Off Wall Street

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New Rec: The Blackstone Group L.P. (BX: $27.03) Jan. 2, 2017

Position: Buy **Target: $39.00**

$MM	3Q16a	4Q16e	2015a	2016e	2017e	2018e
Revs	1,395	1,413	4,556	4,903	6,747	8,476
EPS $	0.57	0.64	1.81	1.96	2.90	3.46
Y/Y Gr	n/m	74%	-52%	8%	48%	19%
P/E	n/m	n/m	14.9	13.8	9.3	7.8
Dividend/Share	0.41	0.51	2.73	1.55	2.21	2.27
Cons EPS	n/m	0.63	n/m	1.95	2.85	3.20

Shares Out: 1.2B (incl. employee shares) Market Cap: $31.9B FYE: Dec.

Concept:

1. BX's excellent investment returns have created significant client demand to invest in its funds.
2. BX has ample room to grow with runway from recently launched products, white space for additional new products, opportunities to cross-sell more products to current institutional clients and likely significant growth in retail.
3. BX's fee related earnings (FRE) could grow at a double digit CAGR over the next few years. BX's FRE and net cash and investments should limit downside for the stock to about $21/share.
4. Along with the increasing FRE, growing performance fees should enable net economic income (NEI) and distributable earnings (DE) to grow significantly over the next few years.
5. Our sum-of-the-parts valuation analysis gives upside of ~60% (including dividends) to our 2-year target price of $39 and downside of ~20% (and only ~5% downside including 2-year dividend) to about $21.

Summary: BX is one of the largest alternative asset managers and is a leading manager of private equity, real estate and credit funds, as well as being the largest allocator of capital to hedge funds through its fund of funds. BX has $361B in assets under management (AUM) which is spread fairly equally across its four major segments. BX has developed a ~30 year track record of significant investment outperformance and is one of the few companies that has achieved such success across so many alternative asset classes. The firm has mostly grown organically, but has also made some complementary acquisitions.

BX has experienced great success in raising capital for its funds. In fact, it raised more than $200B in just ten recent quarters, which was a new record for fundraising, and more than the fundraising achieved by all other alternative asset managers combined. BX has achieved a ~20% AUM CAGR from 2005-2015. BX appears to have ample room to continue to grow, with runway from recently launched products, white space for additional new products, opportunities to cross-sell more products to current institutional clients, and potentially significant growth in retail.

BX's fundraising success is largely a product of its extensive network of institutional investor relationships and its long track record of investment outperformance. BX's LP investors in its funds have enjoyed net IRRs since inception of 16% for real estate (15 funds), 15% for private equity (8 funds), and 14% for credit (4 funds) through 3Q16. Importantly, even the worst performing of BX's major private equity, real estate and credit funds have performed admirably, with 5%-11% net IRRs for the worst performing funds in each class.

BX earns annual management fees that are typically about 0.5%-2% of assets managed and performance fees that are typically about 15%-20% of gains above a hurdle rate for the fund. Fee-related earnings (FRE) from management fees are a recurring, predictable and growing source of earnings, but realized performance fees are much more volatile from period to period, especially depending on when fund assets are sold for significant gains. BX earns performance fees from not only buying and selling businesses at attractive prices but also often from significantly improving the operating performance of the business or real estate asset. Even if BX faces extended periods where it is more difficult to buy or sell companies at attractive prices, it is still likely that BX can benefit from the increase in asset value from operational improvements.

BX's funds seek to capitalize on market dislocations and instances where supply of capital falls short of demand. BX also tries to benefit from an information advantage over rivals and seems particularly adept at collecting and disseminating information and investment ideas from across its groups and portfolio companies which helps its funds make better investments. In addition, BX uses a "Buy it, fix it, sell it" approach across many of its private equity and real estate funds. This means that BX wants to drive transformational changes in the companies and real estate in which its funds invest and must have a specific strategy to improve performance before an investment is made. Overall, BX appears to maintain a disciplined and proven investment process.

Based on our sum-of-the-parts valuation analysis, BX has ~60% upside including the dividend to our 2-year price target of $39. The expected potential downside seems limited to only about 20% for the stock and only about 5% including the 2-year dividend. This 12 to 1 upside to downside ratio (including the 2-year dividend) seems a compelling risk-reward opportunity. We note that BX is currently trading 13% below its $31 IPO price, and it has distributed approximately $12/share in dividends since late 2007. BX currently has a dividend yield over 6%.

We think that BX's diversification across its multiple lines of business is a material advantage for the stock. This diversification can help insulate the company and its earnings from any potential setbacks in one of its business lines and can mitigate some of the volatility in cycles within each of its segments. BX is the most diversified of the alternative asset managers. In addition, BX has an enviable competitive position, with the largest scale, one of the best global brands, the largest network of institutional client relationships, and a unique information advantage of data and deal ideas flowing among BX's multiple best-in-class business lines.

We forecast EPS based on economic net income (ENI) of $0.64 for 4Q16, $1.96 for 2016, $2.90 for 2017 and $3.46 for 2018. Our forecasts are modestly above Bloomberg consensus EPS forecasts of $0.63 for 4Q16, $1.95 for 2016, $2.85 for 2017 and $3.20 for 2018. BX's current stock price is 7.8x our 2018 EPS estimate. At our $39.00 two-year price target, BX would trade at 11.3x our 2018

EPS estimate. We forecast dividends per share of $1.55 for 2016, $2.21 for 2017 and $2.27 for 2018. Investors who hold BX's stock for the next two years should receive over $4 in dividends. Our dividend forecast is based on 85% of our forecast for BX's distributable earnings (DE).

Background:

Blackstone (BX) is an alternative asset manager with $361B in assets under management (AUM) spread fairly evenly across its four product segments of Private Equity (27.6%), Real Estate (28.2%), Hedge Fund Solutions (19.4%) and Credit (24.7%). BX is the most diversified alternative asset manager and the only one to have achieved world-class investment outperformance and scale across each of its four major business lines. Its real estate business has become by far the largest business of its kind, and BX has also become the largest allocator of capital to hedge funds in the world.

Blackstone was founded in 1985 after Steve Schwarzman and Peter Peterson left Lehman Brothers. Originally, the primary focus of the company was M&A advisory work, but most of the advisory business was later spun-off as a separate company in October 2015. The private equity business was started in 1987, and the fund of hedge funds business (also called "BAAM" and "Hedge Fund Solutions") was started in 1990. The real estate business was started shortly thereafter, in 1992, and the corporate debt group was launched organically in 1999 and then expanded with the acquisition of GSO in 2008. The corporate debt group was merged into the GSO acquisition, and GSO is also called the "Credit" group. The firm has grown to more than 2,200 employees across over 20 offices worldwide.

While BX has made some acquisitions, it has grown mostly organically. In fact, BX has successfully and organically grown each of its major acquisitions significantly since BX acquired the original business. For example, BX acquired GSO Capital Partners in 2008 when it had AUM of under $10B. Since the acquisition, GSO has grown more than eight-fold to almost $90B in AUM. BX also acquired Strategic Partners in 2013 when it had $9B in AUM and has grown it from that base. Strategic Partners provides liquidity to entities looking to sell positions in illiquid private equity funds by creating a secondary market.

BX is organized into four primary segments. The Private Equity business has the Blackstone Capital Partners ("BCP") funds, the Blackstone Core Equity Partners fund ("BCEP) and the Blackstone Energy Partners ("BEP") funds. It also contains the opportunistic Tactical Opportunities fund, Strategic Partners, the capital markets services business ("BXCM") and the Blackstone Total Alternatives Solution ("BTAS") product for high net worth individuals. The Real Estate segment includes the Blackstone Real Estate Partners ("BREP") funds, the

Blackstone Real Estate Debt Strategies ("BREDS") funds, and the Core+ real estate fund (also called the "Blackstone Property Partners"/"BPP"), which invests in less risky and substantially stabilized real estate assets with stable cash flows and targets a lower but less risky IRR than the BREP funds. The Real Estate segment also includes the listed REIT ("BXMT") and a non-listed REIT to invest in stabilized US commercial real estate ("BREIT"). BX's Hedge Fund Solutions segment contains the fund of funds business called "Blackstone Alternative Asset Management"/"BAAM". This segment also runs its own hedge funds, owns stakes in hedge fund managers and seeds promising new hedge fund managers. The Credit segment is primarily GSO, which runs several types of credit products aimed primarily at non-investment grade credits.

BX was one of the first alternative asset managers to go public on June 21, 2007. The stock is currently trading below its $31 IPO price. BX's stock went to ~$35 shortly after the IPO but then fell to ~$4 during the Financial Crisis in 2009. In retrospect, the ~$4 low for the stock was a significant over-reaction or even panic by investors. BX not only easily survived the Financial Crisis and Great Recession, but it thrived on the opportunities that the crisis offered. BX's funds also faired relatively well through the crisis, as will be discussed. More recently, BX's stock hit a high of over $43 in mid-2015 before falling to a recent low of ~$23. The stock fell as Economic Net Income (ENI) fell year-over-year starting in 2Q15 and Distributable Earnings (DE) fell year-over-year starting in 4Q15. BX's ENI has already rebounded year-over-year over the last two quarters, but DE has yet to rebound. We expect a significant rebound in both ENI and DE over the next two years.

Discussion:

1. BX's excellent investment returns have created significant client demand to invest in its funds. In fact, the very favorable risk profile of BX's funds and the decent performance of even BX's worst performing major funds may be some of the most compelling of many reasons for clients to provide additional funds for BX to manage.

BX's investment returns for limited partner (LP) investors in its funds have been very strong over many years and across several funds, with average net IRRs (internal rates of return) since inception of 16% for real estate (15 funds), 15% for private equity (8 funds), and 14% for credit (4 funds) through 3Q16. The performance of BX's funds can be seen in Table 1 below.

Table 1: Performance of Blackstone's Funds

Investment Records as of September 30, 2016[(a)]

(Dollars in Thousands, Except Where Noted)	Committed Capital	Available Capital (b)	Unrealized Investments Value	Unrealized Investments MOIC (c)	Unrealized Investments % Public	Realized Investments Value	Realized Investments MOIC (c)	Total Investments Value	Total Investments MOIC (c)	Net IRRs (d) Realized	Net IRRs (d) Total
Private Equity											
BCP I (Oct 1987 / Oct 1993)	$ 859,081	$ -	$ -	n/a	-	$ 1,741,738	2.6x	$ 1,741,738	2.6x	19%	19%
BCP II (Oct 1993 / Aug 1997)	1,361,100	-	-	n/a	-	3,256,819	2.5x	3,256,819	2.5x	32%	32%
BCP III (Aug 1997 / Nov 2002)	3,967,422	-	-	n/a	-	9,184,688	2.3x	9,184,688	2.3x	14%	14%
BCOM (Jun 2000 / Jun 2006)	2,137,330	24,575	21,359	1.7x	-	2,949,591	1.4x	2,970,950	1.4x	6%	6%
BCP IV (Nov 2002 / Dec 2005)	6,773,182	217,886	2,125,204	1.4x	29%	19,095,827	3.2x	21,221,031	2.8x	43%	36%
BCP V (Dec 2005 / Jan 2011)	21,017,728	1,253,958	6,849,581	1.7x	75%	30,692,791	1.9x	37,542,372	1.9x	9%	8%
BCP VI (Jan 2011 / May 2016)	15,187,689	1,908,754	15,469,123	1.3x	23%	3,517,318	1.8x	18,986,441	1.4x	37%	11%
BEP I (Aug 2011 / Feb 2015)	2,436,822	162,546	2,786,424	1.4x	27%	679,656	1.8x	3,466,080	1.5x	44%	14%
BEP II (Feb 2015 / Feb 2021)	4,951,351	4,309,235	445,946	1.1x	-	-	n/a	445,946	1.1x	n/a	n/m
BCP VII (May 2016 / May 2022)	18,898,630	18,772,247	51,636	1.6x	-	-	n/a	51,636	1.6x	n/a	n/m
Total Corporate Private Equity	**$ 77,590,335**	**$ 26,649,201**	**$ 27,749,273**	**1.4x**	**36%**	**$ 71,118,428**	**2.2x**	**$ 98,867,701**	**1.9x**	**18%**	**15%**
Tactical Opportunities	13,179,861	6,368,316	7,412,876	1.2x	5%	1,898,361	1.5x	9,311,237	1.2x	29%	11%
Tactical Opportunities Co-Investment and Other	1,986,509	702,324	1,442,741	1.2x	-	276,909	1.4x	1,719,650	1.2x	n/a	15%
Strategic Partners I-V and Co-Investment (e)	12,143,182	2,070,134	3,491,609	n/m	-	13,620,041	n/m	17,111,650	1.5x	n/a	13%
Strategic Partners VI LBO, RE and SMA (e)	7,402,171	2,440,032	3,839,293	n/m	-	781,874	n/m	4,621,167	1.3x	n/a	30%
Strategic Partners VII (e)	7,147,505	6,887,623	159,764	n/m	-	-	n/a	159,764	1.1x	n/a	n/m
BCEP (f)	3,424,750	3,424,750	-	n/a	-	-	n/a	-	n/a	n/a	n/a
Other Funds and Co-Investment (g)	1,506,482	468,858	53,053	0.6x	60%	577,706	1.0x	630,759	0.9x	n/a	n/m
Real Estate											
Dollar											
Pre-BREP	$ 140,714	$ -	$ -	n/a	-	$ 345,190	2.5x	$ 345,190	2.5x	33%	33%
BREP I (Sep 1994 / Oct 1996)	380,708	-	-	n/a	-	1,327,708	2.8x	1,327,708	2.8x	40%	40%
BREP II (Oct 1996 / Mar 1999)	1,198,339	-	-	n/a	-	2,531,614	2.1x	2,531,614	2.1x	19%	19%
BREP III (Apr 1999 / Apr 2003)	1,522,708	-	-	n/a	-	3,330,406	2.4x	3,330,406	2.4x	21%	21%
BREP IV (Apr 2003 / Dec 2005)	2,198,694	-	477,090	0.5x	17%	4,058,230	2.2x	4,535,320	1.7x	35%	12%
BREP V (Dec 2005 / Feb 2007)	5,539,418	-	3,055,644	2.2x	27%	9,960,604	2.3x	13,016,248	2.3x	12%	11%
BREP VI (Feb 2007 / Aug 2011)	11,060,444	554,547	6,191,837	2.2x	66%	19,656,554	2.4x	25,848,391	2.4x	15%	13%
BREP VII (Aug 2011 /Apr 2015)	13,491,677	2,427,496	14,835,954	1.6x	-	10,271,033	1.9x	25,106,987	1.7x	29%	20%
BREP VIII (Apr 2015 / Oct 2020)	16,148,771	11,221,733	6,150,674	1.2x	1%	1,629,609	1.2x	7,780,283	1.2x	19%	20%
Total Global BREP	**$ 51,681,473**	**$ 14,203,776**	**$ 30,711,199**	**1.6x**	**17%**	**$ 53,110,948**	**2.2x**	**$ 83,822,147**	**1.9x**	**20%**	**16%**
Euro											
BREP Int'l (Jan 2001 / Sep 2005)	€ 824,172	€ -	€ -	n/a	-	€ 1,365,751	2.1x	€ 1,365,751	2.1x	23%	23%
BREP Int'l II (Sep 2005 / Jun 2008)	1,629,748	-	527,954	1.1x	67%	1,716,152	1.8x	2,244,106	1.6x	8%	5%
BREP Europe III (Jun 2008 / Sep 2013)	3,205,140	467,500	2,947,028	1.8x	-	2,719,888	2.1x	5,666,916	1.9x	23%	16%
BREP Europe IV (Sep 2013 / Mar 2019)	6,704,537	1,725,273	7,005,289	1.3x	2%	654,145	1.4x	7,659,434	1.3x	26%	13%
BREP Europe V (TBD)	6,241,060	6,265,288	-	n/a	-	-	n/a	-	n/a	n/a	n/a
Total Euro BREP	€ 18,604,657	€ 8,458,061	€ 10,480,271	1.4x	5%	€ 6,455,936	1.9x	€ 16,936,207	1.6x	16%	12%
BREP Co-Investment (h)	$ 6,819,065	$ 146,573	$ 3,968,497	1.7x	37%	$ 8,973,242	2.0x	$ 12,941,739	1.9x	17%	15%
BREP Asia (Jun 2013 / Dec 2017)	5,082,579	3,219,810	2,755,119	1.5x	2%	1,261,164	1.5x	4,016,283	1.5x	16%	17%
Total BREP	**$ 86,565,707**	**$ 27,055,872**	**$ 50,490,157**	**1.5x**	**14%**	**$ 71,952,026**	**2.1x**	**$ 122,442,183**	**1.8x**	**19%**	**16%**
BPP (i)	$ 12,143,289	$ 3,465,213	$ 10,493,724	1.2x	-	$ 107,286	1.9x	$ 10,601,010	1.2x	36%	14%
BREDS (j)	$ 11,271,187	$ 6,860,509	$ 2,271,859	1.2x	-	$ 6,259,037	1.3x	$ 8,530,896	1.3x	12%	11%
Hedge Fund Solutions											
BSCH (Dec 2013 / Jun 2020) (k)	$ 3,300,600	$ 2,630,702	$ 677,190	1.0x	-	$ 82,913	n/a	$ 760,103	1.2x	n/a	3%
BSCH Co-Investment	75,500	31,237	44,495	1.0x	-	1,427	n/a	45,922	1.0x	n/a	1%
Total Hedge Fund Solutions	**$ 3,376,100**	**$ 2,661,939**	**$ 721,685**	**1.0x**	**-**	**$ 84,340**	**n/a**	**$ 806,025**	**1.2x**	**n/a**	**3%**
Credit (l)											
Mezzanine I (Jul 2007 / Oct 2011)	$ 2,000,000	$ 99,280	$ 231,180	1.6x	-	$ 4,613,434	1.6x	$ 4,844,614	1.6x	n/a	17%
Mezzanine II (Nov 2011 / Nov 2016)	4,120,000	1,441,986	3,305,746	1.1x	-	2,167,785	1.5x	5,473,531	1.2x	n/a	14%
Mezzanine III (Sep 2016 / Sep 2021)	6,482,653	6,385,903	96,857	1.0x	-	-	n/a	96,857	1.0x	n/a	n/m
Rescue Lending I (Sep 2009 / May 2013)	3,253,143	399,836	1,405,895	1.2x	-	4,499,705	1.5x	5,905,600	1.4x	n/a	11%
Rescue Lending II (Jun 2013 / Jun 2018)	5,125,000	2,531,694	3,134,660	1.2x	-	271,552	1.2x	3,406,212	1.2x	n/a	16%
Energy Select Opportunities (Nov 2015 / Nov 2018)	2,856,866	2,576,358	384,627	1.2x	-	131,268	1.4x	515,895	1.3x	n/a	n/m
Euro											
European Senior Debt Fund (Feb 2015 / Feb 2018)	€ 1,964,689	€ 3,258,998	€ 646,742	1.0x	-	€ 142,288	1.2x	€ 789,030	1.0x	n/a	n/m
Total Credit	**$ 26,104,072**	**$ 17,097,521**	**$ 9,285,223**	**1.1x**	**-**	**$ 11,841,214**	**1.5x**	**$ 21,126,437**	**1.3x**	**n/a**	**14%**

There are several important points to note about the performance of Blackstone's funds. First, the IRRs have been very impressive overall. Most of BX's funds have performed in the top quartile of competing funds. Second, the realized IRRs from investments already sold are almost always higher than the total IRRs, which include investments not yet sold for funds with still substantial unsold investments. This is a strong indication that the company is conservative with its valuation for unsold investments, especially private investments with no well-defined market value. This apparent conservatism is consistent with BX's claim that the average gain on sale for an investment is about 30%, which means that the actual selling price of its fund's assets is on average 30% above the value at which the company marked the assets on the fund's books at the quarter-end prior to the sale. These factors suggest that the total IRR is likely to rise (all else equal) as the remaining unsold assets are sold. In addition to conservatism, the gain likely also indicates that BX is good at finding opportunistic times to sell assets. Third, recent larger funds have performed well, indicating that larger fund size has not hurt returns. Lastly, even the worst performing of BX's major private equity, real estate and credit funds have performed admirably.

BX's flagship funds (e.g., BCP I-VII, BREP I-VIII, etc.) have generally grown in each subsequent iteration of the fund. This is in part due to the lengthening track record of the funds' investment outperformance as well as BX's ability to attract new investors while also getting investors in the previous fund to invest in the subsequent iteration of the fund. LP investors will often "roll over" the realized distributions they receive from the previous fund—which is usually much more than the original amount invested (averaging ~1.85x for private equity and real estate)—into the subsequent iteration of the fund. The recent larger funds have performed well, indicating that larger fund size has not hurt returns. For example, the $13.5B BREP VII and $16B BREP VIII have each generated a 20% net IRR through 3Q16. In fact, the realized IRR of BREP VII has been even stronger at 29%. The $15B BCP VI has had a net total IRR of 11% and a realized net IRR of 37% for the small percentage of investments that have already been sold through 3Q16.

As another example, the $5B Rescue Lending II fund was over 50% bigger than its predecessor fund but has still managed to generate a 16% net IRR, above the 11% of its predecessor. One contrary data point is BX's largest fund to date, the $21B BCP V, with a net total IRR of only 8%. However, we think that the relatively poor return is more a function of the timing rather than the size of the fund, as BCP V started its investment period in December 2005, which made its first few years of investment near the peak in the stock and real estate markets. Overall, we think that the larger sizes of funds have not impaired the performance of the funds and that this is one indication that BX should continue to grow its AUM without compromising returns.

Importantly, even BX's worst performing major funds have performed well. As just discussed, we think that the timing of the investment period of a fund was a larger driver of the fund's return than the size of the fund. BX has had 34 private equity, real estate and credit funds which have matured enough to calculate a meaningful net total IRR metric. Of these 34 funds, only 3 of the funds (9%) have generated net total IRRs below 11%. The net total IRRs of each of these poorest performing funds are $2.1B BCOM at 6%, $21B BCP V at 8% and $1.6B BREP Intl II at 5%. Each of these funds had its investment period in late 2005 to early 2006, with BCOM's investment period starting earlier in June 2000 and the other two funds' investment period lasting later, to June 2008 for BREP Intl II or to January 2011 for BCP V. These three underperforming funds were investing during 2006 at the peak for private equity in terms of global buyout deal value and near the valuation peaks in the stock and real estate markets. However, the most important point is that none of BX's major private equity, real estate and credit funds lost money for their LP investors and the worst performing funds that invested during some of the least opportune times still generated a meaningful positive return for their investors of at least 5% per year. This is impressive for the very low end of BX's investment performance. BX's worst performing US$ real estate fund was BREP V which had a similar investing window (Dec. 2005 to Feb. 2007) as BX's other worst performing funds, but BREP V still generated an 11% net total IRR, which seems admirable for the worst performer. Another impressive data point is that the worst realized loss experienced by its real estate funds was a 1% loss, which seems remarkable given the severity of the Financial Crisis.

The good performance of even BX's worst performing funds is a major selling point for investors to invest in BX's future funds. It is also a testament to BX's impressive risk management and disciplined investment process that Blackstone uses to generate such strong risk-adjusted returns. Within BX's Hedge Fund Solutions/BAAM business, within a 15-year period, BAAM's returns were about 50% higher than the stock market, with only 1/3 of the market volatility, another indication of attractive risk management and risk-adjusted returns. BX's funds have significantly outperformed passive investment indices historically by around 800+ bps per year. It is important to examine BX's investment approach, process, and culture to get comfort that BX's outperformance should continue.

BX seeks to capitalize on market dislocations and instances where supply of capital falls short of demand. BX also tries to benefit from an information advantage over rivals and seems particularly adept at collecting and disseminating information and investment ideas from across its groups and portfolio companies. This free flow of data and ideas across BX's multiple business lines seems to be a key advantage that has enabled fund managers to get more ideas and deal flow as well as get richer and more in-depth data which can be used to make better investment decisions. For example, BX collected data across its credit, real estate, private equity and hedge fund business lines to reach the conclusion that the housing market had bottomed. The confidence with which Blackstone fund managers could make this determination was vastly increased by the collective research, insights and data from across the entire Blackstone organization. In this example, multiple funds made several investments that would benefit from the rebound of the real estate market. BX's private equity funds bought $220m in nonperforming residential loans, while the real estate funds took the unusual step of purchasing $1.4B in single family homes as rental properties. The GSO credit group invested over $1B in exposure to homebuilders (including Hovnanian), related industries and financing across private market vehicles.

Other examples of information advantages and sharing include the following: 1) BX's GSO division helped finance Sony's acquisition of EMI Music Publishing. Sony was not able to get bank funding for a $500m bridge loan for its EMI acquisition, so Sony approached BX's private equity group for a potential investment. After Sony and BX's private equity division were unable to agree on terms, the investment opportunity was passed along to BX's GSO division, which ultimately provided the financing and also received equity warrants. 2) When the supply of capital to the energy sector became significantly constrained after energy prices fell sharply, several funds across BX's business lines made very attractive investments across the energy sector which drove future outperformance for multiple funds. The energy investments seem to have paid off well for investors so far despite energy prices remaining low. BX's energy fund BEP I has generated a 14% net total IRR and a 44% net realized IRR through 3Q16, and many non-energy funds mentioned that energy investments drove a meaningful amount of past outperformance. 3) BX's Tactical Opportunities fund mines data and deals across the entire firm to find attractive investment opportunities.

In addition to information sharing and capitalizing on market dislocations, BX uses a "Buy it, fix it, sell it" approach across many of its private equity and real estate funds. This means that BX wants to drive transformational changes in the companies and real estate in which its funds invest and must have a specific strategy to improve performance before an investment is made. In order to support the improved performance of the company or real estate, BX engages a portfolio operations team and functional experts to help manage the company or real estate. It also finds Executive Advisors (usually former CEOs) tailored specifically to each investment to help with the performance improvement.

Even when things do not initially go well for an investment, BX attempts to optimize the situation for its investors. One of the best examples of this is BX's $26B LBO of Hilton Hotel in the fall of 2007 near the peak in the real estate and stock markets. Despite the deal looking disastrous in the depths of the Financial Crisis and Great Recession when BX had written down the value by 70%, the deal ended up becoming the most profitable private equity deal ever. Jonathon Gray of BX's real estate group invested $5.6B from two funds and hired Christopher Nassetta as CEO of Hilton. BX used the crisis to negotiate a voluntary debt restructuring with Hilton's 26 creditors to get them to sell some of the debt back to Hilton at a 54% discount using $819m in additional equity that BX invested into Hilton as part of the deal. BX also convinced the creditors to convert some of the debt to equity and extend the repayment schedule. In addition, Hilton grew its room count, especially overseas, cut costs, improved margins, and signed on additional hotels not owned by Hilton to be managed by Hilton. It also expanded its time share program (often leveraging outside capital to fund up to 80% of the investment), quadrupled the spending on Hilton's luxury brands and started Home2 Suites by Hilton.

After Hilton's IPO in late 2013, when the stock rose to ~$25/share in July 2014, Hilton became the most profitable private equity deal in history, with a $12B profit on paper. Hilton's stock is currently even higher around $27, and BX funds still own 40% of Hilton according to Bloomberg. On the 3Q16 earnings call, BX said that its agreement to sell the majority of BX's remaining stake in Hilton at 3x the original cost basis has created (along with other realized and unrealized gains) over $12B in profit in BX's funds from the Hilton deal. As a sign of BX's exceptional management of it hotel LBOs around the time of the Hilton deal, of the nine hospitality and lodging LBOs that closed around same time, only BX's Hilton and La Quinta were able to avoid bankruptcy or forced debt restructuring like the other seven deals were forced to do.

BX's funds appear to maintain a disciplined investment process. They avoid overpaying and require each investment to meet a minimum unlevered return. The funds can then apply prudent leverage to boost returns. Investment decisions are made by a single investment committee (which includes the business heads) that meets weekly to help drive consistent decision making and free flow of information throughout the firm. BX tries to avoid competitive auctions but instead seeks out its own investment deals. The decades of investment experience, flat organizational structure and movement of key personnel among the firm's international offices help maintain Blackstone's unique culture. The investment success and the financial rewards of this success help retain and motivate BX's investment personnel. In addition, BX's employees are significantly motivated and their incentives are aligned with BX's public shareholders and LP fund investors through the employees' collective ownership of more than half of BX's stock (through Holdings shares) and through significant personal investments that employees make in the funds that they manage. Lastly, BX's funds have significant flexibility in the timing of asset sales, which enables them to be patient and opportunistic.

BX enjoys tremendous scale and success across its lines of business, which often enables it to be the only player that could participate in some of the larger deals. BX is the largest owner of private real estate in the United States and in the world. BX's real estate division is roughly 4x the size of its next largest competitor. BX is also the largest allocator of capital in the world to hedge funds through its BAAM division and is one of the largest providers of debt financing in the world through its GSO division. A few examples of deals that BX did that smaller competitors probably could not have done include General Electric's $23B real estate sale, the $39B Equity Office Properties deal and the $26B deal for Hilton Hotels.

BX has benefitted from the shift in assets to alternative asset managers. In fact, from 2005 to 2013, alternative assets grew at 10.7% CAGR—twice the rate of traditional assets. Within this backdrop, BX has raised funds more successfully than any other alternative asset manager, allowing it to become the largest alternative asset manager, with $361B in AUM. BX raised more than $200B in just ten recent quarters, which was a new record for fundraising, and more than the fundraising achieved by all other alternative asset managers combined. BX raised $69B in just the last four quarters through 3Q16. Blackstone enjoys the strongest global brand name in alternative investing, one of the strongest track records of outperformance across its four businesses and an extensive network among its portfolio companies and institutional investors. BX also benefits from the trend of institutional investors to consolidate relationships with fewer asset managers. These advantages create a formidable barrier to entry for fledgling competitors and explain BX's success in attracting capital for alternative investments. It would take a new competitor at least five years of successful investing to develop a compelling performance track record and much longer to develop a track record comparable to BX's.

BX has also benefitted from some regulatory changes that have reduced its competition, primarily from large banks. However, it is unclear if the Trump administration may roll back or eliminate some of these regulations. For example, the Volcker Rule prevents banks from making "speculative" investments, and the Dodd-Frank law makes lending to junk rated companies less profitable for banks, which helps BX's GSO credit business. On the other hand The Department of Labor's fiduciary rule could drive more retail retirement funds to BX, given its track record of investment outperformance.

2. BX has ample room to grow, with runway from recently launched products, white space for additional new products, opportunities to cross-sell more products to current institutional clients and likely significant growth in retail.

BX's historical AUM growth of ~20% CAGR from both 2010 to 2015 and from 2005-2010 has been driven by flagship funds with generally larger subsequent iterations as well as incremental new products. We think that BX has ample room for future growth with runway from recently launched products, white space for additional new products, opportunities to cross-sell more products to current institutional clients and significant growth potential in retail. BX currently has $102B in dry powder available for future investment.

While a meaningful amount of AUM growth has been driven by larger subsequent funds (without compromising returns), a significant amount of growth has also been driven by innovative new products. There are several metrics that help quantify the growth from new products. As of BX's last analyst day presentation in June 2014 (which generally included results through 1Q14), 71% of GSO's AUM was in funds that did not even exist in 2008. BX had raised $122B since its IPO through 1Q14 in new products that did not even exist at the IPO. The new product launches made BX less dependent on its flagship funds, as the private equity AUM in the flagship BCP funds fell from 97% to 71%, and the real estate AUM in the BREP funds fell from 86% to below 80%.

BX has expanded into new products in adjacent areas that continue to leverage its core competencies. Some of the incremental new products that BX launched (or acquired) over the last few years include Tactical Opportunities, Strategic Partners, and growth equity within the Private Equity Segment. The Real Estate segment's recent new products include Core+, BREDS and the Asian fund. Recent new products in the Credit segment include Energy Select Opportunities, European Senior Debt, Business Development Companies (BDCs), and Strategic Separately Managed Accounts (SMA).

BX has significant opportunities to expand the recently launched products to grow AUM. The Core+ real estate fund is an especially large growth area because it is an open fund that management expects can exceed $100B vs. its current size of $12B. Strategic Partners also has ample room to grow in the private equity secondary market because the transaction volume is only about 2% of the global private equity exposure. More international business through its overseas offices is also an attractive growth opportunity.

Incremental future new products could include product expansions by geography, including Asia and Latin America. In addition, Strategic Partners could grow via co-investments through 700+ private equity general partners, fund administration and expanding beyond illiquid private equity stakes to include creating a secondary market for infrastructure and other hard assets. The hedge fund industry has faced many challenges over the last few years, but BX's Hedge Fund Solutions segment has continued to successfully raise funds and grow AUM during these challenging times. One blemish on BX's very successful investment track record is the struggles of its first in-house, $1.8B multi-manager hedge fund, Senfina, which BX announced on December 20, 2016 would be winding down after a 24% decline during 2016. Senfina was one of the best performing large hedge funds in 2015 (ranked #8 in Bloomberg's top hedge funds over $1B) with a 21% gain, but Senfina gave all of that gain and more back in 2016. Despite this setback for BX's Hedge Fund Solutions segment, it could grow its fund of funds business by negotiating new deals with hedge fund managers to "manufacture" more capacity, including in otherwise closed funds, buy stakes in established hedge funds and seed more promising new hedge fund managers. One last example of future new products is a potential new infrastructure business that the Wall Street

Journal recently reported BX is considering. BX management prides itself on the ability to innovate into new product areas, and we think that BX's growth should not be constrained over the next few years by a shortage of new product ideas.

BX has significant opportunity to grow AUM from its current core base of institutional investors like pension funds, endowments and sovereign wealth funds. BX has and should continue benefitting from the trend among institutional investors to cull some of their alternative asset managers and consolidate assets with a subset of their most trusted managers, including Blackstone. Given the breadth of Blackstone's product range and its world-class performance across each of its segments, BX is uniquely positioned to act as a one-stop shop for LP clients. A Morningstar analyst recently summarized the advantage that BX has by saying, "We think Blackstone is becoming a close substitute for the IBM of the industry, where no one was fired for allocating capital to the company." Despite its success with clients, BX still has a fairly low penetration of products into its current client base, which provides significant opportunities to fundraise by cross-selling more products to current institutional clients. Only about 65% of clients currently invest in more than one Blackstone fund, and only about 20% of clients invest in three or more BX funds. Given BX's breadth of outperformance across products, there is meaningful opportunity for AUM growth through increasing client product penetration.

While BX should be able to continue growing assets from its core institutional investor client base, the most significant and largely untapped source of funds are in the high net worth and retail areas. Retail and high net worth (HNW) individuals control a larger pool of assets than BX's core institutional investors. The penetration of alternative investments in the retail/HNW area is very low with only ~3% of assets allocated to alternative investments vs. 20%-25% for institutional investors. BX is trying to capitalize on this growth opportunity by partnering with large wealth management firms. These wealth management firms benefit as much as BX because they often get incremental new assets (i.e., a higher share of their clients' wallets) by offering Blackstone products and can even attract more HNW clients.

To help quantify the growth opportunity, BX estimates that every 1% shift in allocation of retail/HNW assets represents about $50B from just the five largest wealth management firms. In addition, BX has started "Blackstone U" to educate financial advisors on alternative products. BX is also directly targeting select family offices and ultra-HNW investors. The firm can also reach mass affluent retail investors through sub-advised products that provide greater liquidity. Retail/HNW represented only 12% of BX's AUM as of 1Q14, which was up from 8% in 2010 but still indicates the long runway ahead for BX to grow retail AUM.

3. We expect BX's fee related earnings (FRE) to grow at a double digit CAGR over the next few years. BX's FRE and net cash and investments should limit downside for the stock to about $21/share.

BX's fee related earnings (FRE) are a predictable and stable source of earnings. FRE are primarily driven by management fees and the related compensation. FRE excludes all performance fees such as carried interest or incentive fees (realized or unrealized), which are among the most volatile and unpredictable component of BX's earnings. FRE often lags AUM growth because it can take time for new assets raised to start earning management fees as the funds enter their investment period and any fee holidays (e.g., the first 6 months of the fund) expire.

Table 2 below shows the drivers of BX's annual FRE for the last five years. BX's FRE grew by about 15%-25% for each of the last four years through 2014. However, FRE fell in 2015, but this was primarily because BX spun-off most of its advisory business in October 2015. This spin-off caused advisory fees to drop ~$110m in 2015 and drop another $305m in 3Q16 YTD, indicating that the spun-off advisory business generated ~$100m/quarter in advisory fees. However, if one adjusts the FRE to exclude the advisory fees as we show below, this crude metric shows almost 8% growth in adjusted FRE in 2015. We note that this is a crude measure because it removes the advisory revenues without also removing the related compensation and other expenses associated with the advisory business.

Table 2: BX's Fee Related Earnings (FRE)

(Dollars in Thousands)	2011	2012	2013	2014	2015	
▶ Base Management Fees (a)	$ 1,281,185	$ 1,591,403	$ 1,740,807	$ 1,987,529	$ 2,196,583	Fee Earnings
▶ Advisory Fees (a)	382,240	357,417	410,514	420,845	308,131	
▶ Transaction and Other Fees, Net (a)	247,513	227,119	206,977	246,437	153,685	
▶ Management Fee Offsets (a)	(33,393)	(40,953)	(72,220)	(86,771)	(93,494)	
▶ Other Revenue (a)	7,415	5,149	10,308	9,405	8,500	
▶ Compensation (a)	(960,569)	(1,030,776)	(1,115,640)	(1,153,511)	(1,189,219)	
▶ Non-Interest Operating Expenses (b)	(368,141)	(412,293)	(382,735)	(420,927)	(448,575)	
Fee Related Earnings	**$ 556,250**	**$ 697,066**	**$ 798,011**	**$ 1,003,007**	**$ 935,611**	
Year-over-Year Growth	16.3%	25.3%	14.5%	25.7%	-6.7%	
FRE excluding Advisory Fees	**$ 174,010**	**$ 339,649**	**$ 387,497**	**$ 582,162**	**$ 627,480**	
Year-over-Year Growth	234.4%	95.2%	14.1%	50.2%	7.8%	

Total Assets Under Management	$ 166,228,504	$ 210,219,960	$ 265,757,630	$ 290,381,069	$ 336,384,575
Year-over-Year Growth	29.7%	26.5%	26.4%	9.3%	15.8%
Fee-Earning Assets Under Management	$ 136,756,753	$ 167,880,440	$ 197,981,739	$ 216,691,799	$ 246,146,372
Year-over-Year Growth	24.9%	22.8%	17.9%	9.5%	13.6%

FRE has increased YTD through 3Q16 by 8% despite the spin-off of the advisory business. In the 3Q16 earnings call, BX's CFO claimed that FRE YTD properly adjusted for the spin-off grew 21% year-over-year and reflected ~230bps of underlying FRE margin expansion. The base management fees grew at a 14% CAGR from 2011-2015 and have continued to grow at a double-digit rate so far in 2016. BX's CFO also said that BX expects for FRE to grow at a "strong double-digit percentage" in 2017 as the fee holiday for $19B BCP VII ended in November 2016. The $65B in AUM that will start earning management fees after investment periods begin or capital is invested should drive future growth in FRE.

Management fees and FRE are more stable and predictable than performance fees because management fees recur each year until funds are returned to clients after investments are sold. Much of BX's client capital is locked up for an average of 8+ years, and some of GSO's credit funds are closed end funds with assets captive for 10+ years. Institutional clients are generally sticky relationships, especially because of BX's impressive investment performance. In fact, many clients "roll over" proceeds distributed from past funds into subsequent BX funds.

BX's investment success has allowed it to raise its management fee rates on some of its flagship funds, including the real estate and private equity funds. This should help offset some growth in some modestly lower-fee-rate products, such as Core+ in real estate. Overall, with the leverage from growth and some of the fee increases, margins on management fees should continue to expand as it has over the last several years.

As shown below, our downside scenario values BX's stock at ~$21/share just based conservatively on the company's expected FRE and actual net cash & investments and already accrued performance fees. This downside scenario assumes that BX does not generate any incremental performance fees beyond what it has already accrued through its investment performance through 3Q16.

4. Along with the increasing FRE, growing performance fees should enable BX's earnings—both economic net income (ENI) and distributable earnings (DE)—to grow significantly over the next few years. An earnings rebound could considerably improve investor sentiment on BX shares.

BX should continue to earn significant performance fees on strong investment performance in its carry funds. Since 2003, BX has generated positive performance fees in every year except for 2008 during the Financial Crisis. In fact, performance fees have averaged over 45% of revenues since 2010. As discussed in the first section, BX's major funds have had fairly consistently strong performance across the business lines and across market cycles. In fact, almost every one of BX's major private equity and real estate funds have earned at least some performance fees by having the fund's IRR exceed the hurdle rate (typically about 8% per year). The largest current major fund to be at risk of not earning performance fees is BCP V, which reported a total net IRR of 8%, which is near its hurdle rate. BX's CFO said during the 3Q16 earnings call that a sale of the majority of BX's Hilton stake planned for early 2017 should "drive BCP V towards resuming cash carry, possibly in the first quarter of 2017, by closing out over three-quarters of the current preferred return shortfall."

BX earns performance fees not only from buying and selling businesses, but also often from significantly improving the operating performance of the business or real estate asset. Even if BX faces extended periods where it is more difficult to buy or sell companies at attractive prices, it is still likely that BX can benefit from the increase in asset value from operational improvements. Poorly or under-managed companies are rarely in short supply.

BX's performance fees are volatile and were depressed in 2015 and so far in 2016. Net *unrealized* carried interest was a major drag on economic net income (ENI) and EPS in 2015, and *realized* carried interest has been a major drag on ENI and especially distributable earnings (DE) so far in 2016. DE includes FRE and net *realized* carried interest and incentive fees, *realized* investment income, net interest, and some other items. DE is very important in part because the dividend paid is usually based on 85% of DE. The biggest difference between DE and ENI is that ENI also includes the *unrealized* carried interest, incentive fees and investment income.

We expect BX's performance fees to rebound sharply. Certainly, the strong stock market since the election should help. We expect the unrealized performance fees to rebound with the rising stock market, improved performance of portfolio companies and expected future outperformance of BX's funds. We expect the realized performance fees to rebound and increase DE and, therefore, the dividend, as BX's funds mature and reach the realization cycle when fund assets are sold for gains. BX reported in 3Q16 that 45% of its $3.3B in net accrued performance fees is related to publicly traded stock or pending exits. Also, BX indicated that just a few planned sales in 1Q17 of Hilton, Change Healthcare and some power asset sales should alone drive over $500m in DE, likely all through realized performance fees. This bodes well for future near-term realized performance fees and DE.

The Hedge Fund Solutions business has improved after a challenging 1Q16. As of 3Q16, it has 67% of its fee-earning AUM above the high water mark. Also, 57% of the 33% of the Hedge Fund Solutions assets that were below the high water mark were within 5% of the high water mark. This situation bodes well for future incentive fees in this business.

Looking at performance fees one other way, BX generated ~$2.50/share in performance fees in 2015 from an AUM base that was only one-third the size of BX's current AUM. All else equal, if future investment performance is similar to past investment performance, BX could see earnings from performance fees hitting ~$7.50/share several years from now.

We caution that accurately predicting BX's performance fees, and especially realized performance fees, quarters and years into the future is very difficult. With only limited visibility one would need to predict the timing and gains from major asset sales from funds. However, the good news is that the current stock price seems to give little credit for future performance fees, certainly much less than BX has earned in the past off of a much smaller AUM base. Therefore, most of the likely future realized performance fees should represent upside or "gravy" for the stock, in our view. Those future realized performance fees would provide a very tangible benefit to shareholders through dividends, as ~85% of DE are distributed to shareholders.

We expect BX's ENI EPS to rebound from $1.81 in 2015 to $1.96 in 2016, $2.90 in 2017 and $3.46 in 2018. Our forecasts are modestly above Bloomberg consensus EPS forecasts of $0.63 for 4Q16, $1.95 for 2016, $2.85 for 2017 and $3.20 for 2018. We forecast dividends per share of $1.55 for 2016, $2.21 for 2017 and $2.27 for 2018. Investors who hold BX shares for the next two years should receive over $4 in dividends. Our dividend forecast is based on 85% of our forecast for BX's distributable earnings (DE).

We expect that the forecasted growth in BX's EPS will significantly improve investor sentiment on the stock. We note that BX's stock reached a high of $43.13 in May 2015, so it will not need to exceed past highs to reach our $39 price target.

5. We see a compelling case for BX's stock at $27. Our sum-of-the-parts valuation analysis implies upside of ~60% (including dividends) to our 2-year target price of $39 and downside of ~20% (only ~5% downside including 2-year dividend) to about $21.

BX's current dividend yield of over 6%, its low valuation, expected growth in EPS and DE, diversification, enviable competitive position, best-in-class performance and discount to our sum-of-the-parts valuation make BX's stock very attractive.

Based on the last four dividend payments, which have actually been depressed, BX is trading at a 6.1% dividend yield. The dividends, at ~85% of DE, were depressed because lower realized performance fees due to selling fewer fund assets for gains in 2016 caused DE to fall. Based on the dividends paid on 2015 results, BX is currently trading at a 10.1% dividend yield. Based on multi-year average dividends to smooth volatility, BX is currently trading at 7.6% and 5.0% dividend yield on the 3-year and 6-year average annual dividend, respectively. BX's stock is trading at a dividend yield about 3x-5x the 2.0% dividend yield of the S&P 500 index.

Based on our sum-of-the-parts valuation analysis shown below, BX has ~60% upside including the dividend to our 2-year price target of $39. The expected potential downside seems limited to only about 20% for the stock and only about 5% including the 2-year dividend. This 12 to 1 upside to downside ratio (including the 2-year dividend) seems a compelling risk-reward opportunity.

Figure 1: BX Sum-of-the-Parts Valuation Analysis

BX Sum-of-the-Parts Valuation Analysis

Current stock price	**27.03**			
Number of shares	1,195,800			
Fee Related Earnings (FRE)	**Upside to Target Price**		**Downside Scenario**	
FRE in last 4 quarters	985,895		985,895	
Expected FRE CAGR over next 5 years	10.0%		8.0%	Note 20.3% FRE CAGR 2010-2014
Expected FRE CAGR over years 6-10	8.0%		6.0%	before advisory services spin-off
Expected Terminal Value CAGR	4.0%		3.0%	
Cost of Equity	10.0%		10.0%	
NPV	23,769,945		18,694,558	
Per share amount	**19.88**		**15.63**	
Net cash & investments				
Cash & Equivalents	1,781,882			
Corporate Treasury Investments	2,117,000			
GP/Fund Investments	2,178,000			
Outstanding Bonds (at par)	(2,822,000)			
Net cash & investments	3,254,882			
Per share amount	**2.72**		**2.72**	
Current Estimated Performance Fees Value				
Accrued Performance Fees (net of compensation)	3,335,000		3,335,000	
Expected gain on sale	25%		0%	
FE AUM in Private Equity	69,347,910			
FE AUM in Real Estate	65,785,083			
Fund Gain on Sale	33,783,248			
Carried interest %	15%			
Additional Performance Fees on Gain	5,067,487			
Performance Compensation % of Perf. Fees	35%			
Additional Performance Compensation on Gain	1,773,621			
Net Additional Performance Fees on Gain	3,293,867			
Total Estimated Current Net Performance Fees	6,628,867			
Per share amount	**5.54**		**2.79**	
Estimated Value of Future Generated Performance Fees Based on Current FE AUM				
Total FE AUM	267,757,727			
Avg. Annual Outperformance over Hurdle Rate	3.0%	Compared to ~700bps outperformance historically		
Carried interest %	15%			
Performance Fees Accrued per Year	1,204,910			
Performance Compensation % of Perf. Fees	35%			
Annual Performance Compensation	421,718			
Net Performance Fees Accrued per Year	783,191	1,498,070	Average net perf fees over last 6 years	
Expected Terminal Value CAGR	4%			
Cost of Equity	10%			
PV of Future Net Performance Fees	13,053,189			
Per share amount	**10.92**		**-**	
Total Value	**39.06**		**21.14**	

	Stock price	**2 yr dividend**	**% change after dividend**
Upside	**45%**	**4.48**	**61%**
Downside	**-22%**	**4.48**	**-5%**

Our sum-of-the-parts analysis looks at four components of value: 1) the NPV of the FRE, 2) the current value of the net cash and investments, 3) the current value of our estimate of performance fees largely already earned or accrued, and 4) our NPV estimate of the value of future performance fees earned.

The NPV of the FRE is calculated using the trailing four-quarter actual FRE reported and growing this at the future period growth rates shown in the top portion of Figure 1 and discounting it by a 10% cost of equity. Our upside scenario uses a 10%, 8%, and 4% CAGR for years 1-5, years 6-10 and the terminal value (TV) growth rate, respectively. Our downside scenario uses an 8%, 6%, and 3% CAGR for years 1-5, years 6-10 and the terminal value (TV) growth rate, respectively. We note that the actual FRE CAGR was 20.3% from 2010 to 2014 before the spin-off of the advisory business in 2015. The NPV of the FRE is $19.88 and $15.63 per share for the upside and downside scenario, respectively.

The value of the net cash and investments is shown in the next section of Figure 1. It is the same for both the upside and downside scenarios. It is comprised of approximately $1.8B in cash & equivalents, plus $2.1B in corporate treasury investments, plus $2.2B in BX's investments in its own funds, and minus the $2.8B par value of outstanding bonds, all as of 3Q16. This equates to $2.72 per share on a net basis.

The estimate of the current value of the performance fees is straightforward for the downside scenario but more complicated for the upside scenario. The downside scenario value is simply the $3.3B accrued current value of performance fees net of compensation (effectively the accrued performance fee earnings) reported for 3Q16. This equates to $2.79 per share. However, for the upside scenario, we adjust this likely understated amount to take into account the 30% average gain on sale for investments once they are sold. This largely reflects the conservative valuations at which BX marks its funds' private investments on its books. To calculate this probable gain on sale, we mark up the FE AUM in only private equity and real estate, the two segments with the most assets without a clear publicly traded market value. We mark these assets up by 25% instead of the average 30% gain mentioned by management. We next assume a 15% carried interest rate and a 35% compensation rate on performance fees (based on multi-year averages to smooth out volatility). This markup adds $2.75 per share to equate to $5.54 per share for the upside scenario.

Lastly, we estimate the value of expected future generated performance fees based on current FE AUM. For the downside scenario, we assume that BX never again accrues any additional performance fees beyond the value already accrued by 3Q16. This represents a very bleak assumption, given that BX has earned performance fees in every year except for 2008 and that performance fees have averaged over 45% of revenues since 2010. For the upside scenario, we use conservative assumptions for the generation of future performance fees. We assume that BX's funds outperform the hurdle rate (at which performance fees start accruing) by 300 bps per year compared to the approximately 700bps of outperformance BX has averaged historically. We then apply the same 15% carried interest rate and 35% performance fee compensation rate mentioned above to calculate the net performance fee accrued per year of $783m. This is only half of the average annual net performance fees over the last six years, and the AUM base from which performance fees were generated was substantially lower during that six year period than it is now. To calculate the NPV of this performance fee earnings stream, we use a 4% annual growth rate and the same 10% cost of equity discount rate. Based on these assumptions, the current NPV of future generated net performance fees is $10.92 per share.

To cross check our $39 target price in the upside scenario and our $21 price in the downside scenario, we calculated P/E ratios based on our 2018 EPS estimate and dividend yields for various dividend scenarios as shown in Table 3 below. Based on our 2018 EPS estimate, BX would trade at a 11.3x P/E at our upside target price and only 6.1x P/E at the downside $21 price. The current price is 7.8x our 2018 EPS estimate. For the various historical dividend amounts shown in Table 3, BX would trade at a 3.4%-7.0% dividend yield at our $39 target price, which is still well above the current 2.0% dividend yield of the S&P500. At our $21 downside scenario share price, the stock would have a 6.3%-12.9% dividend yield based on historical dividend amounts. At the current stock price, BX has a 5.0%-10.1% dividend yield based on historical dividend amounts.

Table 3: BX's P/E and dividend yield in various scenarios

	$39 Target Price	**$27 Current price**	**$21 Downside**
Our 2018 EPS forecast	3.46	3.46	3.46
At upside or downside TP, P/E	11.3	7.8	6.1
2017e dividend per share	2.21	2.21	2.21
Dividend yield at upside or downside TP	5.7%	8.2%	10.5%
LTM dividend per share	1.66	1.66	1.66
Dividend yield at upside or downside TP	4.2%	6.1%	7.9%
2015 dividend per share	2.73	2.73	2.73
Dividend yield at upside or downside TP	7.0%	10.1%	12.9%
Avg. dividend per share last 3 years	2.06	2.06	2.06
Dividend yield at upside or downside TP	5.3%	7.6%	9.8%
Avg. dividend per share last 6 years	1.34	1.34	1.34
Dividend yield at upside or downside TP	3.4%	5.0%	6.3%

We note that BX is currently trading 13% below its $31 IPO price, and it has distributed approximately $12/share in dividends since late 2007.

We think that BX's diversification across its multiple lines of business is a material advantage for the stock. This diversification can help insulate the company and its earnings from any potential setbacks in one of its business lines and mitigate some of the volatility in cycles within each of its segments. BX is the most diversified of the alternative asset managers. In addition, BX has an enviable competitive position with the largest scale, one of the best global brands, the largest network of institutional client relationships, and a unique information advantage of data and deal ideas flowing among BX's multiple best-in-class business lines.

6. There are a number of risks to an investment in BX shares.

One key risk is that BX's investment performance may deteriorate and become poor enough that it is unable to raise additional assets or earn significant performance fees. If BX's performance across its key funds were to deteriorate significantly, BX may suffer from falling AUM, falling performance fees and falling FRE. Also, if BCP V's performance were to fall below the 8% hurdle rate, BX could suffer claw backs of some of its performance fees.

There are a few tax-related risks. There could be a tax law change to make carried interest be taxed as regular income. This could substantially increase the taxes paid by BX shareholders, which could cause the stock to become less attractive. Also, tax law could be changed to no longer allow the preferential tax treatment of partnerships and force partnerships to be taxed like corporations. This could significantly increase the amount of taxes paid by BX. The negative impact of this partnership tax change could be partly mitigated if BX were to transform itself from a partnership to a corporation, as this would likely result in the inclusion of BX's stock in key indices, which could significantly increase the demand for the stock. This mitigating factor is more likely if the Trump Administration significantly lowers the corporate tax rate.

BX also has key man risk, including CEO Steve Schwarzman and other top executives. Schwarzman is almost 70 years old and could decide to retire in the next few years. He also owns ~$6B in BX's Holdings stock, so any departure could cause not only the loss of his leadership, but also the perception of a stock overhang if he or his heirs were to sell down his stake in the company. To a lesser extent these issues could also be faced with other key executives.

There is a risk that performance fee revenue recognition could be substantially delayed with FASB revenue recognition accounting guidance that will start for periods after 12/15/17 if it is determined that performance fees and carried interest are forms of variable consideration that may not be included in the transaction price. Please see BX's 10Q and 10K for more details.

7. Recent results.

In 3Q16, BX reported YTD revenues that were down 5% year-over-year (YoY) primarily due to lower realized performance fees. However, BX's diluted EPS rose 26%. FRE was up 8% despite the spin-off of the advisory business in October 2015. Adjusting for this spin-off, FRE was up 21% YoY and reflected ~230bps of underlying FRE margin expansion. Total AUM rose 8% YoY to a record $361B, and FE AUM rose 11% to $268B. DE and the dividend fell ~50% primarily due to lower realized performance fees.

BX's investment funds performed generally well during 3Q16, with the private equity funds up 3.0% on average, the opportunistic real estate funds up 3.7% (and Core+ funds up 2.9%), the BPS hedge fund composite up 2.9% gross, and Credit funds up 6.2% in Performing Credit and 6.4% in Distressed Strategies.

8. Financial Projections

Annual Projections ($MM)	2014	2015	2016e	2017e	2018e
Management Fees	2,568.0	2,564.9	2,485.3	2,930.6	3,106.1
Performance Fees	4,391.9	1,798.1	2,088.7	3,268.8	4,649.6
Investment Income	471.6	52.8	189.2	333.9	500.1
Other Revenues	105.7	140.1	139.6	213.7	220.6
Total Revenues	7,537.3	4,555.9	4,902.9	6,746.9	8,476.4
Compensation Expense	2,439.0	1,753.8	1,863.5	2,432.4	3,357.3
Other Operating Expenses	553.8	624.4	610.3	602.7	627.9
Total Expenses	2,992.8	2,378.1	2,473.8	3,035.0	3,985.2
Economic Income (pre-tax)	4,544.5	2,177.8	2,429.1	3,711.9	4,491.1
Tax Rate	4.4%	1.3%	3.6%	5.7%	6.2%
Taxes	199.5	27.5	87.6	213.4	280.0
Economic Net Income	4,345.0	2,150.3	2,341.6	3,498.5	4,211.1
Average diluted shares	1,155.8	1,188.0	1,195.8	1,204.8	1,216.3
EPS	$3.76	$1.81	$1.96	$2.90	$3.46

Y/Y % Change	2014	2015	2016e	2017e	2018e
Management Fees	12.3%	-0.1%	-3.1%	17.9%	6.0%
Performance Fees	23.5%	-59.1%	16.2%	56.5%	42.2%
Investment Income	-31.4%	-88.8%	258.1%	76.4%	49.8%
Other Revenues	30.2%	32.5%	-0.3%	53.0%	3.2%
Total Revenues	14.0%	-39.6%	7.6%	37.6%	25.6%
Compensation Expense	-3.6%	-28.1%	6.3%	30.5%	38.0%
Other Operating Expenses	13.8%	12.7%	-2.3%	-1.2%	4.2%
Total Expenses	-0.8%	-20.5%	4.0%	22.7%	31.3%
Economic Income (pre-tax)	26.4%	-52.1%	11.5%	52.8%	21.0%
Economic Net Income	23.7%	-50.5%	8.9%	49.4%	20.4%
Average diluted shares	1.0%	2.8%	0.7%	0.8%	1.0%
EPS	22.4%	-51.9%	8.2%	48.3%	19.2%

As a % of Revenue	2014	2015	2016e	2017e	2018e
Management Fees	34.1%	56.3%	50.7%	43.4%	36.6%
Performance Fees	58.3%	39.5%	42.6%	48.4%	54.9%
Investment Income	6.3%	1.2%	3.9%	4.9%	5.9%
Other Revenues	1.4%	3.1%	2.8%	3.2%	2.6%
Total Revenues	100.0%	100.0%	100.0%	100.0%	100.0%
Compensation Expense	32.4%	38.5%	38.0%	36.1%	39.6%
Other Operating Expenses	7.3%	13.7%	12.4%	8.9%	7.4%
Total Expenses	39.7%	52.2%	50.5%	45.0%	47.0%
Economic Income (pre-tax)	60.3%	47.8%	49.5%	55.0%	53.0%
Economic Net Income	57.6%	47.2%	47.8%	51.9%	49.7%

Quarterly Projections ($MM)	3Q16a	4Q16e	1Q17e	2Q17e	3Q17e
Management Fees	601.7	658.2	688.1	718.5	754.9
Performance Fees	672.6	652.7	830.5	743.5	905.5
Investment Income	87.9	68.2	76.4	79.2	93.4
Other Revenues	32.7	34.4	50.1	53.4	53.9
Total Revenues	1,394.9	1,413.5	1,645.2	1,594.6	1,807.6
Compensation Expense	536.0	467.2	597.2	579.0	652.2
Other Operating Expenses	150.9	153.6	148.4	149.8	151.2
Total Expenses	686.9	620.7	745.6	728.8	803.5
Economic Income (pre-tax)	708.0	792.7	899.6	865.8	1,004.1
Tax Rate	3.0%	3.6%	5.2%	5.5%	5.2%
Taxes	21.0	28.6	46.6	47.3	51.9
Economic Net Income	687.0	764.2	853.0	818.5	952.2
Average diluted shares	1,195.8	1,198.3	1,200.3	1,203.3	1,206.3
EPS	$0.57	$0.64	$0.71	$0.68	$0.79

Y/Y % Change	3Q16a	4Q16e	1Q17e	2Q17e	3Q17e
Management Fees	-15.1%	1.3%	12.2%	17.4%	25.5%
Performance Fees	-205.2%	236.4%	164.4%	65.4%	34.6%
Investment Income	-164.6%	-696.8%	-386.8%	32.5%	6.3%
Other Revenues	-5.7%	-23.4%	73.8%	22.1%	65.0%
Total Revenues	-4433%	61.1%	77.0%	36.9%	29.6%
Compensation Expense	169.2%	47.7%	51.8%	24.0%	21.7%
Other Operating Expenses	-4.2%	-1.0%	-0.1%	-4.8%	0.2%
Total Expenses	92.6%	31.7%	37.6%	16.8%	17.0%
Economic Income (pre-tax)	-282.1%	95.3%	132.2%	60.0%	41.8%
Economic Net Income	-265.2%	75.4%	130.1%	57.5%	38.6%
Average diluted shares	0.3%	0.7%	0.5%	0.7%	0.9%
EPS	-264.6%	74.2%	129.0%	56.3%	37.4%

As a % of Revenue	3Q16a	4Q16e	1Q17e	2Q17e	3Q17e
Management Fees	43.1%	46.6%	41.8%	45.1%	41.8%
Performance Fees	48.2%	46.2%	50.5%	46.6%	50.1%
Investment Income	6.3%	4.8%	4.6%	5.0%	5.2%
Other Revenues	2.3%	2.4%	3.0%	3.4%	3.0%
Total Revenues	100.0%	100.0%	100.0%	100.0%	100.0%
Compensation Expense	38.4%	33.1%	36.3%	36.3%	36.1%
Other Operating Expenses	10.8%	10.9%	9.0%	9.4%	8.4%
Total Expenses	49.2%	43.9%	45.3%	45.7%	44.4%
Economic Income (pre-tax)	50.8%	56.1%	54.7%	54.3%	55.6%
Economic Net Income	49.3%	54.1%	51.8%	51.3%	52.7%