THOMSON REUTERS STREETEVENTS

# EDITED TRANSCRIPT

KKR - Q1 2015 KKR & Co LP Earnings Call

EVENT DATE/TIME: APRIL 23, 2015 / 2:00PM GMT

## CORPORATE PARTICIPANTS

**Craig Larson** *KKR & Co. L.P. - Head of IR*

**Bill Janetschek** *KKR & Co. L.P. - CFO*

**Scott Nuttall** *KKR & Co. L.P. - Global Head of Capital & Asset Management*

## CONFERENCE CALL PARTICIPANTS

**Chris Kotowski** *Oppenheimer & Co. - Analyst*

**Bill Katz** *Citigroup - Analyst*

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

**Patrick Davitt** *Autonomous Research LLP - Analyst*

**Chris Harris** *Wells Fargo Securities, LLC - Analyst*

**Luke Montgomery** *Sanford C. Bernstein & Company, Inc. - Analyst*

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

**Glenn Schorr** *Evercore ISI - Analyst*

**Craig Siegenthaler** *Credit Suisse - Analyst*

**Michael Cyprus** *Morgan Stanley - Analyst*

**Devin Ryan** *JMP Securities - Analyst*

## PRESENTATION

**Operator**

Ladies and gentlemen, thank you for standing by. Welcome to KKR's first quarter 2015 earnings conference call. During today's presentation all parties will be in a listen only mode. Following management's prepared remarks the conference will be open for questions.

(Operator Instructions)

As a reminder, today's conference is being recorded. I'll now hand the call over to Craig Larson, Head of Investor Relations for KKR. Craig, please go ahead.

---

**Craig Larson** *- KKR & Co. L.P. - Head of IR*

Thank you, Candice. Welcome to our first quarter 2015 earnings call. Thank you for joining us. As usual, I'm joined by Bill Janetschek, our CFO, and Scott Nuttall, Global Head of Capital and Asset Management. We would like to remind everyone that we'll refer to non-GAAP measures on the call which are reconciled to GAAP figure in our press release. The call will also contain forward-looking statements which do not guarantee future events or performance and please refer to our SEC filings for cautionary factors related to these statements.

This morning we reported strong first quarter results and, more importantly, these results reflect a lot of the themes we've been talking about over the last few quarters so, because of this, we'll be able to quickly review the numbers and then move into Q & A.

Turning to our results. We reported first quarter economic net income of $599 million, which equates to $0.62 of after-tax economic net income per unit. We continue to be active on the realization front, so let me spend a few minutes on our cash metrics. Total distributable earnings were $517 million in the first quarter, which translates into $0.60 of distributable earnings per unit net of taxes. Both of these figures are up over 35%

from last quarter driven by an increase in net realized carry. And in terms of the flow-through to the distribution, we've announced a first quarter distribution per unit of $0.46, which is up over 30% from the fourth quarter of 2014.

And with that, I'll now turn over to Bill to discuss our financial performance in more depth.

---

**Bill Janetschek** - *KKR & Co. L.P. - CFO*

Thanks, Craig. Let me begin with our segments. In private markets, we reported first quarter ENI of $568 million, up meaningfully from the fourth quarter. There are three main drivers of this increase. First, our private equity portfolio appreciated 5.1% in the first quarter, outperforming the S&P 500 by approximately 400 basis points. Our publics performed particularly well increasing over 10% in Q1. Second, our private markets balance sheet assets were up in Q1 increasing investment income quarter-over-quarter. And finally, transaction and monitoring fees increased from Q4 as we receive termination payments in Q1 from Big Heart and Alliance Boots, which contributed about $45 million of net monitoring fees. And keep in mind, we shared these monitoring fees 80/20 in favor of LPs in our traditional private equity funds.

Touching on public markets, we reported $3 million of ENI this quarter. It is worth spending a minute on our investment income. First, on the CLOs. Interest income from our CLO portfolio was approximately $40 million in the quarter, generating an annualized cash yield of about 11%. Total investment income from the CLOs this quarter though was only modestly net positive as the interest income was largely offset by unrealized losses. A big contributor of the unrealized losses in our CLO portfolio relates to our decision to call two of the CLOs. Given repayments within these specific CLOs, our ROEs were trending toward mid single digits so we called them and we'll look to redeploy this capital at higher ROEs. In addition, we wrote down a couple of other investments in public markets, all of which contributed to the unrealized loss this quarter.

Moving to capital markets, we reported first quarter ENI of $28 million, up from $21 million we reported in Q4 driven by higher transaction fees. Here our diversification continues to drive growth in this segment. In the first quarter, 70% of KCM's revenue came from outside of the US and 30% came from our third party business.

I'd like to spend a minute on our balance sheet. We reported on March 31 book value of $12.19 per unit, which is up 9% on a year-over-year basis. This 9% increase, or about $1 per unit, is after paying out $1.90 per unit in distribution over the last 12 months. This is important to understand because combining book value growth with the LTM dividend paid, we've created about $3 per unit of value for shareholders year-over-year on a starting base of $11.18, or 25% return. We've returned 2/3 of that through our distribution with the other 1/3 through the compounding of our book value.

We also grew the carry payable on our balance sheet. Our March 31 book value includes an 8% increase in unrealized carry year-over-year bringing that figure to $1.4 billion with almost $100 million of that coming from our public market segments. And that's after paying out over $800 million of net realized cash carry over the last year. As Craig mentioned earlier, our distribution in the first quarter is $0.46 per unit, which includes $0.15 of fee and yield earnings, $0.22 of realized carry from eight realizations with the remainder coming from realized balance sheet gains.

Finally, in terms of our AUM and fee paying AUM as of March 31, our assets under management were $99 billion and fee paying assets under management with $83 billion. Keep in mind these figure do not reflect approximately $6 billion of committed capital that will be included in AUM once it's invested. And since March 31, we've raised an additional $1.4 billion in follow-on closings for Special Sits II, Direct Lending II and Infra II.

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

---

**Scott Nuttall** - *KKR & Co. L.P. - Global Head of Capital & Asset Management*

Thanks, Bill. I'm going to hit three topics today: performance, monetizations and the development of some of our newer businesses.

Let's start with performance. If you look across the firm, we had a good first quarter with strong investment performance across the majority of our asset classes. In private equity, our portfolio appreciated 5.1%. The larger positions in the PE portfolio continue to perform. This is the second consecutive quarter that we've written up First Data and saw an increase in the value of Walgreens Boots Alliance. Together, these two investments appreciated 9% in the first quarter contributing meaningfully to our accrued carry and balance sheet income. At the same time, many of our recent vintage funds are performing especially well. To give you a sense, our NAXI, Asia II and real estate funds have gross IRRs that range between 25% and 45% since inception and we've only been investing capital here for three years.

Before I leave private markets, I want to touch on energy and infrastructure. Given the continued decline in underlying commodity prices in the quarter, the energy portfolio was marked down modestly. The balance sheet energy assets were down 4% in the quarter. And across our energy funds, our investments were down 5%. Our infrastructure strategies continued to perform with the infrastructure funds up 5% in aggregate in the quarter. And in public markets, KKR Prisma's low volatility composite had a gross return of 3.3% in the first quarter and the gross IRRs on our first special situations, mezzanine and direct lending funds since inception are 19%, 16% and 12% respectively -- all significantly ahead of benchmarks.

Now to the second topic of monetization. We've been active on the private equity exit front in the first quarter, returning over $3 billion of cash to our fund investors through the public markets and strategic sales. We took Go Daddy public at the end of the first quarter and that investment, at $26 per share, is marked at about three times our cost. We also did secondaries at KION and Nielsen at a blended multiple of three times. And we're also creating strategic exits. In the first quarter we sold Fotolia to Adobe and we closed on the Big Heart transaction and the second step of the Alliance Boots transaction. In several of these cases we've taken the strategic stock as a component of the deal consideration and we've seen those stocks trade up. For example, since the original Alliance Boots Walgreens transaction was announced in June 2012, Walgreens stock has almost tripled.

The last thing I want to touch on is the development of some of our newer businesses. A key part of our strategy has been scaling the businesses that we started over the last few years. We're nearing the end of the investment period for several of our first time funds and we're in the process of raising second generation funds as these strategies shift toward harvesting mode. In credit, we've been busy raising the successor funds to our lending partners and special sits funds. In April we had a final close on Lending Partners II totaling $1.3 billion, approximately three times the size of Fund I. And it is early days for Special Sits II fund raising but we've already raised $1.7 billion through its first closing. We also held another close on Infra II bringing total capital raised to date to $2.5 billion, already hitting the low end of our fund raising goal of $2.5 billion to $3 billion. We've also recently announced that we extended our relationship with Texas Teachers to include an additional $2 billion of committed capital, which will be invested in our private markets and alternative credit strategies. This $2 billion is subject to documentation and is not included in the $6 billion of shadow AUM that Bill mentioned earlier.

Stepping back, three years ago the combined assets that we managed in alternative credit, energy and infrastructure and real estate were $7 billion. Today, including closes since March 31 and shadow AUM, we managed $24 billion in these strategies. Alternative credit, including CCT, has grown from $3.5 billion to $15 billion. Energy and infra went from about $3 billion to $8 billion. Real estate went from investing balance sheet capital to $1.4 billion, all in the last three years. This growth has been entirely organic and the balance sheet has been a real accelerator of our efforts in all of these areas. Growing from $7 billion to $24 billion in these strategies, plus Prisma, which has grown from $8.5 billion to $10.7 billion since the acquisition, is early proof of concept for what we've been trying to achieve. The good news is investment performance has been strong, the end markets are large and we see an opportunity to really scale from here.

Our investment performance in business development progress are evident in our results. Over the last 12 months, our total distributable earnings are up 30%. Our distribution is up 25% with the more recurring part of our distribution up 35% and we generated a cash ROE of 20%. We're pleased with our start to the year but there's a lot more to come in 2015.

Thanks for joining our call. Operator? Can we please open the line for any questions?

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions)

Our first question comes from the line of Chris Kotowski of Oppenheimer.

---

**Chris Kotowski** - *Oppenheimer & Co. - Analyst*

Yes, good morning. I wonder if you could expand a bit on the CLOs and the marks and explain what exactly happens when you call a CLO and how that affects the cash flows and the portfolio marks. And just in the broader context, it looked to us like leveraged loan prices were generally kind of flattish in the quarter but you took a couple percent mark-down, so how did that all interact?

---

**Bill Janetschek** - *KKR & Co. L.P. - CFO*

Sure, Chris. This is Bill. At a very high level, the CLO portfolio -- if you have a CLO that you expect to mature over four or five year period, to the extent that it's in the post investment period and you actually have prepayments -- because those prepayments were coming in quicker than expected -- with the leverage on that CLO, the return that you're getting because of those prepayments aren't what you would model out. And so because of the acceleration of the prepayments, you actually see that CLO value come in a little. And so as I mentioned in prepared remarks, the CLO generated a good amount of income, vis-a-via interest income, but we had a mark-to-market on the overall CLO portfolio. So on a net basis, the CLOs were up, again, on a net basis, modestly.

---

**Scott Nuttall** - *KKR & Co. L.P. - Global Head of Capital & Asset Management*

And, Chris, just maybe to add to that, so the way it works is we get a third party mark on our CLO equity every quarter. And when you have a CLO that's in its active investing period, that mark may be higher than the net asset value of the underlying equity by a little bit because you get credit for the ability to reinvest proceeds in the CLO and keep the CLO continuing to grow and generate cash. When you put a CLO into run-off, or you call it, you may see a little bit of a reversion [NAV]. And so really what happened in this quarter in those couple of CLOs we called, we had a little bit of a reversion to NAV. Away from that, if you look at your comment about leverage loan prices being pretty flat, the CLOs performed as expected. So the way I would think about it is with those two CLOs in particular, a mark-down that we would not expect to repeat, free up cash and deploy that cash into new CLOs, which we've been printing quite actively at much higher returns.

---

**Chris Kotowski** - *Oppenheimer & Co. - Analyst*

Okay.

---

**Bill Janetschek** - *KKR & Co. L.P. - CFO*

And, Chris, still again, when you think about it, we don't think that we're going to be calling any other CLOs over the next quarter.

---

**Chris Kotowski** - *Oppenheimer & Co. - Analyst*

Okay. And then I noticed that on your balance sheet you deployed another nearly $200 million of balance sheet capital in the real estate segment and -- but which was more than actually you drew down in the American Real Estate fund. So is that just some properties or are you seating a new fund or what's happening there?

---

**Bill Janetschek** - *KKR & Co. L.P. - CFO*

Chris, that a very good question. We mentioned this on the call, I think, prior to this one in that we brought over a real estate credit team. The whole idea is with our balance sheet, we had them investing in real estate credit. And so you'll see those earnings come through the balance sheet for the time being. The goal is by bringing them over here, having them invest off the balance sheet proof concept, we'll then be able to go out and raise third party capital. So the biggest increase in that number on real estate came from those folks deploying that real estate credit during this quarter.

---

**Chris Kotowski** - *Oppenheimer & Co. - Analyst*

Okay. I'll let some other folks ask some questions. Thanks.

---

**Craig Larson** - *KKR & Co. L.P. - Head of IR*

I was just going to say -- and thanks, Chris. We have well over a dozen folks actually in the queue. So if people could limit themselves to one question. And if it isn't asked, please feel free, naturally, to get back in the queue. It would be helpful.

---

**Operator**

Thank you. Our next question comes from the line of Bill Katz of Citigroup.

---

**Bill Katz** - *Citigroup - Analyst*

Okay. Thanks very much. Maybe I'll cheat and ask a two part question if I could. So I think there's been some changes at BlackGold -- one of the investments you've made in the alternative space around their performance metrics. I'm wondering how did that filter into the marks in the quarter. And then the broader question, Scott, perhaps, is does this change your vetting process as you think about continuing to invest in some of these other smaller entities you're trying to scale? Thanks.

---

**Craig Larson** - *KKR & Co. L.P. - Head of IR*

Hi, Bill. It's Craig. Why don't I take the first one of that. We acquired a 25% stake in the general partner of BlackGold in July of last year, 2014. And the purchase -- while the purchase price isn't public, we're not talking about a material investment for us. So to date, assets are up from when we made the investment. In addition to that, we voluntarily invested $100 million of balance sheet capital as an LP in Q4. And there is a negative mark on that investment this quarter that impacts the unrealized investment income line within public markets in Q1. So the net impact of this, to answer your question, is about $15 million in terms of our ENI in this segment in the quarter.

---

**Bill Katz** - *Citigroup - Analyst*

I'm sorry. You said $15 million or $50 million?

---

**Craig Larson** - *KKR & Co. L.P. - Head of IR*

$15 million.

---

**Bill Katz** - *Citigroup - Analyst*

Thank you. Sorry. Go ahead, Scott.

---

**Scott Nuttall** - *KKR & Co. L.P. - Global Head of Capital & Asset Management*

Sure. And the broader question about the vetting process -- I think the short answer is no. I think we have made two of these stakes investments and we've done one seed, all of which has been done off the balance sheet. And if you look at that portfolio as a whole, its performed very well in terms of the cash-on-cash returns that were generating for the balance sheet. I would say that the BlackGold situation at year-end was unfortunate but really a result of the fact of a very fast changing commodity price right at year-end. And so we don't think that that's something that is recurring in nature. But obviously we've had these investments [closely] and we'll work closely with the managers on a go-forward basis but we're still committed to the strategy.

---

**Bill Katz** - *Citigroup - Analyst*

Okay, thanks.

---

**Scott Nuttall** - *KKR & Co. L.P. - Global Head of Capital & Asset Management*

Thank you.

---

**Operator**

Our next question comes from the line of Mike Carrier of Banc of America Merrill Lynch.

---

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

Thanks, guys. Scott, you gave some color on some of the newer strategies, what you've grown over the past couple years getting to $24 billion. I guess when you look at the outlook and what you guys are working on strategically, where do you see that growth opportunity coming from? And I guess given that we're still on this -- the realization cycle, do you think over the next couple of years you guys are still on the pace of growing your fee AUM over that time? And just related to that, just because like transaction and monitoring fees were high, just any color on that as you're growing the business.

---

**Scott Nuttall** - *KKR & Co. L.P. - Global Head of Capital & Asset Management*

Yes. Great question, Mike. I think in terms of the outlook, I'll take that and then maybe Bill you can comment on transaction monitoring fees, but if you look at where we're growing, I think the short answer to your question of do we expect to be able to grow our assets is yes. And it really kind of runs across all our different asset classes. Private equity, as you know, we've had an active business there for nearly 40 years and we continue to see opportunities to grow around the world. We're in the market now with our European IV fund, which has closed on $2.4 billion so far and will wrap up this year. The Americas private equity fund will be launching later this year for fund raising. You know we closed Asia II not long ago. That franchise went from $4 billion in Asia I to $6 billion in Asia II, plus our China growth opportunities. So we see opportunities globally in private equity to continue to scale.

Our credit business, if you include the AUM that's committed to us that is where we get the fees once we invest the capital, is now a better part of $30 billion. That's been growing very quickly, as I said. The private credit component special situations, direct lending, mezzanine has gone from $3.5 billion to $15 billion so far and we see significant opportunity to continue to scale in private credit and in the leverage credit and opportunistic credit aspects of what we do. We're printing CLOs so we see opportunities in credit.

Our infrastructure business, as I mentioned, has gone from $1 billion in Fund I to now $2.5 billion so far raised for Fund II. And so we see a lot of opportunity to continue to scale there the significant capital needs around the world. Real estate is a young business for us where we see an extraordinary opportunity to invest capital globally and still see some supply demand imbalances quite acute, especially in the opportunistic value-add end of the spectrum. And as Bill mentioned, we're seeing opportunities in real estate credit as well where we're just getting started.

Hedge funds, massive space, the biggest part of alternative assets is actually the hedge fund space. And between KKR Prisma and new products that we're launching there this year, plus our direct hedge funds and the stakes and seeds I mentioned, we see a significant opportunity for growth there as well. So there's opportunities really across the firm and around the world. We've now got 22 offices at KKR. We've got the majority of our investment professionals outside the United States across all these asset classes.

So what I would tell you that we do see significant opportunity. The opportunity to go from Fund I to Fund II is more economically powerful than just we've raised more money. Because if you think about what happens when Fund I gets raised -- you've got all of the expense before the revenue. And then when we raise Fund II, we still get paid management fee from Fund I and Fund II tends to come on at -- so far anyway -- two to three times the size of Fund I. And carry starts to be generated from Fund I at the same time management fees come on for Fund II. So we see a lot of opportunity for growth in economics, which is, I think, the more important thing to look at than just the AUM.

And then the other bigger point I'd make is the end-markets for all of these areas combined is significant. If you add up all of the end-markets that we're talking about, it's about $6 trillion relative to about $1 trillion for traditional private equity. So we see a big opportunity.

---

**Bill Janetschek** - *KKR & Co. L.P. - CFO*

And, Mike, this is Bill. Just quickly on transaction and monitoring fees, when you think about it on the private market side we receive transaction fees from real estate, infrastructure and PE. We've got about $19 billion of dry powder to deploy over the next few years. We're continuing to raise capital -- for example, in PE for E4. And so depending on pace of deployment, that's obviously going to drive those transaction fees. As it relates to monitoring fees, there is a little static in the monitoring fees over the last couple of quarter. But when you think about modeling on a run rate basis, taking into account a few of the termination payments have actually occurred, both in the first quarter of 2014 and the first quarter of 2015 and the fourth quarter of 2014. The run rate should be roughly about $20 million.

---

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

Okay. That's helpful. Thanks.

---

**Operator**

Thank you. Our next question comes from the line of Patrick Davitt of Autonomous.

---

**Patrick Davitt** - *Autonomous Research LLP - Analyst*

Hi. Good morning, guys. On the KFN yield, it looks like maybe there's some noise in there from the CLO call. I don't know -- well I guess there shouldn't -- but looks like it came down to $0.05 from $0.07. Is that a result of any credit issues? Or could you kind of give us some color on what happened there?

---

**Bill Janetschek** - *KKR & Co. L.P. - CFO*

No, Patrick. It really wasn't related to credit issues. The CLO cash earnings out of KFN in the fourth quarter and the first quarter were roughly about the same. Some of the yield from KFN is some energy assets and they were a little light this quarter. And so, as you know, last quarter the KFN number was higher than this quarter. But still, we're pretty pleased with the $40 million. We could hope to expect a little bit of upside, but based upon when we did the acquisition, we were modeling in somewhere around that number.

**Patrick Davitt** - *Autonomous Research LLP - Analyst*

The $0.05 number?

**Bill Janetschek** - *KKR & Co. L.P. - CFO*

Yes.

**Patrick Davitt** - *Autonomous Research LLP - Analyst*

Okay. Thanks.

**Operator**

Thank you. Our next question comes from the line of Chris Harris of Wells Fargo securities.

**Chris Harris** - *Wells Fargo Securities, LLC - Analyst*

Thank you. Hi, guys. Bigger picture question on investing activity. Correct me if you guys disagree with this statement but it seems like a lot of the investing you guys are doing, in some regards, is strategic in nature. Whereas if you normally think about the business cycle, you'd think this environment might lend itself to material large private equity buyouts. Is there something about the environment, maybe, that's not really amenable to those transactions? Or do you guys think that you've got so much going on, so much growth in all these other areas, that's not really a primary focus right now?

**Scott Nuttall** - *KKR & Co. L.P. - Global Head of Capital & Asset Management*

Thanks for the question, Chris. It's, Scott. I'll take it. Look, I think the short answer is valuations are high. And if you look at the markets historically where they've been larger buyouts done, US and Europe in particular, valuations are quite high. And so we do remain very focused on our private equity businesses, of course. But as we've looked at deployment, we're frankly being judicious given what we see as a pretty elevated valuation market.

We talked about monetization. So we've been selling into the strength. But in the US, if you look at where we've been investing, its been pockets of opportunities and really more on the end of taking advantage of what's been a good environment in which to liquidate our portfolio. So we've taken companies public. We've done secondaries. We've sold a lot of companies to strategics and that's been true in the US and Europe outside of some selective opportunities where we have a real angle.

So it's not really as much of a strategic shift for us as it is just a focus on being careful in a very lofty valuation environment. And the one place I would say there's an exception to that; however, has been in Asia. And Asia is not a large buyout market, of course. But if you look at actually where we've been the most active from a deployment standpoint over the course of the last year, its been in Asia. And if you think about what we've done this year, GE Consumer Finance, the Ticket Monster deal we just announced, we are seeing some interesting deployment opportunities as a result of the fall out of the slowdown in China. And so I think you'll continue to see us active there and then selectively active in the US and Europe.

**Chris Harris** - *Wells Fargo Securities, LLC - Analyst*

Helpful. Thank you.

---

**Scott Nuttall** - *KKR & Co. L.P. - Global Head of Capital & Asset Management*

Thank you.

---

**Operator**

Our next question comes from the line of Luke Montgomery of Sanford Bernstein.

---

**Luke Montgomery** - *Sanford C. Bernstein & Company, Inc. - Analyst*

Good morning, guys.

---

**Bill Janetschek** - *KKR & Co. L.P. - CFO*

Good morning.

---

**Luke Montgomery** - *Sanford C. Bernstein & Company, Inc. - Analyst*

You've got $15 billion of fair value in fund 2006. A typical PE fund has a 10 year life. So I think you could argue this one is getting a little bit long in the tooth. I was hoping maybe you could speak to the maturity of the most significant positions in the fund, where you are in the process of making operational improvements that would lead to an exit at some point. And then how likely it is that you'll ask the LPs to extend the life of the fund. I know the actual exits are hard to predict but, obviously, these dynamics are going to have a big effect on how your distributions are phased over the next few years?

---

**Scott Nuttall** - *KKR & Co. L.P. - Global Head of Capital & Asset Management*

Sure, Luke. It's Scott. So I think you're talking about the 2006 fund?

---

**Luke Montgomery** - *Sanford C. Bernstein & Company, Inc. - Analyst*

Correct.

---

**Scott Nuttall** - *KKR & Co. L.P. - Global Head of Capital & Asset Management*

Yes. So one thing to keep in mind, that fund is now marked at about 1.8 times our cost. And so one of the -- I think one of the things that's happening is as we've created value, and we've been selling a lot out of that fund, the remaining fair value continues to be quite high. So if you can see, we invested on the fund table on page 13, $17 billion. And we've realized $15 billion of about $30 billion of fair value so far. So over half of the fair values already been returned in cash. And so that's one thing to keep in mind as you look at that is we've already given a lot of cash back. And I think our investors are pleased with the amount of cash we sent back to them.

If you look at the portfolio itself, we actually don't need to get an extension. We have plenty of time to continue to monetize that portfolio. But one of the things we look at from a maturity of the portfolio standpoint is how those investments are marked. And if you look at one of the things that we're quite pleased with is if you look at the portfolio as a whole, we have more than half of our portfolio marked at 1.5 times our cost or greater. And something like 30% or 40% is marked to two times or more. So it's actually 37%. Is two times our cost or more in our private equity portfolio. So the good news is is that portfolio matures, we're continuing to create value and we find ourselves in a good exit environment. And so I think that the short answer is, you'll continue to see us monetize investments out of that portfolio. And we don't think it's going to create any issues from the standpoint of timing of the type that you referenced.

---

**Bill Janetschek** - *KKR & Co. L.P. - CFO*

And, Luke, just to follow-up -- not specific, really, to the 2006 fund but the private equity fund in general -- when you take a look at where we are today, roughly about a third of the value is in public securities right now. So to the extent that we would think to monetize some of those assets, 1/3 had the ability to be sold and exited through secondary offerings.

---

**Luke Montgomery** - *Sanford C. Bernstein & Company, Inc. - Analyst*

Okay. Thanks very much.

---

**Bill Janetschek** - *KKR & Co. L.P. - CFO*

Thank you.

---

**Operator**

Our next question comes from the line of Michael Kim of Sandler O'Neill.

---

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

Hi, guys. Good morning. So not sure if you really look at things this way but you mentioned over the last 12 months you've generated, I think, about $800 million of realized cash carry. And based on our math, that equates to a little over 60% of the unrealized carry receivable a year ago. So understand that realized carry can be lumpy and it's hard to get a sense of the outlook going forward. But just given the unrealized carry balance continues to grow and the exit environment, as you mentioned, still seems pretty constructive, how should we be thinking about sort of that conversion ratio, if you will, as we sort of try and frame the outlook for cash carry going forward?

---

**Bill Janetschek** - *KKR & Co. L.P. - CFO*

Well, Michael, it's hard to come up with a conversion ratio. But when you think about where we've been over the last couple of years, with all of the monetizations that we've had, remember, in private equity we distributed about $11 billion to our LPs. And the year prior it was, I think, anywhere between $9 billion and $10 billion. So you see a lot of velocity going through with regard to returning cash but, more importantly, we have continued to deploy that capital, new capital, in those funds marking those investments up and actually appreciating the unrealized carry on our balance sheet while making these significant distributions. That was my point earlier. When you look at where we are on a book value per se, we've actually distributed out about 2/3 of the appreciation off our book. And when you take into account the dollar of accretion on our balance sheet over the past year, that's a 25% return.

---

**Scott Nuttall** - *KKR & Co. L.P. - Global Head of Capital & Asset Management*

Yes, I think there's a couple things to focus on. One is you're right that we have been able to keep the -- actually the accrued carry amount growing despite all of the monetizations. It's not going to be possible for us to give you a conversion ratio that we can tell you to be comfortable with. But the reason that we share these metrics, in terms of how much of our portfolios in public stock, should give you a sense. Also, we do find it interesting just how much strategic activity has picked up. And so -- in terms of exits and those exits are much quicker. So it's hard to give you a conversion ratio but it is something that we'll continue to share with you to help you think your way through it.

The other thing to keep in mind, we have this on page 10 of the press release, is we're starting to also create accrued carry from some of these newer businesses. So as you look at the public markets, businesses now are starting to accrue some carry. The same thing will be happening in infrastructure and real estate. And so hopefully we'll have a broader base of accrued carry across all of the new businesses as we move from Fund I to Fund II, which will continue to have that amount grow.

---

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

Got it. That's helpful. And just related to that, any early look into the second quarter distribution? I think you typically give some guidance on that?

---

**Bill Janetschek** - *KKR & Co. L.P. - CFO*

Generally speaking, Michael, we do. But when you look at where we are today, the one item that would impact the second quarter is the possibility of the [Biomet] transaction closing. Right now we have it earmarked for hopefully closing in June. But that might not happen until July or early August. If it were to happen in the second quarter, based upon the value today, that would equate to roughly about $0.06 of carry as well as balance sheet earnings. And then based upon a few of the secondaries that have taken place since March 31, that's roughly another $0.03. So that would be at $0.09. And then when you think about the fee and yield component of our distribution being anywhere between $0.15 and $0.18 right now, if Biomet closed we would be at $0.25 and we're not even through the end of April.

---

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

Got it. Thanks for taking my questions.

---

**Scott Nuttall** - *KKR & Co. L.P. - Global Head of Capital & Asset Management*

Thank you.

---

**Operator**

Thank you and our next question comes from the line of Glenn Schorr of Evercore ISI.

---

**Glenn Schorr** - *Evercore ISI - Analyst*

Thanks -- quickie here. Debt and preferred was up like 22% in the quarter. I'm just curious what the intended proceeds is that to further invest on balance sheet? Expend --

---

**Bill Janetschek** - *KKR & Co. L.P. - CFO*

Well as you know, Glenn, we actually had a $500 million raise of 30 year paper, which we locked in just a tic above 5%. And another thing you'll, you'll see roughly about an increase of $95 million on debt. That was at KCM and that was a call down on a facility to do a debt offering, which was subsequently paid. And so that's no longer on the balance sheet. But with regard to the $500 million, you could take a look at the balance sheet. Over the past few quarters we've been running between $1 billion and $1.5 billion and we continued to deploy that capital in a pretty prudent way. And so I would say that based upon where we are, we're pretty comfortable with our debt level. And as you may know, we deal with the rating agencies quite often and we're rated by S&P and Fitch and we have an A rating.

---

**Glenn Schorr** - *Evercore ISI - Analyst*

Okay. One other tiny one is it's early but good month for energy prices in April so far. Just a mechanical question. Is there any reason why we shouldn't think the marks were to the positive side to the same degree they were to the negative side last quarter? Or I should say, fourth quarter -- on a proportional at basis, obviously.

---

**Scott Nuttall** - *KKR & Co. L.P. - Global Head of Capital & Asset Management*

Well it's hard to predict what's going to happen with energy prices from here and what the flow through will be. But as a general matter, obviously when commodity prices went down, we went -- our valuations went down a bit with them. And you'd expect the reverse to be true. I'd keep on eye on where in the curve you've got the commodity prices shifting though. That's one thing to just keep an eye on.

---

**Glenn Schorr** - *Evercore ISI - Analyst*

Which part of the curve is are you more sensitive, just so I watch the right part?

---

**Craig Larson** - *KKR & Co. L.P. - Head of IR*

It's if when you're -- when you're running a discounted cash flow base analysis, you'll end up being more set -- that valuation will be more sensitive on those prices long term out -- three, five years et cetera -- versus your short-term movements.

---

**Scott Nuttall** - *KKR & Co. L.P. - Global Head of Capital & Asset Management*

We tend to be hedged in the shorter term period and less hedged in the longer term. So look at the long end of the curve.

---

**Glenn Schorr** - *Evercore ISI - Analyst*

Got it. Okay. Thank you.

---

**Scott Nuttall** - *KKR & Co. L.P. - Global Head of Capital & Asset Management*

Thank you.

---

**Operator**

Our next question comes from the line of Craig Siegenthaler of Credit Suisse. Your line is now open.

---

**Craig Siegenthaler** - *Credit Suisse - Analyst*

Thank you. Just a quick one here. What drove the unrealized mark in public markets outside of the CLOs? And I'm guessing it's probably direct lending. And maybe you can also give us a little bit of color around this too.

---

**Scott Nuttall** - *KKR & Co. L.P. - Global Head of Capital & Asset Management*

Craig, it's Scott. So outside of the CLOs, there's really a couple items to point to. One is what Craig mentioned earlier, which is the elective investment that we made in BlackGold. So that was the $15 million that he mentioned earlier. There was FX noise, especially around our European direct lending







THOMSON REUTERS

portfolio that also contributed to the mark this quarter. And then outside of that there were a couple other investments in the credit book that went down a little bit. But we're talking on a base of about $3 billion so it's pretty small movements. But if you add those three up, a collection of the small mark -- one of those energy credit related BlackGold and then FX, you get most of the difference.

---

**Craig Siegenthaler** - *Credit Suisse - Analyst*

Got it. And just one follow-up here. If you look at North America Fund XI, you deployed about half the capital raise and you're also about half way through the investing period. But valuations -- obviously North America continue to kind of creep up. So can you just give us your view on the ability to deploy this capital over the next few years, especially if valuations don't correct from here?

---

**Scott Nuttall** - *KKR & Co. L.P. - Global Head of Capital & Asset Management*

Sure. I think if you look at -- you're right in terms of the observation and in terms of how much we deployed. And clearly prices are a bit elevated. But having said that, we are finding some interesting opportunities in places to put money to work. If you look at what we did in the first quarter as an example, just in our Americas private equity business, we put over $600 million to work in the quarter. The biggest piece of that was a pharmaceuticals deal, so an industry that's less cyclical where we find some opportunities from a value standpoint. Also, we made an investment in this company called Air Medical. So we found some off-the-run opportunities where we think the valuations are attractive where we see real operating improvement opportunities. And so if you look just those two examples, the pharmaceutical deal in Q1, Air Medical is nearly a $600 million investment in its own. So you don't need to find a lot of investments for the dollars to be pretty large. And as I mentioned, given how much we have invested in the pace of deployment that we're seeing, we have to be selective, but the pace of deployment that we expect and are seeing that we would expect to be back into the market with the next North American private equity fund later this year.

---

**Craig Siegenthaler** - *Credit Suisse - Analyst*

Thanks, Scott.

---

**Scott Nuttall** - *KKR & Co. L.P. - Global Head of Capital & Asset Management*

Thank you.

---

**Operator**

Thank you. Our next question comes from the line of Robert Lee of KBW.

Our next question comes from the line of Michael Cyprus of Morgan Stanley.

---

**Michael Cyprus** - *Morgan Stanley - Analyst*

Hi. Good morning. Thanks for taking the question. Just curious if you could share your latest thoughts on the direct lending opportunity, in particular online lending with the Avant transaction that you've done this quarter and the quarter before. Can we expect you to do more on that front? And how big of an opportunity could online lending be for KKR?

---

**Scott Nuttall** - *KKR & Co. L.P. - Global Head of Capital & Asset Management*

Okay. Great question, Michael. So in terms of direct lending as an overall matter, as I mentioned, we've seen it as a real growth area. So we started the effort in the US and have really been pleased with the performance of our first direct lending fund. We also make loans out of other vehicles that we manage, including our BDC. So we've seen quite a bit of activity and here lately what we're doing is really doing senior secured loans to largely middle market companies -- so think EBITDA between $25 million and $100 million. We've seen a real opportunity and a void in the market. Banks have pulled back from that market. We've been able to step into that void and generate some very attractive returns for the risk we're taking.

We're now seeing that same trend in Europe. And so we've seen deployment opportunities become much more attractive in direct lending in Europe and that's why we started our European direct lending business. And we're in the process of raising our first European direct lending fund and have had a small first close on that fund and are seeding some of those investments off the balance sheet, which will drop down into the fund. So overall we see direct lending as a growth business for KKR.

In terms of the online lending component of your question, as you noted we did do the transaction with Avant to give them capital to continue to grow their business. We view that as an investment out of one of our credit portfolios and see that as an opportunity for us to deploy capital at attractive returns. And it's really the same theme: being able to make sure that we step into the void and provide capital to markets that don't have access to it and get paid a little bit of excess return as a result of doing that. Hard to predict how big an opportunity that will be for us. That transaction is the first we've done in that space so we'll keep you posted on it. I think the bigger opportunity for us is going to be in corporate direct lending than online, but time will tell.

---

**Michael Cyprus** - *Morgan Stanley - Analyst*

Any sense on how competitive it is right now just in terms of the marketplace?

---

**Scott Nuttall** - *KKR & Co. L.P. - Global Head of Capital & Asset Management*

Look, I think what we're finding is there have been direct lending vehicles and online lending vehicles that have been created. So there is supply that has been created around the opportunity but the demand is quite high. So if you think about the quantum of capital that has moved away from the middle market, it is quite a large amount of capital. So the supply/demand imbalance has been very large, especially now in Europe. And so what we've seen is some direct lending type vehicles get created. However, relative to the amount of capital that moved away, it's a very small amount. So we're continuing to find very interesting opportunities and the supply/demand imbalances by no means being dissipated. We're actually seeing quite a bit that we are able to do. We'll see -- we've seen relative to the middle of the crisis. We've seen excess spread come down a little bit. But we're still getting paid an extra 300 or 400 basis point or more for taking the risk relative to the public markets.

---

**Michael Cyprus** - *Morgan Stanley - Analyst*

Okay. Great. Thanks, Scott.

---

**Scott Nuttall** - *KKR & Co. L.P. - Global Head of Capital & Asset Management*

Thank you.

---

**Operator**

Our next question comes from the line of Devin Ryan of JMP Securities.

---

**Devin Ryan** - *JMP Securities - Analyst*

Thanks, good morning.

**Scott Nuttall** - *KKR & Co. L.P. - Global Head of Capital & Asset Management*

Good morning.

**Devin Ryan** - *JMP Securities - Analyst*

You guys highlighted in prepared remarks that you've been taking a portion of stock and some of the more recent deals and those have obviously have been good trades for you guys. So just trying to dig into that a little bit more. Has that been a function of just really the best structure from the best buyer? Or is it a positive view on the acquirer if the market rewards them for a good deal? Or is there any other strategic or economic considerations we should be thinking about? Is this maybe becoming more of a theme moving forward other than just something situational?

**Scott Nuttall** - *KKR & Co. L.P. - Global Head of Capital & Asset Management*

I think it's -- I'm not sure there's a broader theme in it. I think it's much more situational. And in a lot of these instances you're right. The market has been rewarding companies that have done M&A transactions. So that obviously is on our mind. But also in some situations what will happen is we'll get approached by a strategic acquirer. We may feel that there's quite a bit left to do in terms of opportunities to create value from there. And so one way you can get a transaction done is to say, okay, if we take some stock, we're not selling out, per se, at this price, we're actually going to continue to participate in that upside and that value creation. And so we'll get the value creation of our asset, plus synergies, plus the potential for the acquirer to have some multiple expansion. And so we'll look at a situation on a case-by-case basis but those are some of the thoughts we go through.

**Devin Ryan** - *JMP Securities - Analyst*

Got it. Thank you.

**Scott Nuttall** - *KKR & Co. L.P. - Global Head of Capital & Asset Management*

Thank you.

**Operator**

Thank you. Our next question comes from the line of Patrick Davitt of Autonomous.

**Patrick Davitt** - *Autonomous Research LLP - Analyst*

Thanks for the follow-up. You have some pretty sizeable Chinese equity positions now that have been on fire this year. I think up 30% plus on a weighted average basis. And we're starting to hear a little bit more chatter about bubbles in those markets. Is there anything contractually keeping you from trimming those positions? Or -- and how do you think about those exposures now that they've done so well?

**Bill Janetschek** - *KKR & Co. L.P. - CFO*

Well, Patrick, this is Bill. You are right. We're pretty happy with some in the early performance that we've seen in some of these companies. But when we got into these companies we made a minority investment. The understanding between that company and us is that we would help them operationally, help them diversify, help them be more strategic, especially internationally. And so we still think even though the market has been robust, to your point, we still see a lot of upside. And so I would think you're not going to see any monetization from any of these Chinese investments in certainly the very short-term.

---

**Patrick Davitt** - *Autonomous Research LLP - Analyst*

Thanks.

---

**Operator**

Thank you. Our next question comes from the line of Chris Kotowski of Oppenheimer.

---

**Chris Kotowski** - *Oppenheimer & Co. - Analyst*

Yes, hi. Just thinking about the development of the course of the year, it just seems like a lot of your big public positions -- Big Heart to Smucker's, Go Daddy, Boots to Walgreens and Biomet and US Foods -- that they are all just recently went public or you've got the position or it's about to happen. And given that they are 180 day lock-ups generally, should we be thinking that second and third quarter that you're fairly constrained in what you can monetize and that it opens up later in the year?

---

**Bill Janetschek** - *KKR & Co. L.P. - CFO*

Well, Chris, this is Bill. It depends company by company. 180 day lock-up on some of these would be quite long. I don't know the particulars, quite honestly, about Go Daddy but I would venture to say it's probably not long. That said, take away from some of the quote/unquote more recent new public securities that we have, that's just a component of that 33%, 34% that I mentioned earlier. So even if we are locked-up, I would say, over the next quarter on some of those positions, we still have the ability to monetize others if we decided to go the secondary route.

---

**Scott Nuttall** - *KKR & Co. L.P. - Global Head of Capital & Asset Management*

Yes. I think another thing -- just the math is interesting, Chris. We have about $38 billion of unrealized value in our private equity portfolio. So it's a big portfolio and that's just private equity and there's all of the other asset classes. Of that $38 billion, about $14 billion is either public or announced sales. So I wouldn't get too focused on individual names because if you focus on just the ones you mentioned, it's a pretty small amount of that $14 billion on a percentage basis. So we have lots of different ways to create monetizations across the portfolio.

---

**Chris Kotowski** - *Oppenheimer & Co. - Analyst*

Okay. That's it for me. Thanks.

---

**Scott Nuttall** - *KKR & Co. L.P. - Global Head of Capital & Asset Management*

Thank you.

---

**Bill Janetschek** - *KKR & Co. L.P. - CFO*

Take care, Chris.

---

**Operator**

Thank you. Our next question comes from the line of Bill Katz of Citigroup.

---

**Bill Katz** - *Citigroup - Analyst*

Okay. Thanks so much for the follow-up as well. Sort of curious your latest thoughts on tapping to the US retail or maybe even the global retail opportunity. And more specifically within US retail, has the firm thought about making a strategic stake in any of the publicly traded asset managers to potentially accelerate the opportunity?

---

**Scott Nuttall** - *KKR & Co. L.P. - Global Head of Capital & Asset Management*

Thanks, Bill. Look, I think in terms of giving you an update on where you are, as you know we've been investing more of our efforts around the individual investor. So just as an example, in the first quarter about 17% of the money we raised came from individuals. Over the last couple of years it's been just shy of 20%. And as you know, probably three or four years ago that number was virtually zero. So we've been investing both from a product standpoint and people inside the firm that we've hired to focus on the high net worth market platforms. And in the product development space we've been spending a lot of time trying to think about and working on some products that could be attractive to the individual investor. So what we've really done thus far is focus on high net worth and ultra high net worth. The broader retail market -- we've introduced a couple of products, one of which will be rolling out pretty soon. We'll see how that develops but it's relatively early days.

The short answer to your question about are we thinking about taking a stake in a public asset manager to accelerate that effort is no. What we have done is create some distribution partnerships with platforms that have access. We have got our BDC where we have a partnership where we have been using them as a distribution partner and we're the sub advisor that does the investing. And so you'll continue to see us do things like that. But we're pleased with the progress we're making. And one of the things we're keeping an eye on is the profitability net to all of us as shareholders from these efforts because the distribution channel can be an expensive element in terms of how much of the fee and carry they may want to take. So we'll keep developing it probably more organically and with partnership than with any bigger strategic move for the time being.

---

**Bill Katz** - *Citigroup - Analyst*

Okay. Thank you very much.

---

**Scott Nuttall** - *KKR & Co. L.P. - Global Head of Capital & Asset Management*

Thank you.

---

**Operator**

Thank you. And I'm showing no further questions at this time. I'd now like to turn the conference back over to Mr. Craig Larson for any further remarks.

---

**Craig Larson** - *KKR & Co. L.P. - Head of IR*

Thanks, Candice. And thanks, everybody, for your attention this quarter. Please follow-up with us naturally after the call if you have any follow-ups.

---

**Operator**

Ladies and gentlemen, thank you for participating in today's conference. This does conclude today's program and you may all disconnect. Have a great day, everyone.

---

**Editor**

Company Disclaimer - The company has not verified the accuracy or completeness of this transcript.

---