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OAK - Q3 2016 Oaktree Capital Group LLC Earnings Call

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PRESENTATION

Operator

Welcome and thank you for joining the Oaktree Capital Group third quarter 2016 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. William, you may begin.

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

Thank you, Laura, and welcome to all of you who have joined us for today's call to discuss Oaktree's third 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 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 funds. 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 that information shared 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 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 $0.65 per Class A unit payable on November 14 to holders of record as of the close of business on November 7.

Finally, we plan to issue our third quarter Form 10-Q at the end of next week.

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

Jay Wintrob - *Oaktree Capital Group LLC - CEO*

Thank you, Andrea, and hello to everyone on the webcast.

For the second consecutive quarter, Oaktree achieved year-over-year growth in all earnings metrics: fee-related earnings, adjusted net income, and distributable earnings. Our nine-month results also compared quite favorably to the same period last year, reflecting improved investment performance and higher levels of incentive income from closed-end fund realizations.

Much of the latter arose in Europe where our nearly 12-year investment in building one of the industry's strongest private equity teams is bearing fruit. It is natural that a strong realization environment will not simultaneously offer plentiful bargains and thus we're maintaining our "move forward but with caution" investing posture.

That said, our teams continue to be resourceful in identifying attractive investments, as Bruce will discuss, but overall we are a net seller in the current environment.

Returns on existing investments were strong in the third quarter. Our closed-end funds generated an aggregate gross return of 5.3%, bringing the year-to-date return to 8.9%. Distressed debt had a 4% gross return, reflecting continued strength in some public equities and real estate-related holdings.

Our highest quarterly gross return was in Global Principal at 18% as the strategy benefited from certain public equity holdings such as AdvancePierre Foods, which we took public last July. Real Estate Debt generated an 11% gross return, Real Estate Opportunities a 2% gross return, and Emerging Markets Opportunities Fund a 7% gross return as our team nimbly navigated the recent political turmoil in Brazil. European Principal had a gross return of 5% in the quarter, more than reversing its Brexit-related negative 3% in the second quarter.

In terms of closed-end fundraising, during the third quarter we raised $1.2 billion of capital primarily consisting of Real Estate's new Value-Add strategy, which is closing on large separate accounts in advance of our anticipated marketing of a comingled fund, and the first close for Oaktree Infrastructure Fund I. Additionally, we held a close for Real Estate Opportunities Fund VII and expect that fund to reach approximately $3 billion in committed capital by the end of the year.

In terms of fourth quarter closed-end fundraising, earlier this month we raised $400 million for Real Estate Debt Fund II and finally in this quarter and into early 2017, we are expecting to hold additional closes for Opps Xb, Infrastructure Fund I, European Capital Solutions, European Principal Fund IV, and again for Real Estate Debt Fund II.

Investment performance in the third quarter was solid across our open-end and evergreen funds. Even though strong markets do not always reward our emphasis on risk control and thus can cause us to lag benchmarks, it is noteworthy that the Emerging Market Equities, US and Non-US Convertibles, and US Senior Loans strategies had 11%, 7%, 4%, and 4% gross, respectively. All excelled on both an absolute and relative return bases in the quarter.

Emerging Market Debt Total Return and Strategic Credit were standouts among the evergreen funds with gross returns in the quarter of 7% and 6%, respectively.

Now several of the strategies I just named are among the nine new ones that we have launched since 2011, demonstrating Oaktree's ability to innovate in response to client demand. Over the past year, this cohort further grew by $1.5 billion to $18.4 billion of AUM. And you should expect additional strategy innovation in the future.

Today we announced the appointment of Steven Gilbert to Oaktree's Board of Directors. We're looking forward to leveraging Steve's over three decades of experience in our industry and benefiting from his valuable perspectives as a Board member. This news coincides with the retirement of Steve Kaplan, Director, Principal, and Founder of Oaktree's Global Principal Group. Steve will also transition to serving as an Advisory Partner and step down from Oaktree's Board effective December 31, 2016. We thank Steve for his many contributions to Oaktree over the past 21 years and look forward to his continued support through his role as an Advisory Partner.

In closing, I would like to say a few words about our announcement this morning regarding the retirement of one of our most esteemed Oaktree family members, David Kirchheimer, and the promotion of one of our most talented and well-respected colleagues, Dan Levin, to Chief Financial Officer. As many of you know, David has been with us since Oaktree's founding, having joined us as employee number one. He has contributed greatly to Oaktree's success via the expansion of our global infrastructure, hired and developed many of the firm's department heads and next-generation leaders, readied the firm to be an enduring public company, established and nurtured important banking and investor partnerships, and perhaps most importantly, has been a consummate carrier of the Oaktree culture.

As transitions go, this one has been considered for quite some time and we have taken steps to make it seamless. In that vein, Dan Levin, Oaktree's Head of Corporate Finance and Chief Product Officer, will assume David's responsibilities as CFO effective April 1 of next year.

Dan joined Oaktree from Goldman Sachs in 2011 and since then has contributed significantly in the areas of corporate development, financial planning and analysis, and product governance. For several years, David and I have worked closely alongside Dan, who is supported by an accomplished team of department leaders with extensive Oaktree tenure. We have every confidence in Dan and the entire finance organization to ensure continued excellence across these functions on behalf of Oaktree's many constituents.

With that, I'll turn it over to Bruce to cover the investment landscape.

Bruce Karsh - *Oaktree Capital Group LLC - Co-Chairman and Chief Investment Officer*

Thanks, Jay, and hello, everyone. After a relatively strong second quarter in the global credit markets, investors' thirst for yield did not abate in the third quarter. The US high-yield bond market continued its strong rally primarily driven by a low interest rate environment and the stabilization of global commodity prices, both of which outweighed any short-lived concerns over central bank monetary policy changes and political uncertainty.

As central banks maintain their accommodative stance, trillions of dollars of Asian and European sovereign debt are trading with negative yields. US high yield bonds, followed by leveraged loans, continue to offer the highest returns across the universe of marketable debt securities, resulting in global funds flowing in as managers seek to deploy high levels of cash and meet return targets.

In the third quarter, the European high yield bond market shrugged off Brexit concerns to deliver its best quarterly performance in nearly four years. Concerted action by the region's central banks was among the key drivers, with both the European Central Bank and Bank of England actively engaged in corporate bond purchases. The trickle-down effect of those QE programs helped push up high yield bond prices, boosting year-to-date returns to heights that few investors expected when the year began. These market surprises underscore why at Oaktree we place virtually no reliance on market forecasts, instead choosing to follow a bottom-up, fundamental, value-based approach.

In our closed-end funds, most notably in the Opps Funds, we have continued to find value in a few interesting pockets. We also have continued to sell bonds as yields have come down. As prices for some of our holdings reflect limited probability of a company needing to restructure, we can recycle the proceeds from these investments into new opportunities. Two attractive areas for new investment include buying assets of non-performing loan pools from European banks and privately sourcing opportunities on the energy front.

For example in August, we formed an entity to acquire and develop acreage in the Delaware basin of West Texas, a sub-segment of the Permian basin. We teamed up with an experienced management team led by long-time energy executives in an effort to obtain superior risk-adjusted returns by developing premier acreage without bearing significant commodity pricing risk.

In our Global Principal Funds, the third quarter's strength in the US leveraged debt markets resulted in another subdued quarter for distress-for-control purchases. That said, in October, the team successfully closed on an attractive structured private equity investment in SunOpta, a leading global food company focused on organic, non-genetically-modified and specialty products. This investment builds on our team's successful track record in food companies.

Looking ahead, how do we view the current market risks and uncertainties in the context of prices that in many cases strike us as elevated? Among the risks is the chance that the market is leaning the wrong way by assuming capital flows into US assets will remain strong. Those flows could reverse, of course, as central banks outside the US begin tapering asset purchases or in other ways start trimming their monetary stimulus.

Other risks center on possible economic weakening in Europe post Brexit, or in China where ongoing currency devaluation could trigger another downturn in commodities. Conversely even if these or other downside risks materialize, the insatiable thirst for yield may continue to cushion the market against any prolonged sell-off. Thus our mantra remains the one Jay mentioned, "move forward but with caution". It has set the right tone over the last five years, not shying away from investing but insisting on a significant element of selectivity.

Meanwhile you can expect us to maintain our focus on realizations. I look forward to answering your questions. But now I am delighted to turn the call over to David.

David Kirchheimer - *Oaktree Capital Group LLC - CFO*

Thanks, Bruce. Good morning, everyone. The third quarter definitely was a strong one. At the outset, however, I want to caution that the quarterly year-over-year comparisons can be overly flattering because amid weak financial markets, last year's third quarter generally had the lowest quarterly income results of 2015. In contrast, this year's third quarter benefited from particularly strong markets, driving the highest net incentive income in six quarters and the most investment income since 2013.

For the third quarter, adjusted net income grew to $162 million or $0.92 per Class A unit from just $0.15 a unit a year earlier. For the nine-month periods, ANI rose 56% to $410 million from $262 million in 2015. Gains in all three income categories -- fee-related earnings, incentive income, and investment income -- drove the increases for both the quarter and year-to-date periods.

Distributable earnings followed suit. For the third quarter of 2016, they rose 46% over last year's third quarter to $141 million or $0.82 per Class A unit. The increase in distributable earnings was 15% for the nine-month period to $395 million or $2.21 per Class A unit.

Next I would mention economic net income, a metric that captures value creation because it recognizes incentive income on a mark-to-market basis rather than the realized basis employed by adjusted net income. Third quarter ENI was $264 million or $1.52 per Class A unit, up sharply from a year earlier and the highest in any quarter in nearly three years. Moreover, the quarter's economic net income was substantially higher than adjusted net income, reflecting the fact that net incentives created exceeded net incentive income recognized.

For the nine months ended September 30, ENI more than tripled to $471 million or $2.62 per Class A unit. For both the third quarter and first nine months of 2016, fee-related earnings grew 23% on a 5% increase in management fees. These gains reflect the initial effect of 2015's record gross capital raised. A considerable amount of committed capital still is not yet generating management fees. This so-called shadow AUM totaled $13 billion as of September 30.

Opps Xb represents $8 billion of that amount. To repeat what I said last quarter, including all the usual caveats about predicting the future, I wouldn't be surprised if quarterly management fees remained roughly around current levels until we begin earning full management fees from Opps Xb, which in the current environment we don't expect to occur until late 2017.

Fee-related earnings represent the most recurring and predictable income stream. But at Oaktree, investment income proceeds aren't too far behind in terms of dependability and the other characteristics associated with FRE. Our 20% stake in DoubleLine Capital coupled with our diversified portfolio of Oaktree fund investments produces a healthy level of cash flow. In fact the third quarter marked the 18th out of the last 19 quarters in which aggregate investment income proceeds exceeded $25 million. Together, fee-related earnings and investment income proceeds totaled $103 million in the third quarter and $279 million for the year to date.

Incentive income also was robust in the third quarter, reaching $52 million net of compensation. Six funds across five different strategies accounted for the underlying incentive distributions. Moreover, at $154 million, net incentives created was three times greater than net incentive income recognized. Thus, accrued net incentives rose 13% from last quarter's balance. Of the $873 million in net accrued incentives, about one-quarter represents either evergreen funds or closed-end funds that are currently paying incentives.

Lastly, with respect to the current fourth quarter, currently known incentive income net of compensation expense and fund-related investment income proceeds are estimated to be roughly $1 million and $6 million, respectively.

Finally in closing, a few words about my upcoming retirement and I want to start with a thank you to Jay for your very gracious comments. It's been a great honor and privilege to have served Oaktree's stakeholders including all of you, our unitholders, to have worked alongside my friends and partners in building Oaktree, and to have led an employee team that is second to none.

As both CFO and a fellow Oaktree unitholder, I could not be more proud or confident in passing the reins to my friend Dan who will join me on this call next quarter and who has distinguished himself as a business partner and as a key contributor to some of Oaktree's most important initiatives and relationships. Moreover, the team Dan inherits is exemplary in every respect, thus Oaktree is in better hands than ever.

And with that, we are delighted to take your questions. So Laura, please open up the lines.

QUESTIONS AND ANSWERS

Operator

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

Michael Carrier - *BofA Merrill Lynch - Analyst*

Thanks, guys. Maybe first for Bruce. You mentioned a little bit in terms of the deployment in the investment environment and I just wanted to get some understanding given that it's somewhat unusual or atypical. Are there things that you guys are doing maybe any differently in terms of how you are looking at investing -- you know if we are in this kind of a long -- or a longer cycle and central banks being very involved?

And then also just when you think about that from a timing standpoint, when you think about when you raise funds and put money to work, your cycles becoming longer, how should we be maybe thinking about that?

Bruce Karsh - *Oaktree Capital Group LLC - Co-Chairman and Chief Investment Officer*

Right, one of the hallmarks of Oaktree of course is controlling and managing risk and the further we get along in the cycle, the greater the potential there is for risk and losses. So we tend to be very realistic about the pitfalls and as a consequence, we try to be quite careful in terms of not reaching for yield, not reaching for returns that would be imprudent and would be above and beyond the risk that we are prepared to accept as a firm and historically that we've done. So I think that would be the key.

As the cycle continues on, we tend to be quite realistic about the returns that we will accept and very, very importantly will not reach for a return and accept higher risk to obtain it. And our clients and LPs understand this and expect that out of us.

In terms of the prolonged cycle, one of the things that I mentioned is the fact that even if certain risks do materialize, there is a lot of cash out there looking for yield and so it's possible that buying opportunities may be shorter than had been the case in earlier times. And that's one thing that we thought about and we saw that earlier this year where there was a brief period of real opportunity, but the environment changed very rapidly in February and March of 2016.

Michael Carrier - *BofA Merrill Lynch - Analyst*

Okay, thanks. Then maybe as a follow-up, this I guess for either David or Jay. But when I look at the expenses and particularly this quarter, it seems like they came down and the FRE was relatively strong. I just wanted to get a little bit of perspective on the expense run rate, particularly if the fees turning on maybe take a bit more time. I know, Jay, you've been working on the operational side. And then David just when you guys look at the expense outlook, did anything change there and maybe the FRE level until the fees do turn on?

Jay Wintrob - *Oaktree Capital Group LLC - CEO*

Thanks, Mike. I think as a general matter things haven't changed. I think probably the best run rate to look at is the nine-month year-to-date number. The quarterly numbers are going to bounce around as you would expect for individual items. But I think the nine-month number is probably a reasonable one to anchor to.

As far as FRE goes, it was a strong quarter especially for FRE and FRE margins. I said previously that when we were in the high 20% for that margin that our first stop and our first goal was to get into the low 30% range, and that's still what we are generally focused on as a target. Over time, a longer time frame, probably when conditions are somewhat improved, in a number of respects we will look to see if we can get to the next level of maybe the mid-30s.

But I think the right target to think of for us is probably the low and creeping into the mid-30s over a longer timeframe, but no major changes. We continue on with a reasonable amount of discipline and focus on being conscious of our costs, budgeting, assessing our results, but no major changes.

Michael Carrier - *BofA Merrill Lynch - Analyst*

Okay, thanks a lot.

Operator

Alex Blostein, Goldman Sachs.

Alex Blostein - *Goldman Sachs - Analyst*

Great, good morning everybody, and congrats to both of you, David and Dan and all the best.

A question for -- on the realizations I guess first, so given your comments that you are more of a net seller, should we anticipate kind of the current pace of exits, roughly about $2 billion a quarter, to continue? But I guess more importantly, which ones do you guys anticipate to be the bigger contributors to this exit activity as we sort of try to figure out where we could see a faster catch up on this sort of the 80/20 waterfall with some of your larger accrued carry contributors?

Bruce Karsh - *Oaktree Capital Group LLC - Co-Chairman and Chief Investment Officer*

Alex, I'll take that. It's Bruce. It's hard obviously to pinpoint which funds are going to be realizing. I can just say in an environment like this, we are always looking for opportunities to realize. And our realizations probably were closer in the aggregate in the closed-end side to $3 billion this past quarter. I don't know what they're going to be in the fourth quarter. It's more likely that we will be looking to the earlier funds to realize, obviously, than the later funds. And that's really all I can say. We are very opportunistic about what we sell and what we realize and when we do it.

David Kirchheimer - *Oaktree Capital Group LLC - CFO*

By the way, Alex, I want to start my portion of this answer with saying thanks for the kind remarks on behalf of Dan and myself. We appreciate it.

All I would add to what Bruce said given the sort of main focus of your question in terms of the waterfall and net incentive income is a couple things. First as I mentioned in my remarks, about $225 million of the net accrued incentives is in funds that are currently paying incentives. So as you can see in the fund table, that's primarily Opportunities Fund VIIb and then we've got Real Estate Fund IV and a gaggle of other funds as well.

But I would also use this opportunity to plug what I also mentioned in my remarks about the investment income proceeds often overlooked but still a very nice, dependable source of distributable earnings from these realizations regardless of whether the fund is at the portion of its waterfall where it's paying incentives. In fact, thanks to the quarter's strong investor performance, total unrealized investment income proceeds grew to almost $300 million as of September 30, of which roughly half I think it's a little under $150 million to be specific, is in closed-end funds that are in their liquidation period.

And coupled with DoubleLine, which of course has continued at a very nice growth pace, almost doubling its AUM over the last couple of years, that gives a very nice, steady level of cash flow regardless of what our incentive income happens to be that particular quarter.

Alex Blostein - *Goldman Sachs - Analyst*

Thanks, super helpful. Then just my follow-up actually along the same lines, David, that you were just talking about. Just thinking through the reinvestment opportunities for some of these balance sheet exits, versus just returning them through DE. Do you guys think of them at all any differently in terms of a payout versus FRE or incentive income, or the realizations of the balance sheet just kind of follow the same methodology?

David Kirchheimer - *Oaktree Capital Group LLC - CFO*

They follow the same methodology. Distributable earnings is in one bucket. Cash is fungible. We have kept to this payout ratio of about 85% as you can see for now a couple of quarters or so and that is regardless of whether we are reinvesting or not. We benefit from a very strong balance sheet, strong access to the debt markets, etc. So we've got ample cash to maintain our healthy payout ratio and continue reinvesting in the business.

Alex Blostein - *Goldman Sachs - Analyst*

Makes total sense. Great. Thanks very much.

Operator

Chris Harris, Wells Fargo.

Chris Harris - *Wells Fargo Securities LLC - Analyst*

Thanks. So we have been on a lot of asset manager calls this cycle and actually going back a few quarters now, and there's been quite a lot of bearish sentiment about the Department of Labor's fiduciary rule, the impact on flows, and then also potentially fees. I know you guys aren't necessarily directly exposed to that. But thinking about your stake in DoubleLine, do those risks sort of alter how you are approaching that investment? I know you have historically viewed it more as a long-term investment but there's some thinking that there's going to be some pretty big structural changes as a result of this new ruling.

Jay Wintrob - *Oaktree Capital Group LLC - CEO*

Thanks, Chris. It's Jay. The short answer is no. First of all, related to Oaktree specifically, as you said, but I just want to underscore, we have been acting as a fiduciary for ERISA Plans and ERISA Funds since the beginning. So with just a few minor exceptions, the DOL fiduciary rule, now just being proposed early regulations interpreting the rule are really of little relevance to us in terms of our existing business.

On the DoubleLine side, I think our assessment of DoubleLine is that it has been an excellent strategic investment. We serve as an excellent partner of theirs. I am confident that they will course correct to the extent if necessary, if any, to make sure that their offerings and their distribution methodology is compliant with the DOL fiduciary rules. I don't have total visibility into what portion of their investments are in retirement assets broadly defined. But I don't think it changes the outlook for our investment in DoubleLine or from what I can see their prospects going forward as a growing mutual fund and institutional investment advisor business at all.

Chris Harris - *Wells Fargo Securities LLC - Analyst*

Okay, thank you.

Operator

Patrick Davitt, Autonomous.

Patrick Davitt - *Autonomous Research LLC - Analyst*

Good morning, thanks. So there's been a lot of press chatter about risky lending in the shadow banking sector and I imagine if that's the case, a lot of this stuff crosses your team's desk. So I have two questions around that. First, from what you can tell, is the press chatter fair in that private pools of capital may be doing more reckless lending?

Second, has the pace of deals that you would put in that bucket increased or decreased or been about the same over the last year?

Jay Wintrob - *Oaktree Capital Group LLC - CEO*

Let me just start. You might want to comment also, Bruce. As to the first part, sitting in my chair, it's very, very hard to assess the media versus the reality for two reasons. One, we just don't have insight into virtually any of our competitors and specifically what they are doing. And secondly, the categorization of direct lending or shadow banking or risky lending into one big bucket as one homogeneous thing really is not accurate. Private lending comes in a number of flavors, a number of levels of riskiness from senior secured, all first lien, secured second lien, unit tranche and quite frankly goes even further down the spectrum and I think that gets all caught up in the name direct lending. Some of it, obviously by its own design, has greater risks than others.

From what I see and from what I hear, I don't see any particular degree of aggressiveness or certainly recklessness in the loans being made by non-bank lenders versus bank lenders.

And then in the case of Oaktree, I guess I'll let Bruce comment. But I would say that we have been engaged in making private loans or direct loans for many, many years. Most of that activity resides in our strategic credit, mezzanine debt and/or European direct lending strategies, but it also leaks into some of the other strategies. And I don't think our standards or philosophy about risk versus reward has changed all that much over time. So there is a lot of media focus but it's really hard to validate the accuracy of the trend that you described as sort of increased reckless lending.

Bruce Karsh - *Oaktree Capital Group LLC - Co-Chairman and Chief Investment Officer*

Patrick, let me just add one or two points. First of all, I agree with Jay. I feel very comfortable about the direct loans that Oaktree is making. I don't feel that it's reckless in any way, shape or form. But harkening back to Michael's question about the cycle and where we are in the cycle, I think it's fair to say that as the cycle has unfolded, we have seen more and more aggressive loans being made.

I wouldn't characterize them necessarily as reckless at this stage but certainly much more aggressive than two years, three years, five years ago. And of course you are right that the regulated banks are stopped out in terms of the risks that they can take and in terms of multiples of EBITDA etc., and probably more of the aggressive loans and lending is taking place outside of the traditional bank markets.

I wouldn't characterize -- I tend to agree with Jay that it's hard for me to say at this stage, at a reckless stage. Certainly in the aggregate, there are pieces, pockets of loans, that are made that we scratch our heads and say wow that's very aggressive, but it's not on a level that I would say is worrisome in terms of the overall non-bank lending market.

Patrick Davitt - *Autonomous Research LLC - Analyst*

That's great, thank you.

Operator

Brian Bedell, Deutsche Bank.

Brian Bedell - *Deutsche Bank - Analyst*

Thanks, good morning. Also congrats to you, David and Dan, as well.

Maybe, Jay, if you can just -- sorry if I missed this -- but I know you talked about funds, closed-end funds that are in the pipeline right now for raising. Is it possible you could summarize what roughly that total amount is over the next couple of quarters that you would expect?

Jay Wintrob - *Oaktree Capital Group LLC - CEO*

I appreciate the question, Brian, but I really don't have a total that I'm comfortable sharing with you for especially in the timeframe like a quarter or two. But we do have a number of closed-end funds in the market. I won't repeat what we mentioned -- and then also continue to work on innovation in strategies. So that could lead to some additional offerings as we move into next year.

Brian Bedell - *Deutsche Bank - Analyst*

Right, I guess the funds that are, versus their predecessor funds, you are probably looking to raise roughly the similar amount. Is that a safe or higher?

Jay Wintrob - *Oaktree Capital Group LLC - CEO*

It really varies fund by fund. As you know, one of our hallmarks at Oaktree again is to try to raise capital commensurate with what we think the investment opportunities are. And so we aren't troubled -- or flip side we don't celebrate simply because the subsequent fund is bigger or smaller than the last one. We feel best when we are raising funds in a timely way that are commensurate with the pipeline of investment opportunities, and have a lot of confidence that if we underestimate the amount of demand, we can go back to our good clients and partners and raise funds relatively quickly again. That has been our history.

And so it's not -- as David or someone I believe mentioned, we continue to have near record levels of dry powder, so we believe we are very well-positioned should the opportunity set expand. And at some point, the absolute level of dry powder really isn't all that relevant. What's more relevant is what is the opportunity set and how comfortable we are at deploying strategy by strategy.

Brian Bedell - *Deutsche Bank - Analyst*

Right, right, maybe just as a follow-on to that then I guess looking out over the next year or so and I know the future is always hard to predict, but as you look at that opportunity set, and I know you mentioned I think Bruce you mentioned of course NPLs, the NPL strategy in Europe and privately sourcing energy assets a few specific opportunity sets. But I guess as we think about that over the next say 12 to 15 months, do you feel you are pretty well roughly sized in terms of your current dry powder versus those opportunity sets?

Bruce Karsh - *Oaktree Capital Group LLC - Co-Chairman and Chief Investment Officer*

Well, we certainly have a lot of dry powder and we are ready for an outsized opportunity if it were to materialize. Otherwise we are plugging along at a fairly decent pace of deployment where our various investment strategies and groups are finding interesting things to do even in this environment, investments that we feel very comfortable about from a risk-adjusted basis. And as I said earlier, we are not reaching for return in this environment, but this past quarter we deployed about $2 billion in the closed-end funds and we are very, very happy with some of the investments that we've made in some of our groups, very happy.

So if the environment doesn't change, we will keep doing what we are doing. If it does, we have ample dry powder to take advantage of it.

Brian Bedell - *Deutsche Bank - Analyst*

Great, thanks very much.

Operator

(Operator Instructions). Michael Cyprys, Morgan Stanley.

Michael Cyprys - *Morgan Stanley - Analyst*

Good morning, congratulations to David on the retirement and to Dan on the new role.

Just a question on Real Estate Fund V that continues to get closer to crossing the preferred return hurdle and has some very meaningful accrued incentives. So just given the pace of liquidations in Real Estate Fund V that we have seen over the past 12 months, it seems that should probably cross in the next few quarters if you just kind of assume a similar pace of liquidations. Is that a fair conclusion? Can you just help us understand maybe the types of investments that are in that fund so maybe we can try and spot that in the headlines?

David Kirchheimer - *Oaktree Capital Group LLC - CFO*

I will start and probably pass it to Bruce for a little more specific commentary on the investment expectations. You are absolutely right. So thank you -- by the way, thank you for the nice comment, Mike, at the start to Dan and me. I appreciate it. But also thank you for using our fund table for its intended purpose, which is exactly what you did. Yes, Real Estate Fund V is among those funds that made continued distributions in the third quarter and therefore is working its way closer.

Our crystal ball, and certainly mine is no clearer than yours so I don't want to commit on behalf of our real estate team, though it certainly has been the case in this market and in this year that for that fund -- Real Estate Fund IV earlier in the year that crossed over I think it was the second quarter and you're beginning to see it cross the Real Estate Funds that they certainly don't get sentimental about their investments and therefore are quick to capitalize on strong markets and selling to them, and therefore work their way closer to the point of paying net incentives. And in the meantime, of course we also reap the investment income proceeds that -- I love plugging -- that come in virtually devoid of any compensation, by the way, and so that goes straight into distributable earnings.

In terms of the composition, like I think is typical for the real estate funds, very well diversified across their broad range of a half dozen or so specialties. And so we don't get into the particulars of individual funds and the holdings, but I would say it's representative for among the strong real estate funds that we have here that have really delivered very consistent strong returns.

I don't know, Bruce, if you want to add anything to that?

Bruce Karsh - *Oaktree Capital Group LLC - Co-Chairman and Chief Investment Officer*

I'm not going to be specific about this particular fund but I will say just coincidentally, I ran into a senior member of the real estate group early this morning who told me they are very focused on realizations, and as I mentioned to Alex particularly in the earlier funds and Fund V was one of the early funds that they are focused on. In terms of the holdings, it's what you would expect with a lot of properties. And they have been realizing and they will continue to realize at a pace that optimizes and maximizes the value of that fund for the LPs and for Oaktree. So they are focused very much on that fund.

Michael Cyprys - *Morgan Stanley - Analyst*

Great, thanks for the color there. If I could just ask a follow-up, just on the net flows into fee-paying AUM, were little soft in the quarter. I understand you had some strong realization activity pressuring on the closed-end side, but just curious about the weakness on the open-end funds. It seems like you had some very good performance there, yet they were in outflows. So just curious if you could just help us think through the moving pieces there and also the outlook there too on the open-end side?

Jay Wintrob - *Oaktree Capital Group LLC - CEO*

Yes, I think that's a fair observation and that's one area that we've been focusing on quite a bit, and in particular we are focusing on what we should be focusing on, which is investment performance. I think you really have sort of three different phenomenon going on depending on which open-end strategy. It's been an excellent return year for certain asset classes such as high yield, here and in Europe, and so we do see some clients rotating or cutting back in that sector. As a general matter, not really specific to Oaktree.

In the second case, there are some open-end strategies we are involved in where, if you look at sort of industry flows such as for example Converts, especially US Converts, we have got that headwind and we have had that for several quarters as that market continues to shrink. And unless we alter the way we choose to invest or take undue concentrations, that is going to be challenging probably until rates rise and you see that market start to grow again.

Then I think in a couple of areas, some of our intermediate-term performance, probably US Converts and maybe US Senior Loans, have been modestly challenged and we've heard from some clients about that. The good news is that in those strategies in particular, and in Emerging Market Equities, the very recent performance has been very good and that's what we are focusing on. I think over the next several quarters, we will continue to improve upon some of the intermediate-term performance track records.

But I would say that we don't have an undue concern about this area. A lot of it is market-driven and we will continue our focus on trying to maintain good performance and continuing to develop our track record.

Michael Cyprys - *Morgan Stanley - Analyst*

Great, thank you.

Operator

Robert Lee, KBW.

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

I guess my question is really kind of more big picture, strategic. You clearly have had a large European business for a long time, but one place where I don't think you do too much is Asia and that is a place where you do see other alternative managers, whether it is in real estate or even some credit here or there, are starting to and have been and I think are starting to kind of even ramp it up a little bit. So can you talk about kind of what your thoughts are about the geographic expansion and more deeply or broadly into Asia?

Bruce Karsh - *Oaktree Capital Group LLC - Co-Chairman and Chief Investment Officer*

I will start and then turn it over to Jay. In Asia, on the distressed side in the Opportunities Funds, we are starting to add resources. We think that there is a real opportunity coming at some point and we feel it's prudent to start building in anticipation of that. So we have hired a key person in Singapore. We've hired a key person in Hong Kong and we're going to keep adding to those offices and be in a position probably better than we ever had in Oaktree's history to access the opportunities that we think are going to unfold in Asia over the next couple of years.

Jay Wintrob - *Oaktree Capital Group LLC - CEO*

I just want to underscore that if you follow our growth and headcount, especially on the investment side here, where the growth has been has been outside of the US and in particular not only in Asia but Australasia, so Australia also. And we have added resources, the real estate strategy, the principal funds and distressed. We also have a lot of good collaboration across some of the other strategies who may be able to participate in certain opportunities as they are identified. A lot of the recent headcount adds are focused on building relationships, sourcing potential transactions.

I should also mention in our Emerging Market Debt strategy, you may have read this quarter that we entered into a joint venture relationship with Virtus, which is a Brazilian investment bank, long-standing, doing business down in Latin America for similar reasons, trying to increase the sourcing and deal flow that we look at.

So we hope we are ahead of the curve by putting more people on the ground especially in Asia, Australasia and entering into arrangements elsewhere with others who can focus on sourcing. So we are ready to go when the opportunities and the opportunity set increases.

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

Great. Just maybe a follow-up on fundraising and newer strategies. I noticed that the Real Estate Value-Add is up and running with about $600 million-odd of commitments. It would seem like that's a potentially large strategy. I assume the pool of potential investments would be larger than an opportunistic strategy.

So are you still fundraising for that or is that more just kind of the first go-round, see how that goes and then as you've done in the past maybe in a year or two bring Fund II or III?

Jay Wintrob - *Oaktree Capital Group LLC - CEO*

We are continuing to fundraise. As we mentioned in earlier quarters, we are in effect seeding the strategy with a handful of large separate account clients and we are underway as you noted. Hope to have announcements about further progress in that regard when we speak next. And it is in anticipation of marketing a comingled fund under that strategy. I think you are right about the addressable market is significant, and more importantly we think it's very complementary to the resources we have that have done such a great job in the opportunistic side, and the relationships we've built with banks and borrowers and intermediaries in sourcing those deals over the past several years and growing that strategy quite nicely.

We don't have any targeted fundraise numbers, really don't have that in any of our strategies because we continue to be opportunistic. So I think the potential is there for that to be an important part of the real estate platform in the years ahead.

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

Great, that was it. Thanks for taking my questions.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Andrea Williams for any closing remarks.

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

Thank you again for joining us for our third quarter 2016 earnings conference call. The replay for this conference call will be available in approximately one hour after this broadcast on Oaktree's website in the Unitholders section. You can also access the replay by dialing 877-344-7529 in the US or 1-412-317-0088 outside of the US. Please use the replay access code 10093550. Thank you.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.
