it is pretty small, but the Emerging Markets Opportunities Fund is -- even though I guess it just finished its investment period -- can you just update us on the intentions for Fund II there, I guess?

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

I think the investment period for EMOF I ends in the third quarter of this year.

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

Yes, right.

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

And all things equal, we definitely have ambitions to raise a second EMOF fund. We expect it will be based on good performance and probably start to look hard at that later this year, and with a planned biggest emphasis at the beginning of next year.

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

We are excited about that one. Our group has done a nice job in deploying capital during the downturn and has generated some nice returns recently on a larger base of capital. I think we are probably about 60% -- close to 60% drawn down invested. I believe the LPs are very, very happy with what's going on there.

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

Great, thanks for taking my questions.

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**Operator**

Chris Harris, Wells Fargo.

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

The question is on fee AUM. I thought I heard you guys say not a whole lot is going to be falling in in the second quarter. I wonder if you could talk a little bit about the outlook for that in the second half of the year, maybe qualitatively which funds could be migrating into fees, and quantitatively, perhaps what the size of that could be?

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

A couple of points; first, remember fee-generating AUM is a forward-looking metric, so if you take the number as disclosed at March 31, multiply it times the blended fee rate, it will underscore why I noted and highlighted the fact that, notwithstanding the growth in management fees that we describe in the first quarter, we don't expect that to continue in the second quarter.

Looking past the second quarter, we've got two or three moving parts here. One, all the fundraising that Jay described, and the timing of that -- and the magnitude, obviously, of the fundraises continued for Real Estate Fund VII. New fundraising for European Principal Fund IV, Infrastructure I, etc., I won't go through all of them.

And when those funds start generating management fees and at what rate, and do they start fees initially based on drawn capital or full-committed, all of that will determine the magnitude of the increase probably starting late in the second quarter, but we are not expecting a very significant amount. I would expect an increase in the third quarter from that. But I would, at the same time, point out if you look at the fund table, there are a handful of closed-end funds that enter their liquidation period as we are traveling through 2016.

And of course that invariably is associated with the reduction in the total management fees from those particular funds. So that is a bit of a headwind. And then the other component is, of course, so-called shadow AUM, which at March 31 was a little over $12 billion -- and a reminder for everybody, that represents committed capital that is not yet generating management fees. The largest portion by far of that, over $7.5 billion, is Opps Xb. And subject to all the usual caveats that we certainly don't expect that to start generating any management fees until after 2016, but that is very exciting in terms of future expectations past 2016, whenever that may be.

And there are several billion in that shadow AUM spread across Strategic Credits, Real Estate Debt, etc., Mezzanine Fund IV, where, as that capital is drawn down, it will start generating management fees. And we would expect that to occur over the next couple of years or so at a pace that of course is impossible for me to predict. Long answer to a very good short question, so apologies. But sitting here today, with all the uncertainties inherent in anything, I would be surprised if you don't see management fees start to pick up later in 2016 and certainly as you get into 2017, when Opps Xb starts generating at least meaningful management fees.

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

Got you, thank you.

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**Operator**

Thank you. We have no further questions. Ms. Williams?

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

Thank you again for joining us for our first quarter 2016 earnings conference call. A replay of this conference call will be available for 30 days on Oaktree's website in the Unitholders section, or by dialing the following numbers: 866-423-4835 in the US or 1-203-369-0847 outside the US.

That broadcast will begin approximately one hour from now. Thank you, see you next quarter.

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**Operator**

That concludes today's conference. Thank you for participating. You may now disconnect.

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