



Investment Thesis

Outlook

Buy-rated Blackstone is a leading alternative asset manager, and is well positioned to generate solid growth in distributable earnings over the next few years. The firm is well diversified and executing well in each of its core businesses – private equity, real estate, credit, hedge fund solutions, and advisory. We see the following positive catalysts for BX units over the next 12 months: 1) a steep earnings ramp over the next several quarters with solid double-digit year/year distributable earnings (DE) growth; 2) a substantial realization cycle for at least the next 1-2 years becoming more evident, 3) a spike up in realized carried interest in 2014 from BCP V moving into carry, 4) continuation of good organic asset growth momentum across all four business lines, & 5) a better appreciation for BX' diversified business mix, which should continue to fire on all cylinders in 2014. We see these dynamics helping BX narrow its P/E gap to traditional asset managers over the course of 2014, a trend benefiting the alternative asset managers (Alts) broadly as well.

Valuation

We believe DE, from which cash distributions are paid to unit holders, is the most important earnings metric to value the Alts, rather than economic net income (ENI) that forms Consensus estimates. Our valuation is based on assigning a target PE on our 2015 estimate for distributable earnings, a year from now. We think several catalysts will drive BX' P/E from 10.4x 2014E ENI to over 13x 2015 DE 12 months from now, narrowing its discount to the S&P 500 P/E from ~30% to ~10%. This drives a \$39 PT, which implies a total return of 30% over the next 12 months, inclusive of a 6.3% forecast distribution yield for 2014.

Risks

Downside risks for BX are: 1) a slowdown in US/global economy, 2) a prolonged equity market correction, 3) an inability to generate strong organic growth in 2014 that would jeopardize long-term growth in DE after a likely strong realization cycle over 2014-15, 4) a significant decline in real estate values in the US, and 5) a failure to narrow P/E gap vs. traditional asset managers and the market broadly. Additional downside risks are: loss of key personnel, a deterioration in investment performance, unfavorable regulatory legislation, a change in tax laws creating higher taxation on carried interest and/or the partnership structure, increasing competition from traditional asset managers diversifying into alternatives, and inability to broaden the investor share base if as holding partnership units can be prohibitive for some investment funds.