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Q3 2018 KKR & Co Inc Earnings Call

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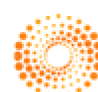

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PRESENTATION

Operator

Good day, ladies and gentlemen. Thank you for standing by, and welcome to KKR's Third Quarter 2018 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded. I would now like to introduce your host for today's conference, Craig Larson, Head of Investor Relations for KKR. Please begin sir.

Craig Larson ***KKR & Co. Inc. - Head of IR***

Thank you, Norma. Welcome to our third quarter 2018 earnings call; thanks for joining us. As usual, I'm joined by Bill Janetschek, our CFO; and Scott Nuttall, our Co-President and Co-COO. We'd like to remind everyone that we'll be referring to non-GAAP measures on the call, which are reconciled to GAAP figures in our press release, which is available on the Investor Center section at kkr.com.

And the call will also contain forward-looking statements, which do not guarantee future events or performance, so please refer to our SEC filings for cautionary factors related to these statements. And like previous quarters, we've posted a supplementary presentation on our website that we'll be referring to over the course of the call.

This morning, we announced a strong quarter, with total segment revenues of $1.2 billion and after-tax distributable earnings of $497 million, increases of 27% and 21%, respectively, year-over-year.

Now, before we get into all of the numbers, this is also a notable quarter for us because it's our first as a C-corp, having completed the change in our structure from a partnership to a corporation on July 1.

To begin, the dialogue we're having with institutions continues to only reinforce in our minds what we've felt for a long time, that the partnership structure was a real impediment for many investors, and the best path for us to broaden our appeal, and ultimately maximize shareholder value, was through our being structured as a mainstream equities security.

We've traded on the New York Stock Exchange as a PTP for the better part of 8 years, and at this point, we've been trading as a C-Corp for only a handful of months. So we're in the earliest of innings, but we're encouraged by the dialogue we've been having. And it feels to us like we are experiencing a transition in our shareholder base.

We believe we are seeing an increase in the breadth of our shareholders, and the shareholders we're attracting are focused on the long-term opportunities we have to create equity value through our combination of earnings growth, asset growth as well as book value compounding. In short, it feels like we're attracting a shareholder base that thinks about our business and our stock more similarly to how we think about our business and our stock, and that's great to see.

Also, as part of this, we've seen some index buying. As of September 30, we're owned at roughly a dozen index funds at Vanguard in addition to passive funds focused on S&P's total market index. Total buying across these index funds in Q3, we believe, is in excess of 50

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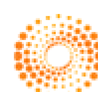

million shares.

Returning to the results for Q3. Please take a look at Page 2 of the supplement. This morning, we reported after-tax distributable earnings of $0.60 per share. Management fees reached $277 million in the quarter. That's up 19% year-over-year. And this growth, combined with a continued strong performance in capital markets, led to a strong fee-related earnings quarter, which Bill is going to discuss in more detail.

On the bottom half of the page, you'll see that our book value per share on a marked basis was $16.68 per share as of September 30, representing 21% growth year-over-year. Strong performance in our core investment strategy and in our PE investments were the key contributors here.

Now, as we've talked about on our calls historically, as we think about our performance, there are 5 things that we need to do well: one, we need to generate investment performance: two, raise capital; three, find attractive new investments; four, monetize existing investments; and finally, five, use our model of AUM, Capital Markets and balance sheet.

I'll update you on the first 2, and Bill is going to cover the final 3. Starting first with investment performance, please take a look at Page 3 of the supplement. We've had strong investment performance across our asset classes over the last 12 months.

In private equity, our 3 flagship funds you see on the page have appreciated 19% on a blended basis, and our overall private equity portfolio appreciated 7.3% for the quarter and 19.9% over the last 12 months.

Our real asset strategies are performing, with our more mature real estate, infrastructure and energy flagship funds up 10%, 11% and 15%. And in credit, we continue to see strong performance, particularly in our mezzanine and Special Situations strategies.

This performance has resulted in a 20% increase in the net accrued carry figure on our segment balance sheet on a year-over-year basis, despite $1.3 billion of realized carried interest over this time frame.

Turning to fundraising. Over the last 12 months, we've raised $38 billion organically, with an additional $15 billion of inflows from both our partnership with FS Investments and an incremental 5% stake in Marshall Wace. Notably, all of our fundraising efforts these past 12 months have come from outside of what we've historically defined as benchmark traditional private equity funds.

We've seen our core investment strategy, which consisted solely of our position in USI at this time last year, scale from $1 billion to over $10 billion of AUM today.

The growth and scaling of many of our other newer strategies have continued as well. In Q3, we held the final close on our $7.2 billion Infra III Fund over 2x the size of its predecessor, and over the last 12 months, we've seen inflows in Real Estate II, as well as several billion of new capital raised across our private and leveraged credit strategies.

And our level of fundraising activity remains high. We're currently fundraising across our European private equity, Impact, Real Estate Credit, Energy and Direct Lending strategies, with fundraising likely to be launched across an additional half dozen carry paying strategies over the coming months.

Capital inflows over the trailing 12 months have contributed to $58 billion of dry powder at quarter end, up 22% year-over-year. And importantly, we also have $20 billion of capital commitments that become fee-paying when it is invested at a weighted average rate of around 100 basis points, providing direct line of sight for us towards future management fees.

And with that, let me turn it over to Bill.

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William J. Janetschek ***KKR & Co. Inc. - Member & CFO of KKR Management LLC***

Thanks, Craig. I'll start with the third thing we need to do well, which is find new investment opportunities. This was an active deployment quarter for us. We invested $5.5 billion across businesses and geographies. Public Markets deployment was $1.6 billion, coming primarily from investments made in our Direct Lending space. On the private market side, we invested $3.9 billion. The largest contributor was the carve-out of Unilever's spreads business, which I'll discuss in more detail shortly.

Other notable uses of capital include the acquisitions of Discovery Midstream, an investment out of both our Infrastructure and Energy funds, and AppLovin out of Americas XII.

The fourth thing we need to do well is monetize our existing investments. We are continuing to see significant monetization activity across our PE business. As stated in our September press release, exits were diversified between strategics and secondary activity, and on a blended basis, the PE exits were done at 3.4x our cost.

In total, realization events drove a 21% increase in cash carry since the second quarter.

And finally, the last thing we need to do well was use our model of AUM, Capital Markets and balance sheet to capture greater economics for our investors.

A great example of our model at work in the third quarter was our acquisition of Upfield, a carve-out of the Unilever's spreads business. This investment provided a compelling opportunity for our fund investors. We were the sole sponsor in this EUR 7 billion enterprise value transaction that required approximately EUR 2 billion of equity.

KKR Capital Markets was instrumental in syndicating EUR 1.2 billion of equity to third parties, and the team also helped underwrite and place the debt financing. Capital Markets fees from Upfield alone were over $60 million in the quarter and helped contribute to the strongest quarter on record for our Capital Markets business.

And we've announced 2 additional investments, BMC and Envision, which follow a comparable firm-wide approach. These transactions closed in the fourth quarter, and as such, the outlook for Capital Markets in Q4 is quite strong.

Slide 4 highlights our fee-related earnings profile. AUM growth, which in turn has led to management fee growth, together with an active Capital Markets backdrop, has led to a significant step-up in our fee-related earnings. On an LTM basis, we generated $970 million in fee-related earnings, representing a 26% increase compared to the prior period.

And Page 5 of the supplement summarizes our core fundamentals across the 5 categories. The power of our model is evident in our results, and we are pleased with the progress and momentum we are seeing across the firm.

Before I turn it over to Scott, I want to briefly touch on one additional item related to our hedge fund partnerships. Nephila, as you may recall is a Bermuda-based investment manager specializing in catastrophic and weather insurance linked securities and reinsurance linked assets. In 2013, we acquired a 25% stake on our balance sheet.

This past August, we announced that Nephila is being fully acquired by Markel, a public specialty insurance company.

Since our initial investment in 2013, Nephila's management team has done an excellent job growing AUM from $8 billion to $12 billion. Over this time frame, our investment has also proved successful. The exit reflects a roughly 3x return on our investment and will allow us to book an attractive realized gain.

While we'll be reflecting roughly a $3 billion outflow in our public markets fee-paying AUM as a result of the sale of Nephila, this will be partially offset by an incremental 5% ownership stake in Marshall Wace, which we expect this to close in the coming weeks and which should contribute roughly $2 billion of Public Markets fee-paying AUM upon closing.

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Marshall Wace continues to be one of the premier hedge fund players in the world, so we're excited to enhance our stake and continue the strong partnership we've formed with them.

So in summary, please take a look at Slide 6, which highlights the 4 metrics that we really believe matter: AUM, management fees, total distributable earnings and book value per share.

We feel we have a real opportunity to continue to create and compound shareholder value substantially by enhancing each of these metrics, which will be driven by investment performance and the efforts of our global team as they continue to collaborate and execute.

And with that, I'll turn it over to Scott.

Scott C. Nuttall ***KKR & Co. Inc. - Co-President, Co-COO & Director of KKR Management LLC***

Thanks, Bill. As Craig and Bill discussed, we had a great third quarter, and we're having an excellent year. Our returns have been strong. AUM is up 27% over the last 12 months, and our book value per share has grown over 20%.

Our model is working. But to many of you on the phone, I'm sure September 30 feels like an eternity ago, so I thought I would talk about the recent volatility and how we look at it.

We tend to think in multi-year and decade increments, not daily or quarterly periods. Our business model allows us to do this. The public markets think in shorter increments, and in times like the last few weeks, the disparity in our time horizon relative to the public equity market becomes incredibly obvious.

So I want to tell you how we think about what's going on both from a business standpoint as well as our stock price. Over the last month, the S&P 500 Index is down 9%; the Russell 2000 is down 14%.

There's been a meaningful downward move. And stocks, including KKR and the alternative space broadly, have not been immune to this. Our stock is down about 20% over the last month. When we've been in periods like this, we're always surprised by the extent of the sell-off of our stock and space.

To be clear, we don't think like the public markets think. In our view, our firm is worth more today than 3 weeks ago. Our business is very stable. We have locked-up capital that's diversified across asset classes.

About 80% of our AUM is contractually committed to us for 8-plus years at inception. And we have $58 billion of dry powder, an amount that is up 22% over the last 12 months.

So we have a lot of capital to put to work and a lot of visibility on the management fee line. In our experience, volatility in the market is a good thing for our business, because if you have $58 billion that is ready to be put to work, and that capital cannot be taken away from you, it's good news when things get cheaper.

We can buy assets at lower valuations. In fact, in our 40-plus years of experience, some of our best investments have been made in periods of dislocation and volatility in the public markets.

We saw this coming out of the financial crisis a decade ago, and more recently in Asia, where we've increased our capital deployment into a volatile market and have a growing pipeline at attractive valuations.

And we can also buy back our stock at lower prices. So from our seats, our stability is worth more today, and the firm has even more opportunities and better prospects today, than a month ago. And as we invest aggressively into dislocation, our company will have the opportunity to grow in value over the long term at a faster pace than if valuations had not dropped.

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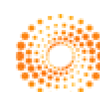

And as a reminder, our long-term incentives are aligned, as employees of KKR owned about 40% of the stock. We believe our stock will be worth more down the road because of what's going on, and we continue to be committed to equity value creation. So in our view, if the volatility continues, we think our long-term value will be higher.

With that, we're happy to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Patrick Davitt of Autonomous Research.

Patrick Davitt ***Autonomous Research LLP - Partner, United States Asset Managers***

It looks like the LTM performance numbers are fine in credit, but some of the balances on the balance sheet went down fairly significantly. Is there anything to point out from a credit stress standpoint there? Or is it really more about just selling some positions?

William J. Janetschek ***KKR & Co. Inc. - Member & CFO of KKR Management LLC***

Patrick, it's Bill. You're referring to Page 9. It's a little bit of both. There was some sell in the assets, but in Special Situations, we had one position just on a mark-to-market basis written down in the quarter, but I wouldn't spend too much time highlighting that one particular area. When you look at the balance sheet itself, the balance sheet was up 5% for the quarter and 15% on a year-to-date basis. And when you look across all the other platforms that we're invested in and the balance sheet, so we're talking about Private Equity and Core and Energy, Real Estate, Infrastructure, performance in all those other assets were above benchmark. So nothing to be worried about.

Patrick Davitt ***Autonomous Research LLP - Partner, United States Asset Managers***

Okay. And I guess, just more broadly, particularly the last few weeks, obviously, everyone's getting a little bit more worried about credit. When you look at your own portfolio, do you see any kind of broader deterioration? Or is it really just mark-to-market at this point?

Scott C. Nuttall ***KKR & Co. Inc. - Co-President, Co-COO & Director of KKR Management LLC***

Patrick, it's Scott. No broader deterioration. Actually, the fundamentals of the companies in our credit portfolio and our private equity portfolio continue to be strong. And actually in the liquid credit markets, we've seen some volatility come into high yield, but the leveraged loan market is actually quite stable. So no broader readthrough as of yet that we'd be worried about.

Operator

Our next question comes from Bill Katz of Citigroup.

William R. Katz ***Citigroup Inc, Research Division - MD***

The first question is you ticked off a number of things that you're going to be in the market for, plus, I guess you said a half dozen of other things that will be coming down the pike. I was wondering if you could maybe help quantify the opportunities set here, collectively, of how much incremental assets you might be able to bring on? A couple of your peers have sort of been bold enough to give specific guideposts in terms of what they think they can raise over a set period of time. And just trying to frame out the incremental opportunity in terms of capital raising.

Craig Larson ***KKR & Co. Inc. - Head of IR***

Bill, it's Craig. We don't have a specific number or specific guidepost to give you. I think the broad fundamentals as we think about that opportunity set is as we've described for some time. We think the industry as a whole is growing given a number of secular trends. Against that backdrop, we've taken share. And again, as we think about our businesses that we're in, most of them are younger and they're scaling. So that leads us to look and think we have a lot of meaningful growth opportunities relative to where we stand today. Again, just recognizing how young a number of those businesses are. And I think over the coming periods, another dynamic we've talked about are adjacencies as we think about opportunities for us in geographies like Asia. So I think there's a lot of good things to come, but not a hard specific number to give you.

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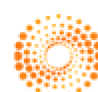

Scott C. Nuttall ***KKR & Co. Inc. - Co-President, Co-COO & Director of KKR Management LLC***

Yes. I would point out, Bill, that the last 12 months, we've raised $38 billion organically without having a flagship private equity fund in the market. So we've been busy on a lot of different fronts.

William R. Katz ***Citigroup Inc, Research Division - MD***

No doubt. Okay, and then just as a follow-up question, Scott, maybe for you. So, you sort of highlighted both the volatility as an opportunity to both invest in companies as well as potentially buy back. Could you sort of frame out how you're thinking about that dynamic, if you will, between maybe stepping in buying your stock here at just under $23 versus the incremental opportunity to sort of grow either in public or private markets?

Scott C. Nuttall ***KKR & Co. Inc. - Co-President, Co-COO & Director of KKR Management LLC***

Sure. So I think, first, back on the volatility itself. The first thing I'd point out is, outside the U.S., we've already been in bear market territories. So the EURO STOXX 50 is down about 13% in the last 12 months, China is down about 20%. And we've been increasing our deployment outside the U.S., Asia in particular, this year. And so the way we kind of look at it is we've been investing into this location already and are pleased with that. And the good news is we're doing this at a period of time where we've got $58 billion of dry powder, as I mentioned. And just to put that in context, that was about the total AUM of the firm in 2011. So we've got a lot of capital to put to work and a lot of cash on the balance sheet. But I think in terms of the buyback, as we've said several times in the past, we're focused on and committed to making sure there's no dilution from compensation-related share issuance. And so I think what you should expect, Bill, is all else equal, in periods of time when we see a dislocation like this in our own stock, you should expect us to be more active in delivering on that promise than when the stock's higher. But no change in overall policy, but just, directionally, you should expect us to be more active when we've got periods like this.

William J. Janetschek ***KKR & Co. Inc. - Member & CFO of KKR Management LLC***

And Bill, just a little more color on that and to drive home Scott's point about actually executing on what we've said, we said specifically that we wanted to make sure that we didn't deal with share creep as it relates to share issuances to our employees. When we changed our distribution policy in 2015, the share count adjusted for Marshall Wace shares that we used for an acquisition were roughly $864 million. We issued shares at the end of '15, '16 and '17 to our employees. And the share count today stands at $864 million.

Scott C. Nuttall ***KKR & Co. Inc. - Co-President, Co-COO & Director of KKR Management LLC***

Shares.

William J. Janetschek ***KKR & Co. Inc. - Member & CFO of KKR Management LLC***

Yes 864 million shares, yes. And one other final point is keep in mind that we did authorize a buyback when we announced our conversion to a C-Corp, and we still have roughly $366 million of dry powder relating to that buyback.

Operator

Our next question comes from Alex Blostein of Goldman Sachs.

Alexander Blostein ***Goldman Sachs Group Inc., Research Division - Lead Capital Markets Analyst***

So just maybe picking up on the question from earlier, from Patrick, around direct lending and the trends you guys are seeing. So it feels like competitor dynamics are getting a little bit more intense. I guess I should say, Franklin announced an acquisition of a middle-market direct lending platform this morning. So I guess, in the past, you guys have talked about playing and continuing to move in kind of, like, the higher end of the direct lending market. So maybe you could speak a little bit to the differences between various kind of parts of the direct lending you're seeing, kind of where the industry is versus where you're deploying capital? And any metrics you guys can help us to think about your exposures, so within Direct Lending, i.e., like, what's sort of the EBITDA run rate for some of the companies, leverage levels, interest coverage, anything like that would be helpful just to get a sense how your business might be different.

Craig Larson ***KKR & Co. Inc. - Head of IR***

Alex, this is Craig. Let me start and see if Scott has anything he wants to add. Look, I think you're right, the overall dynamics within direct lending have changed. Money has come in and it's more competitive than it was a few years ago. But in our view, as you said, the place

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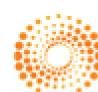

where it's become most competitive is in the lower end of the middle market, where you really do have many, many firms that can be relevant. And these dynamics are different at the upper end, which is our area of focus. And so things that are critical for us in this, broad origination capabilities, both as it relates to corporates as well as third-party sponsors. It's important to have multiple pools of capital to allow someone to be creative and offer a potential range of solutions when you're evaluating financing opportunities. And ultimately, the competitive dynamics are better, because they aren't that many players that can be $250 million and greater as a sole lender. And as part of that, just as from a structure standpoint, in the investments we're making, because you're right, look, the decision, the investment decision is an underwritten approach as it relates to the investments. And structure is an important part of that. And as a lender, just to give you a sense, in our most recent Direct Lending fund, so the vast majority, almost 95% of the investments we've made have true covenants, so that's leverage and/or interest coverage. We're focused on equity cushion, call protections and deleveraging mechanisms, including hard amortization as well as excess cash flow sweeps. So the weighted average equity cushion in Direct Lending III is about 50%. The majority of these investments have excess cash flow sweeps and/or hard amort. So again, the terms you see here really offer protection for us as a lender.

Scott C. Nuttall ***KKR & Co. Inc. - Co-President, Co-COO & Director of KKR Management LLC***

Yes, so I'd say, look, I think Craig captured it well, Patrick, I think -- or Alex. I think the other thing I would mention is, we talk a lot about direct lending in Private Credit, but we also have a fast-growing Principal finance business as well, where we're stepping into the void left by a bunch of banks pulling out of hard asset financing. And that's also a part of the platform that we're particularly excited about. So we continue to see opportunities on the large end of direct lending. Our average EBITDA for our Fund III, for example, in Direct Lending has been north of $100 million. If you go back to Fund I, it was closer to $50 million. So these companies are a lot bigger, and by virtue of their size, more diversified and, in our view, safer through a cycle.

Alexander Blostein ***Goldman Sachs Group Inc., Research Division - Lead Capital Markets Analyst***

Got it. And then my follow-up is just around the exit backdrop. So accrued carry continues to actually grow very nicely. If the environment remains pretty choppy, I imagine it might be more difficult for you guys to exist in the public markets, but can you talk a little bit about the opportunity to monetize some of the investments in the private markets, whether it's through strategics or other private equity firms coming in and just kind of any flavor of how we should think about the exit backdrop over the next quarter or 2?

William J. Janetschek ***KKR & Co. Inc. - Member & CFO of KKR Management LLC***

Alex, this is Bill. I could just give you a little color about the fourth quarter. But as we stand here today, based upon transactions that have closed or signed transactions that have yet to close and may close either in the fourth quarter or possibly the first or second quarter of next year, although I would think that most of it would be occurring in the fourth quarter with some slippage into the first quarter, I'm giving you that caveat, that the gross carry and the realized investment income combined right now, as we stand here today, is roughly about $580 million.

Scott C. Nuttall ***KKR & Co. Inc. - Co-President, Co-COO & Director of KKR Management LLC***

The only thing -- one just thought for everybody is to keep in mind, we have a majority of the investment professionals in our firm actually outside the United States. So I know there's a tendency, especially for those of us in New York, to focus on the U.S. markets, but we actually have quite a global business. And so to the question on exits or kind of the overall environment, we've actually been operating in an environment in Europe and Asia where we've already seen a stock market pull back over the last several quarters in a lot of those markets. And even with that, we've seen significant monetization activity. So we don't sit here today with a very different perspective than we would have had 3, 4 weeks ago.

William J. Janetschek ***KKR & Co. Inc. - Member & CFO of KKR Management LLC***

And Alex, just one final point. When you look at the assets that we have, and I'm just talking about PE, roughly a third of those assets are in public securities. So to the extent that this volatility settles down and the market recovers over the next 3 to 6 months, we will still have the ability to monetize that. And also keep in mind, you mentioned the accrued carry, which is shown on Page 8 of the earnings release. Away from just private markets, we've got about $165 million of accrued carry on the public market side. And you could see we had a small monetization this quarter, which drove about $10 million, but we're optimistic that we're going to actually see some more monetizations come through our public market side in the next couple of quarters.

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Operator

Our next question comes from Craig Siegenthaler of Credit Suisse.

Craig William Siegenthaler ***Crédit Suisse AG, Research Division - MD***

So just starting on Capital Markets fee. So we know they're included in fee-related earnings, but they can be more cyclical than the management fees on locked-up capital. So I just wanted to see, like, what type of volatility do you expect in these fees in the next down cycle, which maybe has already started, versus the underlying growth in the business and share gains that you expect?

William J. Janetschek ***KKR & Co. Inc. - Member & CFO of KKR Management LLC***

Craig, this is Bill. I'll take this one, and if Scott or Craig wants to chime in later, feel free. But when you're in the capital markets business, it's hard to predict what that earnings base is going to be the next particular quarter. But as you did see in the supplement that we sent around with the press release, Capital Markets fees over the last 4 quarters were in excess of $100 million. You could see that the Capital Markets fees in this third quarter were quite significant at roughly $186 million. And I did mention that Unilever actually drove $60 million of that $186 million. We did give you a little bit of visibility into the fourth quarter about Envision and BMC, and so we feel really comfortable that Capital Markets performance in the fourth quarter is going to be solid. But when you drill down, and what actually happened even in this third quarter, 60% of the economics came from equity, 40% came from debt. And the income generation of that $186 million came from 40 mandates. And the one thing that we're quite excited about with our Capital Markets arm is that, when you look at where we started in inception, it was just based in the U.S. and, specifically, around the KKR portfolio companies. That has grown to Europe and that has grown to Asia, and we've diversified into a third-party business. And so when you look at the year-to-date number, for the third-party business against a very large number year-to-date, it still represents about 20% of the economics. And almost, probably more importantly, about 35% of the revenue from Capital Markets year-to-date is actually coming from outside the U.S. So that's a long-winded me -- way of me telling you that the business is actually global, and it's got a lot of reach both from KKR and KKR's portfolio companies plus the third-party business. But again, the capital markets, the way it is, each and every quarter, we don't have the stable fee base that we have vis-à-vis a management fee, but we're pretty comfortable that it's quite a mature business, and we're cautiously optimistic about the results prospectively.

Scott C. Nuttall ***KKR & Co. Inc. - Co-President, Co-COO & Director of KKR Management LLC***

Craig, the way I would think about it is we have a lot of ways to win in capital markets. We've got our third-party business and a lot of activity on that front working with other sponsors and corporates, and we're investing more in origination there. We've got the debt of our own private equity portfolio companies, which are always doing refinancings of some description, virtually every week. We've got the equity that we own in our companies, both the public companies, where we're doing secondaries and companies going public where we're in the IPO. We're scaling in non-PE. So if you look back a few years, our Capital Markets business was almost entirely related to our PE business. But now, we're working across credit, Infrastructure, Real Estate, and to Bill's point, increasingly, it's a global set of activities. And then on top of that, you do have the large deal dynamic across private equity, Real Estate, Infrastructure and Energy, where we do these syndications. So it is -- you're right, it's not contractual like a management fee. But what we've found is, by virtue of the breadth of activity and the fact that Capital Markets is integrated into everything we're doing around the world, on an outcome basis, it's turned out to be quite steady around the world, because we're just so busy somewhere in the world in any given quarter. And it continues to scale in terms of just number of transactions.

William J. Janetschek ***KKR & Co. Inc. - Member & CFO of KKR Management LLC***

And the good news is we have the ability now to get a lot of that back just because we're so diversified.

Operator

Our next question comes from Glenn Schorr of Evercore.

Glenn Paul Schorr ***Evercore ISI Institutional Equities, Research Division - Senior MD & Senior Research Analyst***

Just a little follow-up in private credit land. First is, for Lending Partners II, can you remind us of what the hurdle rate is there? And if there is anything that's weighing on performance that we should note? And then just a quick follow-up on Franklin Square.

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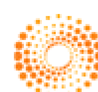

William J. Janetschek ***KKR & Co. Inc. - Member & CFO of KKR Management LLC***

Glenn, this is Bill. The hurdle rate, I believe, 8%.

Glenn Paul Schorr ***Evercore ISI Institutional Equities, Research Division - Senior MD & Senior Research Analyst***

Got it. And then on Franklin Square, do you mind just reminding us where are we now in the process on the combination? And then, are there funds that are in the pipeline that are going to be part of that fundraising over the next, say, 6 months that you talked about?

Craig Larson ***KKR & Co. Inc. - Head of IR***

Glenn, it's Craig. So we've -- there is a proxy statement that's out as we think about CCT and FS. So there is -- I'd point you to that as it relates to that transaction specifically. And then more broadly, on the question about the opportunities for us, it's interesting, and we've talked about this over time, we have a penchant to only have within our firm what really needs to be within the firm. And FS is a great example of how we can work with partners. So FS has built out a lot of capabilities, and they have a few hundred people that spend their time focused on being best-in-class and administering, running, selling these more permanent-type capital structures to an audience of hundreds of thousands of retail investors. I think we look at what they do and think they're better at that than we could ever be. So we've partnered with them on the BDC front, and we're talking with them about other products that we can create together over time where we can marry our 2 capabilities that we think can really be differentiated. So more to come on that over time, but we do think that is a -- that's a growth area for us.

Glenn Paul Schorr ***Evercore ISI Institutional Equities, Research Division - Senior MD & Senior Research Analyst***

Okay. And is it fair to say that if you do expand in that space, it will be through that partnership?

Scott C. Nuttall ***KKR & Co. Inc. - Co-President, Co-COO & Director of KKR Management LLC***

I think in terms of the private credit space, you should expect that we will continue to grow in partnership with Franklin Square, both by expanding our existing vehicles and then, over time, launching new ones together. And to Craig's point, I think it's also going to be an opportunity for us to create non-private credit vehicles with Franklin Square, so we'll keep you updated. But we are talking about, on an R&D basis, what else we can be doing together. But we will continue to have a private fund and SMA component of our private credit business as well. But if I'm looking at aggregate dollars, I'd say the majority is going to be through our Franklin Square partnership, but we'll continue to be active on the private side as well.

William J. Janetschek ***KKR & Co. Inc. - Member & CFO of KKR Management LLC***

And the benefit of that mandate, and you mentioned it earlier, is that, for the most part, this is permanent capital, which is the best capital to have.

Operator

Our next question comes from Michael Carrier of Bank of America Merrill Lynch.

Michael Roger Carrier ***BofA Merrill Lynch, Research Division - Director***

Scott, maybe one for you. Just on -- with the recent volatility in the market and your comments in terms the deployment opportunities, all that's helpful. I just wanted to get a sense, when we're in this type of backdrop, how you guys are thinking about, like, deploying capital and then also the current portfolio. And just kind of a couple of things if you wanted to touch on, maybe how you're thinking about underwriting if we go through sort of a recession at some point. Where we are in terms of the multiples on invested capital, the typical revenue, EBITDA trends, anything on, like, entry multiples, leverage, how you're structuring it. And then how the business plan can shift if you do get into that phase in terms of the portfolio companies focusing on maybe efficiencies versus growth. I know that's a lot, so whatever you want to hit on.

William J. Janetschek ***KKR & Co. Inc. - Member & CFO of KKR Management LLC***

I'll agree with you on that.

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Scott C. Nuttall ***KKR & Co. Inc. - Co-President, Co-COO & Director of KKR Management LLC***

Thanks, Michael, all great questions. But I think, let's just do the backdrop first. I mean, I think the -- to the comments from before, our feeling is that this -- to some extent, what we've seen in the last few weeks is the U.S. starting to catch up a little bit with the rest of the world. We've already seen a meaningful sell-off in China. We've seen the beginnings of some valuation changes in Europe. In the U.S., I think for us, we've kind of been waiting for this to some extent. We're past the peak in earnings growth. At the same time, the Fed is tightening. And if you really just step back from it all, 8 of the last 8 times the Fed raised rates, multiples in the U.S. markets peaked. So with all that happening at the same time you've got QE ending, which is impacting risk assets, kind of liquidity is starting to leave the system a bit. And margins being under pressure, at least the concern about it with wages, oil, rates, tariffs, all of this, from our seat, is kind of as expected that we're starting to see a bit of an adjustment in the U.S. and starting to catch up a little bit with the rest of the world. But we shouldn't overdo it. I think the recency has an impact on all of us as people, but the S&P is up nearly 30% over the last 2 years. So we've sold off quite a bit in the last few weeks, but the last couple of years, we've seen a meaningful uplift in value. But multiples, we think, have peaked, and they're going to start to come back down, all else equal, and this is just kind of an expected beginning of that. We're excited about it. I mean, I think as I said, we've got nearly $60 billion to put to work plus the cash on the balance sheet. So I'd say our teams have been waiting for a valuation adjustment to make some assets that they really like more attractive. And we're hopeful there will be even more to do from a deployment standpoint going forward given that, and then we'll work with these assets and then monetize them over the long term. But I'd say the presiding emotion here is excitement that valuations have started maybe in the U.S. to come down a bit. In terms of your question about how we're underwriting, I'd say we've been underwriting for a while assuming that everything we're doing, we're going to own through some kind of an economic slowdown. Because if you think about most of what we do, we're going to end up owning an asset or lending to a company through a several year period, given where we are in the cycle. We've already been assuming we're going to own -- or lend through some kind of a recession, and we've been pricing transactions on that basis. To be clear, a lot of cases, we're assuming that we exit at lower multiples than where we get in, as an example. In terms of your questions on the portfolio, we have not seen a pullback in the fundamentals in our own portfolio. Our private equity and our credit portfolio revenue and EBITDA trends continue to be very attractive, kind of low-double digit revenue and EBITDA growth across the PE portfolio the last 12 months, as an example. And so I don't think it's really a material change in terms of how we're -- what we're seeing in our portfolio nor a material change in how we're assessing companies. And in terms of efficiencies versus growth, we continue to focus on both. But a lot of what we're doing, especially in PE is, we need to find assets we can make materially better, both growing the top line and oftentimes finding efficiencies, but really, through a cycle, we find the top line opportunities are far more powerful in terms of creating return for the people we work for. So that's a little bit of color. I'm happy to take more offline, but I think it's exciting times.

Craig Larson ***KKR & Co. Inc. - Head of IR***

I was just going to say, Mike, the one thing when I'm asked this question, when we're asked this question, it's often in the framework of private equity deployment. And it ties into this, because when you look at our recent investment in Americas PE, our entry multiples today are actually lower relative to 2 years ago. And that's interesting. And I think the reason you're seeing this is because there is a different risk reward in those investments. And in many ways, we're buying into complexity; we're not buying into growth. And you see this in some of our larger transactions. Bill talked about the Unilever transaction. It was complicated. We have a global team as we evaluated that. Envision is an investment where we're going to be focused, together with management, on a series of operational improvement opportunities. And in BMC, again, the mainframe industry, it's an industry with complexity. So we're leaning into complexity. We're focused on opportunities where we can bring expertise to help reposition an investment. And if you then also think about, if we had to bucket the areas where we've been particularly active, we'd point to corporate opportunities. So whether it's through our portfolio companies pursuing M&A where there can be real synergies. We announced a pretty significant investment this week in the auto parts industry through which Calsonic, which is one of our portfolio companies, is going to acquire Magneti Marelli from Fiat. It's a great example of this. And we've talked previously about transactions involving Internet Brands, Air Medical, PharMerica, again, all examples of working with portfolio companies that can fit in this category. Carve-outs, again, that can be complicated. Upfields. We acquired earlier in 2018 2 businesses out of a large diversified corporation in South Korea as well as the activity we've talked about in Japan. So I think, in an environment like we're in, those are examples of areas and themes where you'd see us be -- try and lean into the opportunity.

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Operator

Our next question comes from Chris Harris of Wells Fargo.

Christopher Meo Harris ***Wells Fargo Securities, LLC, Research Division - Director and Senior Equity Research Analyst***

So we've already touched on Asia a little bit. I was wondering if you guys might be able to share your perspective on what you're seeing economically in that part of the world? The stock markets seem to be indicating that things are pretty bad. So I'm curious to hear what you guys have to say. And then related to that, you've already mentioned that you're not really seeing too much weakness, or any weakness, in your portfolio in the aggregate. But what about Asia specifically? Are you seeing any sort of weakness for some of those investments that are already in the ground there?

Scott C. Nuttall ***KKR & Co. Inc. - Co-President, Co-COO & Director of KKR Management LLC***

Chris, its Scott. So I think, Asia, it's really hard to talk about as a monolith, given all the countries. So let me try to do a quick kind of spin with you. So, we've been particularly active the last few years in Japan. And it's not because the Japanese economy we think has an extraordinary amount of opportunity in the near term. It's more because we've seen corporates in Japan start to be comfortable selling noncore subsidiaries. And so a lot of the activity you've seen, and it really started with our Panasonic Healthcare transaction, has been around us doing corporate carve-outs from large-scale companies in that country. And then what we've been doing, and we've done this twice in a very visible way now, is to help those companies, post carve-out, go global. So Panasonic Healthcare, we did an acquisition of Bayer's Diabetes business in Germany, and then we just announced this transaction Craig just referenced with Calsonic and Fiat. So the companies in Japan continue to operate as expected, no change. The kind of the ability to get out efficiencies and drive growth is as expected, and the global opportunity expansion in terms of cross-border M&A, we think is real. So no change to the question in terms of recent views. And the big opportunity, we think, ahead is there's thousands of noncore subs in that country. And we're just starting, we think, to scratch the surface on the opportunity. China is another place that we're quite active. Keep in mind, what we've -- where we have focused in China has historically been largely focused on the growth of the consumer and the spending power of the individual. So if you look at what we've done, it's been things in technology. We've been busy, increasingly, in healthcare as of late. And so those companies, so far, we have not seen a meaningful change in how they're performing, but -- and in fact, we've had quite a busy deployment year in China over the course of the last 12 months. Hospital roll-ups, tech in particular. And so we continue to be active in China. We've got a portfolio of over 20 companies in that part of the world. And the performance, a bit weaker than what we've seen, but nothing that I would call out as causing us any real concern. The other trends that we see there, food, safety, environmental, safety continued to be real opportunities for us. Australia, as another active market, no meaningful change. Southeast Asia, a market with a lot of growth opportunity for us, no meaningful change.

Operator

Our next question comes from Michael Cyprys, from Morgan Stanley.

Michael J. Cyprys ***Morgan Stanley, Research Division - Executive Director and Senior Research Analyst***

Just on the CLO market, you guys are active in that space, and the market has broadly seen tremendous growth in CLOs across the industry. But just some concerns are manifesting around equity buyers potentially stepping away and concerns around weakening terms and higher use of leverage. Just curious to hear your perspective on what you're seeing, what you're hearing, what your perspective is on that. And how you're underwriting criteria has evolved over the past 12 to 24 months in the context of the CLO market?

Scott C. Nuttall ***KKR & Co. Inc. - Co-President, Co-COO & Director of KKR Management LLC***

Great. Happy to take it. So you're right, we continue to be active in the CLO market in both the U.S. and Europe. Our issue has not been around equity buyers stepping away so much, because remember we tend to use our balance sheet to retain a decent portion of equity in our own CLOs, so we have heard that, but we haven't seen a big impact on our business from equity buyers stepping away. I think the bigger thing that we're focused on is your second point, around how does the math work right now in terms of creating new CLOs, and are the returns for the equity attractive given the spread between asset returns and liability cost. And so we, for example, we have been very busy this year, U.S. and Europe. The math has becoming most compelling in the very recent past, but it doesn't change our thinking in terms of our ability to scale that business over the long term. We think it's a bit of a transitory shift. We've been issuing $2 billion to $3 billion with the CLOs a year, and our expectation is that we will continue to do that.

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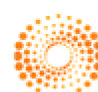

William J. Janetschek ***KKR & Co. Inc. - Member & CFO of KKR Management LLC***

And just a little more color on that. Away from the CLOs that we're actually raising in the last 12 to 18 months, we have been doing a lot of refinancing and resets. And when you do a reset, you actually get to extend the maturity. So we actually get little more economics out of the CLO that has already been raised.

Michael J. Cyprys ***Morgan Stanley, Research Division - Executive Director and Senior Research Analyst***

Great. Just a follow-up question, back to your comment on principle finance business that you guys have. I just hoping you could just talk a little bit more about the opportunities set that you see if you could just help us remind us size, where is your business is today, how you're building it out, and where you see this going over the next couple of years?

Scott C. Nuttall ***KKR & Co. Inc. - Co-President, Co-COO & Director of KKR Management LLC***

Great. Happy to take that. So the principal finance business is largely funded for us out of 2 pools. One is our Principal Credit Opportunities Fund, which we call PCOP. And then, also, we make these investment sometimes also on our BDC platform. So the high level is that what we've found, and it really started in Europe and is now kind of expanding into the U.S., is that there are number of hard assets -- types of hard assets that were historically funded by banks, European banks in particular. And with the banks pulling back, there was an opportunity to invest into businesses that were lending to these markets. But as opposed to going to invest into a company that has a legacy balance sheet and a legacy portfolio that we needed to worry about, to a very large extent, what we've been doing is creating new principal finance platforms. So we've created the better part of 10 specialty finance companies where we'll invest the equity, work with the management team and create a deal flow for that entity, and then work with the company to finance that deal flow and create a balance sheet for that new enterprise. And so our team has been very active doing that across a number of different spaces, everything from construction lending in Ireland to auto lending in the U.S., U.K., to the housing market. And so we've been quite busy there. We haven't spent a lot of time talking about it in the past, but we've been just working away building this platform out, and we think we've got the beginning of something quite special. So it's a business that we think we can grow over time, because we continue to see that this space, as opposed to some of the other spaces we've talked about today, has yet to attract large-scale capital. And so we continue to be quite active.

Operator

At this time, I would like to turn the call back to Craig Larson for closing remarks.

Craig Larson ***KKR & Co. Inc. - Head of IR***

Okay. Thank you, Norma and thank you, everybody, for joining our call. If you have any follow-up questions, of course, please reach out to us directly. Thanks so much.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. You may disconnect. Have a wonderful day.

Editor

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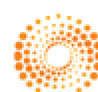

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