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OAK - Q4 2014 Oaktree Capital Group LLC Earnings Call

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

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

## CONFERENCE CALL PARTICIPANTS

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

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

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

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

**Amanda Yao** *JPMorgan - Analyst*

## PRESENTATION

**Operator**

Welcome and thank you for joining the Oaktree Capital Group fourth quarter 2014 conference call. Today's conference call is being recorded. (Operator Instructions)

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

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

Thank you, Elon, and welcome to all of you who have joined us for today's call to discuss Oaktree's fourth quarter and full-year 2014 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 Co-Chairman Howard Marks, Chief Executive Officer Jay Wintrob, 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'd 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 Investors section of its corporate website to announce material information. Accordingly, Oaktree encourages investors, the media, and others to review the information that it shares on its corporate website at IR.OaktreeCapital.com.

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

Additionally, references to amounts per Class A unit are after taxes and other costs borne directly by Oaktree Capital Group. Today we announced a quarterly distribution of $0.56 per Class A unit payable on February 25 to holders of record as of the close of business on February 19.

Finally, we plan to issue our 2014 Form 10-K on February 27. With that, I'll now turn the call over to Howard Marks.

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**Howard Marks** - *Oaktree Capital Group, LLC - Co-Chairman*

Thank you, Andrea, and hello, everyone. As is our practice at year-end, I'll devote most of my remarks to our investing activities and the environment. David will cover financials, followed by Jay Wintrob, who as you know became our first ever CEO in November of last year.

Last quarter I told you that Jay embodied an ideal combination of fresh thinking and continuity with our culture and values. Since then he's more than validated our confidence in his leadership potential.

We'll soon mark the 20th anniversary of Oaktree's founding and the third anniversary of our IPO. While those are naturally times to reflect on past accomplishments, our focus is on doing even better in the future.

Oaktree was founded on the belief that doing right by clients is the surest path to the Firm's long-term sustainable growth and prosperity. While I believe that our record over the past two decades demonstrates the soundness of that guiding principle, the challenges and opportunities over the next 20 years demand more.

In Jay, we have the perfect leader to tackle the challenges, capitalize on the opportunities, and pursue even greater growth and prosperity. On Jay's first day, he sent a note to employees saying, quote: I'm not here to change Oaktree; I'm here to make it better.

I couldn't have been more thrilled with that message. In just three months, Jay has integrated smoothly into the organization and begun to make his presence felt in many constructive ways, the common denominator of which is engaging employees to the benefit of all Oaktree stakeholders. We are thrilled to have him working alongside us.

Now on to the main topic. I often say I'm not sure what to root for: bear markets, when our portfolio market values drop but we are able to sow the seeds for future gains; or bull markets, when bargains are hard to find but we harvest earlier investments and produce strong returns for clients and unitholders. The global financial crisis illustrated the former, while the subsequent period through 2013 generally characterized the latter.

2014 defied easy labeling. Equity indices went up, down, or sideways depending on market cap, industry, or geography. Fixed income markets also diverged, with government debt benefiting from continued aggressive monetary policy, while riskier corporate debt suffered from the possibility of increased defaults.

Against this backdrop, it's not surprising that our performance was also unusually dispersed, with the blended return for our markets and for ourselves well below the recent average. Across our closed-end funds we rebounded slightly from the third quarter's blended gross return of minus 1%, to the fourth quarter's plus 1%. That brought the full-year gross return for our closed-end funds to 9% in 2014 as compared with 22% in 2013 and a 20% IRR since inception.

Continuing with the theme from early last year, two of the areas where we are busiest investing, real estate and Europe, featured the highest returns. For the fourth quarter, real estate had a gross return of 8%, boosting its full-year return to 28%, while European Principal generated a 5% gross return in the fourth quarter, pushing the full year to 20%.

Distressed debt, while benefiting from cross-holdings with real estate, suffered for a second straight quarter from market price declines in some public equity holdings. Quarterly and annual gross returns for the strategy were negative 3% and positive 1%, respectively.

The relative lack of distress opportunities of the last few years had caused portfolios to be relatively concentrated. As our funds age, we sell fully valued holdings, further increasing our concentration, and exchange some of the remaining debt holdings into equity in restructuring. The greater share of distressed debt portfolios in public and private equity holdings, now close to 60%, has increased the volatility of our quarterly returns.

Recall that the Opportunities Funds sold and distributed $24 billion back to their investors during 2011 to 2013, leaving just $11 billion among funds in their liquidation period as we entered 2014. That cyclically lower level of capital lessened the impact on our funds' since-inception returns of the quarterly and annual returns that I just described. That since-inception return remains strong at a blended 23% gross.

Over the past two years our closed-end funds have deployed a total of $15 billion, of which about $8 billion went into real estate investments. That real estate deal flow, which is up significantly over the prior two years, is testament to the global platform built by John Brady and his team.

Often working in concert with our distressed debt group, they've done a terrific job of sourcing and managing a broad range of very attractive investments. Prime among these have been commercial and hospitality properties, as well as non-performing loan pools bought from eager sellers in the US and Europe.

The fourth quarter featured an excellent example of our resourcefulness and internal synergy in real estate. Back in 2011 the real estate and distressed debt groups collaborated to form a specialty REIT in the middle-market sale-leaseback business that they named STORE Capital. STORE stands for Single Tenant Operational Real Estate.

Together with a management team that has worked together to 30 years and that we knew well, they proceeded to acquire a $2.8 billion portfolio of restaurants, health clubs, movie theaters, and supermarkets, to make STORE among the fastest-growing net lease REITs in the United States. After scaling the business and its strong cash flow, STORE executed an IPO in November, which was quite successful. The current price represents a 1.8 times multiple of cost and a 35% gross IRR for our funds.

Stories like this illustrate the successful growth of our real estate effort, which we expect to continue this year with the third new Real Estate Opportunities Fund in just the past four years. That pace is remarkable, given that these funds have four-year investment periods.

Moving on to open-end funds, 2014 also produced a mixed investment performance story, given a trend toward risk-bearing for much of the year, declining security prices in the second half, and performance concentrated in a few standout securities for some benchmarks. For example, in our high-yield bond and senior loan strategies, people often expect Oaktree to excel in more challenging credit markets like we saw in 2014. That's understandable, given our emphasis on risk control and our historical outperformance in down markets.

But our real strength is in constructing portfolios that perform with the market but embody less risk of default. In 2014, defaults generally continued to run at below average levels, meaning our potential to add value by avoiding them was quite limited. As a result, we generally did not outperform our benchmarks in these categories.

In US convertibles we underperformed the index by 6% in 2014 because, unlike the benchmark, we never hold securities whose underlying stocks soar to the point that the convertibles become what we call equity substitutes. Given this bias, our 2014 return was roughly what it should have been relative to the 5% gain for the Russell 2000, which is the index that's usually most closely correlated with convertibles.

To anticipate a question, let me address the impact of falling oil and other energy prices. Across the entirety of Oaktree funds, as of December 31, energy represented about 8% of our holdings. Needless to say, some of those holdings fell in price, contributing in part to the low returns in certain funds during the second half of 2014.

The good news is that we had better buying opportunities, which we were quick to exploit. For example, in the fourth quarter our distressed debt and value opportunities funds invested about $400 million in energy-related securities.

On the open-end fund side, we are underweight energy in many strategies. The biggest strategy, US High Yield Bonds, holds 13% in energy as compared with the benchmark's 16%.

For the past three and a half years, Oaktree's mantra has been: move forward, but with caution. With the recent arrival of some disarray and heightened risk aversion, events tell us it's appropriate to drop some of our caution and substitute a degree of aggressiveness.

Thus it's timely that we have commenced a sizable fundraising program for closed-end funds. Jay will address that topic; but first David will cover the financial highlights, as usual.

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

Thanks, Howard, and hello, everybody. I'll start with profitability before moving on to cash flow.

Fee-related earnings for the fourth quarter were $68 million, off 7% from the year-earlier period, while the full year's $253 million of FRE was down 3% versus 2013. Quarterly comparisons always have some noise, with annual ones being more meaningful.

The 3% decline for full-year 2014 contrasted with a 15% drop in FRE the prior year. The smaller percentage decline in this measure reflects the traction of newer products and a slower rate of growth in compensation and other operating expenses. Management fees from products launched in the last four years reached $56 million in 2014, up from $21 million in 2013.

Fourth-quarter incentive income was down on a year-over-year basis, consistent with the recent trend and our guidance. This drop reflected the natural tendency for incentive distributions to shrink and become more sporadic, given that crisis-era fund Opps VIIb is far along in its liquidation, coupled with the fact that most other closed-end funds are not yet at the stage of their distribution waterfall where Oaktree is entitled to incentive distributions other than tax-related ones.

Between the decline in incentive income and lower mark-to-market investment income on our corporate fund investments, as compared with the 2013 periods, adjusted net income was down 63% for the fourth quarter to $98 million, and 47% for full-year 2014 to $575 million. Distributable earnings slightly exceeded ANI at $122 million for the fourth quarter and $608 million for 2014, as proceeds from investment income were greater than the mark-to-market counterpart.

For full-year 2014, distributable earnings excluding incentive income amounted to $349 million, or over $2.25 per operating group unit, testament to our solid base of cash generation. Our quarterly distribution of $0.56 per Class A unit represents a payout ratio of 85% and brings aggregate distributions to $2.71 for 2014 and $10.31 per Class A unit since our April 2012 IPO.

Ample cash and liquidity allow us to invest in the future without impairing our healthy payout ratio. Our past product development investments bore significant fruit in 2014, as Jay will describe in greater detail. For now, I'll simply note that a year ago at this time we mentioned that 2013's gross capital raised of $12.5 billion represented a record for a year without a distressed debt fund.

I'm delighted to report that we achieved a new record in 2014, at $14.7 billion of gross capital raised. And that's before counting the $2.3 billion added with the Highstar acquisition in the third quarter. Of the $14.7 billion, $2.3 billion came in the fourth quarter.

As we mentioned on last quarter's call, we expect to raise approximately $20 billion in closed-end capital through mid-2016 or so. Please recall that management fees may not start immediately when the capital commitments are received.

As we have done at certain times in the past, the investment environment may cause us to delay starting a fund's investment period, and thus its full management fees, to prevent disproportionally impacting net returns to our clients. While the timing is inherently uncertain, over coming years we expect this slate of higher-fee funds to help produce higher management fees and fee-related earnings.

Adding to the positive outlook is our 20% stake in DoubleLine Capital, which produces income and cash flow that in most respects are identical in character to fee-related earnings. In 2014, DoubleLine's AUM grew 30% to $64 billion, evidencing the five-year-old firm's rapid rise to top-tier status among bond managers.

We received $47 million in distributable earnings from DoubleLine in 2014. But recall that we carry the investment on our balance sheet under equity method accounting at just $20 million.

Finally, let's look briefly at the current first quarter which is underway. To date in the first quarter we have had no incentive income and $4 million of investment income proceeds.

Other than tax-related incentive distributions, we currently have limited visibility regarding incentive distributions by closed-end funds over the remainder of this quarter. We do expect to recognize incentive income in this first quarter from tax-related incentive distributions paid by closed-end funds that generated taxable income in 2014 but aren't yet paying incentives.

It's too early to make a precise estimate, although current indications are that net incentive income from tax-related incentive distributions will be roughly $40 million to $45 million. With that, it's now my pleasure to turn the call over to Jay.

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

Thank you, David. It's been a real honor joining you and Howard and the rest of the team at Oaktree, and I look forward to meeting many of you on this call in the months to come.

My journey to becoming the first CEO of Oaktree began when I started working with Bruce Karsh in 1982 as a lawyer in Los Angeles, in an office right next door to where Oaktree is headquartered today. I then became an Oaktree client in the 1990s, when I worked for Eli Broad and we invested in the first special credits fund in 1988, when Howard and Bruce were at TCW, and in the first Oaktree funds at inception.

What impressed me then and what I know remains the foundation of Oaktree's success today is, first, the enduring pursuit of superior risk-adjusted investment performance; and second, transparent, fair and principled business practices in all that we do. As a client of Oaktree, the communication of the Firm's mission, investment philosophy, and business principles, the performance of its funds, and the commitment to putting the client's interests first was always clear. And it remains so today.

In 2011, after a professional relationship and friendship lasting 30 years with Bruce and 20 years with Howard, I was honored to be elected to the Oaktree Board of Directors. I have participated in many of the significant events of the last few years, including our IPO in April of 2012.

As a Board member, my appreciation for Oaktree and our position in this young industry has grown tremendously. The public alternative asset managers are in the early stages of what I believe is one of the best growth opportunities in financial services.

The strong demand for investment management comes from individuals and from institutions serving as fiduciaries for individuals: individuals relying on pension and defined contribution plan payouts, on grants from endowments, benefits from insurance companies, and support from government programs. That demand will continue to grow as populations around the globe get older and people live longer, as government entitlement programs designed to support retirees fall short, and as individuals realize their personal savings efforts are often too little or too late.

Oaktree is very well positioned to take advantage of this growing demand, with strong footholds in a number of diverse strategies, a sterling reputation in the industry, and the steady and growing support of our Limited Partners, as evident from our recent fundraising success.

So as we head into 2015 and seek to thoughtfully expand and diversify our investment fund offerings, broaden and deepen our distribution relationships, and further grow our footprint and capabilities globally, I believe my experience in growing financial businesses in complex, highly regulated operating environments will serve Oaktree well.

The foundation for a confident outlook for Oaktree resides in our strong marketing pipeline for both established and recently launched products. Recently launched funds, including those focused on senior loans, strategic credit, emerging markets debt and equities, as well as in real estate, comprised 51% of the total gross capital raised last year, or almost $8 billion. Our largest-ever marketing pipeline will further that growth in 2015 and beyond.

Having deployed nearly all of its available capital, distressed debt will soon start accepting commitments to Funds X and Xb, for which we eventually expect $10 billion of aggregate committed capital. Another $10 billion is expected to be raised among several other closed-end funds in the next 18 months that are in the market now or will be later this year.

Power Opportunities Fund IV will have its first and possibly only closing this quarter. By early in the second quarter, we expect to hold the first closing for Real Estate Fund VII, followed later in the year by our inaugural infrastructure fund.

When I arrived last November it was clear that Oaktree is an outstanding Firm with a superb reputation, and the highlight of my first 100 days at the Firm has been meeting and working with so many truly dedicated and talented professionals.

Thus, as I told our employees on my arrival and as Howard said, I was not hired to change direction at Oaktree, but rather to make Oaktree even better by driving our focus on achieving excellence in investing, increasing efficiency and profitability, and pursuing appropriate growth opportunities. After all we've accomplished in building a leadership position in the market and in earning the trust of our clients, the challenge ahead is to strengthen the foundational cornerstones of Oaktree.

I believe we can build a more sustainable, enduring firm that can capitalize on growth prospects while remaining true to our investment philosophy, business principles, and bedrock belief that our clients and employees deserve to be treated fairly. With that, we look forward to answering your questions; so, Elon, we can open up the lines for questions.

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## QUESTIONS AND ANSWERS

**Operator**

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

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

Thanks, guys. Just first question, I guess, Howard, you went through some of the performance strengths and then some of the challenges in the quarter. So partly a question for you and then partly for David.

It looks like Opps IX, the performance in the quarter took a bit of a -- had some pressure. So just wanted to understand: what drove that? What's the outlook here for the fund?

Then, David, you mentioned in the text just in terms of the acceleration on the ENI side, what that can do to the mark-to-market. So just wanted to understand that and if any other funds contributed to that.

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**Howard Marks** - *Oaktree Capital Group, LLC - Co-Chairman*

Mike, it really is what I said. We got tagged in a couple of equity positions; and since the environment during Opps IX's life has been non-distressed, that fund has done rifle-shotting rather than a shotgun approach like Opps VIIb, which had large numbers of distressed companies to choose from.

So you start off with a more concentrated portfolio, and in some cases you convert positions. You either take positions in equity, or more likely convert positions into equity.

And then as it happens, some of our industries were the ones that were in decline in the fourth quarter, obviously, like energy. So we don't think that the performance in the fourth quarter says anything about the long term, but we ran into a considerable bout of volatility.

Another example I think would be drybulk shipping -- we've taken a large and diversified position in shipping, and drybulk was doing the best. And in the fourth quarter that reversed and drybulk did the worst.

But nothing fundamental changed, and we don't think that it has any implications for long-term performance.

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

And, Mike, just to address the ENI impact, when we had negative returns like you referenced, of course that caused negative incentives created, which in turn caused a small amount of pretax ENI which ended up being negative after-tax. So specific to Opps IX, I would just mention that and anticipate maybe a follow-up question from you, that with where it stood as of December 31, the fund would need a little under 4% return to regain the level at which it's creating positive incentives.

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**Howard Marks** - *Oaktree Capital Group, LLC - Co-Chairman*

I'll just add, in conclusion, that these are the periods that make us glad that we don't take incentives created onto the financial statements. And so we are never faced with having to un-earn income that we previously recognized.

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

Okay, that's helpful. Then Jay, maybe you'd just -- you hit on some of the areas that you're going to focus on in terms of maintaining performance, the profitability, and the growth. I know it's still relatively new for you.

But just, when you look at Oaktree, if you had maybe one area where you want to focus on to make it better, and then one of the areas -- maybe just given your background -- where you see the growth opportunities, where you could add value given your experience.

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

Thanks, Mike. I'm going to cheat a little bit. I think there's probably more than one in both categories. But, look, I think there's opportunities at Oaktree for improvement across the board. There's really nothing that's off limits.

But I mentioned earlier the Firm is in excellent shape and the opportunities are just to make it better. Obviously I think in the area of products the firm has done a very good job the last few years in establishing new open-end and evergreen strategies; plus bringing in the Highstar group, which will be the backbone of the new infrastructure fund later this year. I would hope that there'd continue to be no shortage in creativity about possible new opportunities in the future that may arise there.

I think on the distribution side, with the launch of our two new mutual funds in December, which are still very, very early in their life, it's obvious though that Oaktree is underweight exposure in retail, sub-advisory arrangements, also in the management of insurance money as compared to its core Limited Partners in the pension, both public and private, side and endowment side. So there's opportunities there.

And roughly three-quarters of our clients are based inside the United States and only a quarter outside the United States. So obviously without going region by region, there is opportunity there. And I think there is a lot of activities in flight to accomplish things in all three of those areas: product, distribution, and geography.

Then in terms of focus, it's fair to say, initially I've spent more time internally and less time externally -- meeting people, becoming comfortable, so I could be authentic about what I'm speaking about. I think that my background in operations and managing a large organization has me, at a minimum, asking an awful lot of questions, asking for an awful lot of data. And I think through that process we will find opportunities to become more efficient, possibly to do things a little bit differently, that allow us to leverage our people more.

So I'd say there's opportunities throughout, both on the growth side and also in terms of over time improving our profitability.

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**Howard Marks** - *Oaktree Capital Group, LLC - Co-Chairman*

I would like to add one word, Jay, and that word is systematic. What I see in what Jay is doing is that he is taking a systematic approach to understanding and managing our operations. That illustrates in good part why we brought him in, because he is a professional manager, whereas his predecessors were not.

I think that his systematic approach, while not dogmatic or inflexible or mechanistic, can't help but have a great effect.

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

Okay, thanks a lot.

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**Operator**

Michael Kim, Sandler O'Neill.

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

Hey, guys. Good morning. First question, just given the volatility in the credit markets more recently that you mentioned, just curious where you stand in terms of being able to fully capitalize on opportunities that may present themselves. Has the scale or timeline for Opps X and Xb shifted at all, just in light of making sure you have the capacity in place should things start to maybe move a bit more quickly?

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**Howard Marks** - *Oaktree Capital Group, LLC - Co-Chairman*

Well, we have about $10 billion in dry powder at the present time, which is a lot of money. And as you know, we are targeting another $10 billion for Opps X and Xb. The first close of those funds is days away, and we think that it will be a substantial close.

The beauty of the A/B fund structure is that it gives us flexibility, and the recent events do a lot to illustrate the need for or the desirability of flexibility. If the distressed environment were to remain slow, then after completing Fund IX we would have a $3 billion Fund X -- approximately $3 billion, based on our targets. If the environment were to darken further, such that there is more distress, then at our option we can swing into investing the capital for Fund Xb whenever we want.

So the point is we already have a lot of capital with which to move if it's appropriate. And especially through X and Xb but also the other funds that we talked about, we're going to have a lot more.

Flexibility is not inherent in the investment management business, especially in the closed-end fund business. But our A/B structure which we've been using for the last -- well, we actually imagined it 25 years ago -- has given us a lot of flexibility and permitted our best-performing funds to be our biggest funds.

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

Got it. That's helpful. Then in terms of the percentage of your accrued incentives that relate to funds currently paying incentives, if I'm doing the math correctly, it looks like that ratio stepped up from about 36% in the third quarter to 42% as of the end of December, which I think is the highest percentage we've seen since the third quarter of 2013. I understand part of that is just a function of the lower denominator, just given some negative incentives created during the quarter and realized gains.

But can you just maybe walk through some of the drivers behind the higher numerator, if you will? It looks like Opps VI crossed over last quarter. I mean more broadly --

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

It's primarily Opps VI, Mike. So while I appreciate your pointing out and we like the percentage going up as opposed to down, I wouldn't place too much importance on that.

It's more Opps VI just doing as we had been talking about it doing, which is working towards being in the status of paying incentives, joining Opps VIIb, a few other funds. So yes, you hit it on the head.

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

Yes, okay. Then just maybe more broadly the thought or the outlook for incentive income going forward. I know you gave some color in terms of the first quarter, but just beyond that would be helpful.

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

Sure, yes. First quarter, for now all I'm seeing are the tax-related incentive distributions. That may change; but it may not.

But in addition to the 42% or so that you mentioned as the portion of $1 billion of accrued net that's currently paying incentives, there is about another 30% -- I think it's 32% -- that resides in closed-end funds that are in the liquidation period, but simply have not gotten to the point of their waterfall, where we're entitled to incentive distributions.

So all together obviously, that means about three-quarters of the $1 billion is in closed-end funds in liquidation. And certainly in the meantime, while the second half of 2014 was off for a couple of strategies, real estate was up. There are a lot of strategies that have very good momentum going into 2015.

So that accrued net we consider to be still strong, but we guide to continued moderation in terms of near-term incentive income, in terms of where the pipeline is, just like we had in 2014.

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

Fair enough. Okay. Thanks for taking my questions.

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**Operator**

Michael Cyprys, Morgan Stanley.

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

Hey, good morning. Thanks for taking the question. Jay, you mentioned some of the opportunities on the retail side and distribution. Just given your background, I was wondering if you could elaborate a bit more on the opportunity there. How are you thinking about increasing distribution and getting on the DC plan menu?

What do you see as some of the hurdles? And what should we be thinking about in terms of what the time frame might be?

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

Well, the good news for Oaktree is that, because of its strong relationships with a lot of the large firms that have significant wealth management platforms, on ancillary business I've actually been very impressed with the relative ease of access to the decision makers for a firm that's mainly been focused on institutional marketing. Having said all of that -- and I guess I'd add to that, a lot of the consultants that Oaktree works with on the institutional side also are involved on the defined contribution side. So there's another good point of access.

Having said all of that, the key really is the product set, and having the right open-end and/or evergreen structures that are suitable for the institutional product lines. I think that's what needs to develop more over time.

We started these two mutual funds with two of our most liquid and to some extent least alternative asset classes: high-yield bonds and emerging market equities. And we are in that process of needing to build up a longer-term track record, of course, to do that.

We also have a couple of products that we are currently either distributing or about to distribute -- not in large amounts, but in reasonable amounts -- through high net-worth platforms that include sleeves or parts of our closed-end funds. We look internally at developing certain products -- by way of example only -- such as target date funds, but target date funds that would both be suitable for the defined contribution market and would be appropriate for certain of Oaktree's strategies.

The fact is if you look at the largest fund flows on the retail side, they tend to be in obviously the large public equity markets or investment-grade debt markets. And those are not areas that Oaktree has focused in previously and not really part of our focus currently.

So the real issue is having the product that suits the retail side and/or developing our distribution of closed-end funds in part on the high net-worth platforms, and we are seriously committed to that. By the way, I should be clear that that initiative began before my arrival.

It's small, but it will grow over time. But I do think there is an opportunity there.

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

Okay, thanks. That was helpful. I guess just on the deployment side, I think Howard mentioned real estate and Europe are areas of deployment opportunities right now. Just curious if you could elaborate a bit more around that, just in terms of the types of real estate properties or specific geographic regions.

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**Howard Marks** - *Oaktree Capital Group, LLC - Co-Chairman*

Well, in the States obviously when you have a big gain like we had in our funds in 2014 it indicates that prices have been on the move. So one side of the coin is appreciation, and the other side of the same coin is the diminution of subsequent opportunities.

But we think that the opportunities in commercial in non-prime cities and non-A buildings is still superior. It's an area where, for the most part, we think prices are not back to pre-crisis highs in the US. So we are continuing to be quite active in the US.

At the same time, we are also active in certain parts of primarily Western Europe, such as Germany and the UK, with less activity elsewhere. The US and Europe constitute the vast majority of our activity.

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

Okay, thank you.

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**Operator**

(Operator Instructions) Brian Bedell, Deutsche Bank.

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

Hi, good morning. Jay, maybe if you could talk a little bit more, explain a little bit more on the open-end and evergreen effort. Are you feeling that there is any capacity constraints as you attempt to tackle these markets, in terms of the investment staff and the product range that you have?

Then just to dovetail with that, do other acquisitions of teams like Highstar -- is that something that you are thinking is a good intermediate to long-term strategy to develop that?

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

Thanks, Brian. I don't think capacity constraints are a serious concern with regards to the open-end strategies. In fact, obviously I think when you launch open-end strategies, given the distribution and such, I think you have to be long-term committed there. And I think we are. So I don't feel that capacity is our issue on our current open-end offerings with respect to that.

And the second part of your question was --?

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

Around Highstar --

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

Oh, the other -- I'm sorry, like Highstar? Yes, I guess I'd say Oaktree being an opportunistic firm in large part, sure, other acquisitions are a possibility. It's sensitive. It's people; you have to find the right group, the right structure, right timing.

But we continue to, fortunately, have opportunities to look at individuals, small groups. There is movement, and there will be movement.

I think having successfully integrated the Highstar team and about to launch the first infrastructure fund just burnishes our image and reputation with others, that we can do this right and have had experience in it. So I think that bodes well for the future. But again it's opportunistic, and we have to find the right people in particular that will fit well with the Oaktree culture.

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

Right.

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

And if I might -- back on the prior question, Howard, if I might, on the real estate, I just wanted to say that continued low interest rates obviously helped a lot of the borrowers refinance -- effectively kick the can down the road. But speaking with John Brady and his team, I think the volume of what they like to call zombie real estate -- real estate that continues to be worth less than the face amount of its debt, but debt that has very, very low debt service -- continues to be ample.

So the circumstances could change relatively quickly over the next several years, where you have a lot of debt maturing on real estate that is not worth as much as the face value of the debt. John and his team have made that an important part of their real estate efforts. I know they continue to track that like a hawk. So it gets another opportunity down the road possibly.

**Howard Marks** - *Oaktree Capital Group, LLC - Co-Chairman*

Then I'd like to, as they say in the Senate, extend and whatever -- my remarks. Your question I only answered about real estate. I didn't answer about European activities per se, non-real estate.

I just want to say that we see continued very strong deal flow of loan pool offerings. We do not feel that there is any reduction in the opportunity from that source. It has been strong for about two years now and continues to be very good.

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

Great. Maybe just a follow-up. Howard, you talked about how you didn't know what to root for in terms of the bull or bear markets. Obviously it's a tough call to try to predict what will happen.

But am I right in surmising that, as you are raising the $20 billion over the next six quarters in closed-end funds, plus the raises on the open-end and evergreen funds, that you feel like you are coming into a much stronger fee-related earnings profile that would potentially offset any negative marks from downward pressure on credit?

**Howard Marks** - *Oaktree Capital Group, LLC - Co-Chairman*

I would prefer to say that there is a good chance we are coming into a better period in terms of securing investment opportunities. We have three jobs to do: raise money, invest it well, and harvest when the time comes. Really the most important moving part for us I think is the invest-it-well part.

By definition you can't invest it well and harvest well at the same time. In high markets you harvest; in low markets you invest.

The whole train or process starts with good investments. So we are not going around high-fiving in an environment like 2013 or 2014 where the investment pickings are slim. We prefer it when securities are in the bargain basement, and investors are depressed and panicky and forced sellers.

We haven't had that. And we feel that if we buy cheap, there will always come a time eventually when we can sell dear and harvest more earnings and incentives.

As I say, the whole thing starts with buying cheap. And we kind of lick our lips when the market becomes more in disarray.

And there is a chance of that. There's a chance of that.

There is no ground on which to predict it at the present time, merely to say that within the investment period of Opps X and Xb, Real Estate VII, and Power IV, and some of these other funds, we'll hit the 10th anniversary of the crisis. And recessions don't come along like clockwork, but 10 years since the last one usually gives us reason to believe that the economy may be less than buoyant.

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

Okay, great. That's very helpful. Thank you.

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**Operator**

Ken Worthington, JPMorgan.

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**Amanda Yao** - *JPMorgan - Analyst*

Hi, good morning. Thank you for taking my question. This is Amanda Yao stepping in for Ken.

Believe it was mentioned during the last call that fundraising is migrating towards closed-end funds where the fee rates are higher. But can you talk about any additional nuances we should keep in mind that may weigh on fee rates within other closed-end funds or evergreen funds?

Here we see evergreen management fee being down 10 bps compared to the last quarter of last year. Just trying to understand what drove that and if we should expect rates to stabilize going forward.

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

Hi, Amanda. First to address the question at the end about evergreen funds, all of these are high-class issues, or at least how I view them. It's the growth of the lower fee products that have been quite popular the last three or four years -- lower fee because they are in lower return areas.

Specifically for Evergreen funds that would be Strategic Credit. So as that strategy has drawn down more capital -- and that's one of those strategies where the management fees are not based on committed capital, instead based on drawn -- and as Edgar Lee, the PM of it, sees investment opportunities and chooses to draw it on the capital, well, of course, that reduces the blended fee rate for Evergreen funds.

And to your first question about the nuances, well, I would just reference my prepared remarks, where it is important to recognize that with closed-end funds raising the capital is not necessarily, and usually does not immediately translate, to earning full management fees on that capital. Instead, we certainly have and we would expect in the future to start some of these funds' management fees based on drawn capital and to delay starting the official investment period.

It's only during the investment period of the funds that the management fees for Opportunities Funds X, Xb, Real Estate Fund VII, Power IV, the funds that Jay and Howard have already alluded to, it's only when the investment periods officially start -- which is up to us and up to the PM -- that the full management fees are earned on committed capital. Before that the fees are going to be lower.

And it's unknowable what the pace of investing will be for those funds and when the PMs will elect to turn on the investment period. So therefore it's unknowable as to when the fees will start at their normal full level; and that will affect the average management fee rate because those closed-end funds are at average levels of about 1.5% of committed capital per year. So all things being equal they will pull up the overall blended rate for the Firm. But, meanwhile of course, it may well be the case that these lower-fee products, the ones that we've raised a lot of capital in the last few years -- emerging market equities, you've seen the senior loan product, etc. -- that they may continue.

To Jay's observation about capacity limits really not being an issue in most of those areas, certainly the biggest ones, we may raise more capital there and/or the price gains may increase the amount of fees we get. So those are the nuances. Does that help, Amanda?

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**Amanda Yao** - *JPMorgan - Analyst*

Yes, it does. Thank you very much.

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**Howard Marks** - *Oaktree Capital Group, LLC - Co-Chairman*

Let me -- if I can say one thing to get away from the nuances, there are three things at work here in establishing the fees we show. Number one is the mix, which David spent a lot of time on. Number two is the timing, which David spent a little time on.

The third factor, which I don't think David mentioned, is the level of fees per product. And in answer to your question, I believe it's safe to say that the level of fees in our products is essentially stable. So I don't feel price pressure on the fees in Opps or Real Estate or Power or the EM or whatever it might be, or Strategic.

Things come and go because of mix and timing. But as long as the underlying fee rates are stable, then that's, I think, the most important thing and the best we can hope for.

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**Amanda Yao** - *JPMorgan - Analyst*

Thank you very much.

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**Operator**

Thank you. I am showing no further questions. I'd now like to turn the call back over to Ms. Williams.

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

Thank you again, everyone, for joining us for our fourth quarter 2014 earnings conference call. A replay of this conference call will be available for 30 days on Oaktree's website in the Unitholders section. You may also dial 800-568-3942 in the US, or 1-203-369-3812 if you are outside of the US. That replay will begin approximately one hour from now. Thank you so much.

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**Operator**

Thank you. This does conclude today's conference. You may disconnect at this time.

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