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KKR.AS - Q1 2010 KKR & Co. (Guernsey) L.P. Earnings Conference Call

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CORPORATE PARTICIPANTS

Jon Levin

KKR & Co. (Guernsey) L.P. - Treasurer, Head of IR

Scott Nuttall

KKR & Co. (Guernsey) L.P. - Head - Global Capital and Asset Management Group

Bill Janetschek

KKR & Co. (Guernsey) L.P. - CFO

CONFERENCE CALL PARTICIPANTS

Michael Kim

Sandler O'Neill - Analyst

Sanjay Sakhrani

Keefe, Bruyette & Woods - Analyst

Marc Irizarry

Goldman Sachs - Analyst

Michael Loungo

Liberum Capital - Analyst

Doug Rothschild

Scoggin Capital - Analyst

Mark Sunderhuse

Red Rocks Capital - Analyst

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to KKR's First Quarter 2010 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)

This conference is being recorded. I would now like to turn the conference over to Jon Levin, Treasurer and Head of Investor Relations for KKR. Jon, please go ahead.

Jon Levin - KKR & Co. (Guernsey) L.P. - Treasurer, Head of IR

Thank you, Lori. Welcome, everyone, to our earnings call. As usual, I am joined on today's call by Scott Nuttall, a member of KKR, and Bill Janetschek, our CFO.

As required, we would like to remind everyone that the following prepared remarks contain forward-looking statements regarding future events and the future performance of KKR. Representatives from KKR may make additional forward-looking statements in response to your questions.

These statements do not guarantee future events or performance. Therefore, undue reliance should not be placed upon them. KKR does not assume any obligations to revise any forward-looking remarks that may be made in today's release or call.



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Last night, we issued a press release announcing our results, which you can find on our website. We're pleased with the results for the quarter. We reported fee-related earnings of \$90 million, economic net income of \$675 million, and AUM at the end of the quarter was up to approximately \$55 billion.

On today's call, I'll start with a brief update on our relisting process. The relisting process now has the added element of concurrent primary capital raise. I'll also make few points regarding this quarter's disclosure. Scott will then comment on the environment and what it means for our business, and Bill will conclude with a discussion of our financial results. Of course, we will then open the call to questions.

As you are aware, we are in the process of relisting our company on the New York Stock Exchange. The process started with the initial filing of a registration statement with the SEC on March 12th. We filed the first amendment to the registration on April 16th, and the second amendment was filed earlier this week on May 10th.

Also on May 10th, we filed a second registration statement, which contemplates a \$500 million capital raise through a primary stock offering. This is a primary deal only, and no one at KKR will be selling any stock in the offering.

We intend to use the capital from this offering to grow our business, including funding general partner capital commitments to our funds; to provide capital to support the continued development of our Capital Markets business and to facilitate expansion into complementary lines of business.

We believe we have sufficient liquidity to meet our existing commitments without this offering, so we expect the proceeds from this offering to be deployed for new opportunities. We are the single largest investor in our funds, and we like that dynamic of aligned interests, and our limited partners tell us they like it to.

We also believe that the offering of new shares provides the opportunity to bring in new investors. Finally, we think the relisting and offering gives us a chance to educate investors about our business.

With regard to timing, we hope to complete the relisting and equity offering pending market conditions as soon as possible following completion of the SEC's customary review process. The completion of the relisting is not contingent upon the completion of the equity offering.

As a result of SEC quiet-period restrictions, we will not be able to comment further on the relisting or the capital raise during the Q&A session. We also do not intend to make any other public comments on these events outside of the SEC process.

As for disclosure, the first quarter was our second as a combined business. We decided to report two comparisons, a year-over-year comparison and a sequential-quarter comparison. The conventional year-over-year comparison compares the first quarter of 2010 to the first quarter of 2009, and for this comparison we present the 2009 figures on a pro forma basis.

The sequential comparison compares the first quarter of 2010 with the fourth quarter of 2009. We like the sequential comparison because there's minimal seasonality in our business, and we believe a run rate methodology is more helpful in analyzing our performance.

With our usual emphasis on transparent disclosure, you will continue to see comprehensive balance sheet information, specific transaction in overall fund valuations, as well as a detailed calculation of our distribution for the quarter.

With that, I'll turn it over to Scott.



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Scott Nuttall - KKR & Co. (Guernsey) L.P. - Head - Global Capital and Asset Management Group

Thanks, Jon, and thank you, everyone, for being on the call. I'm going to speak to what we are seeing in the macroeconomic environment and then discuss how it impacts how we think about our business.

Through our ownership of more than 50 portfolio companies with over \$200 billion in consolidated revenue, we are fortunate to have some insights into what's happening in the global economy. We witnessed a shift in sentiment in the first quarter. We are beginning to see a real change in consumer behavior. The shift started towards the end of the first quarter, and it has continued into the second quarter.

Like consumers, corporations are operating with more confidence as visibility and earnings have improved. Last year, most corporate earnings growth came from cost-reduction measures. Companies are now starting to experience some revenue growth. The improvement, therefore, feels more sustainable and management teams have gained confidence as a result.

This increased confidence is leading to a pick-up in corporate M&A activities as companies look to deploy some of the excess cash built up on the balance sheets over the last few years. These positive trends are especially prevalent in the United States and Asia, however, Europe continues to lag.

We are also seeing continued strength in the debt and equity capital markets. The equity, leveraged loan and high-yield markets remain open for the right companies. In spite of all of these improving trends, we still have some questions and concerns about the medium and longer-term picture. If we have learned one thing over the past two years it's that the environment can change very quickly.

In addition to our concerns around sovereign debt risk, we have long-term concerns about inflation and interest rates. Also, we must remember that unemployment remains high. As companies have seen productivity levels improve, they have concluded that they can operate with fewer employees and less capacity.

This development leads us to believe that rehiring to historical employment levels will be a multi-year process. Given our view of the environment, we are working hard to capitalize on the current stability while maintaining a healthy respect for the potential risks that may lie ahead.

So, what does all this mean for our business? Well, in our Private Equity business, we are quite active. While we are making new investments, we are approaching new investment opportunities with discipline and caution. We put \$1 billion of equity to work in the first quarter across five transactions.

We also announced five additional transactions requiring approximately \$800 million of equity that are yet to close. And while we've seen a significant increase in opportunities to deploy capital, we are being very careful and selective as valuations have increased materially and are projecting positive momentum into the foreseeable future.

Our existing private equity portfolio continues to improve. The value of our portfolio in aggregate increased by 9.9% during the first quarter, outpacing the S&P 500 Index return of 5.4%. Importantly, each of our private equity funds experienced a lift in value in the quarter.

We remain very focused on creating value in our portfolio by driving operational improvements and generating EBITDA growth. We are also focused on accessing the capital markets for both debt and equity. We are accessing the debt markets to extend maturities at our portfolio companies and the equity market to deleverage businesses and return cash to our investors.

During the quarter, we returned \$589 million to the limited partners in our private equity funds. Due to the strength in corporate balance sheets and the uptick in corporate M&A, we also believe that some of our assets may attract strategic interest.



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On last quarter's call, we discussed our philosophy with respect to taking portfolio companies public. We try to take a long-term view, with a goal that our companies outperform in the public markets. This requires a disciplined approach to when and how we take companies public.

IPOs of our portfolio companies focus principally on raising primary proceeds to deleverage the business, and we tend to remain significant shareholders in companies for several years following an IPO. As such, stock performance post-IPO is absolutely critical. Over the past five years, we have completed ten IPOs, which have materially outperformed the average performance of other IPOs and the US equity market as a whole.

Now turning to our Asset Management business, we are seeing attractive opportunities to invest across the capital market. While the availability of capital has certainly improved, middle market companies still do not have the same ready access to capital as their larger counterparts. Through our mezzanine and special situations investing platforms, we are focused on building our efforts to provide capital to these companies.

Additionally, although the high-yield unleveraged loan markets have rebounded quite significantly, we are still finding attractive opportunities in the primary and secondary markets. We believe our bottoms-up, fundamental approach to credit investing is well suited to the current investing environment.

Now turning to our Capital Markets and Principal Activity segment, we reported a very strong quarter in this segment. We participated in 14 capital markets transactions during the quarter ranging from acquisition financing, to debt refinancings, to equity offerings. Also, our principal investments benefited from the appreciation in carrying value that we saw across our private equity portfolio, which Bill will cover in more detail later in the call.

I'm going to wrap with a few comments on some of our new efforts at KKR. First, we are seeing real momentum in Real Assets. This is our term for natural resources, specifically oil and gas, as well as infrastructure. We are building businesses in these areas because we have significant experience investing in both and because our concerns about potential inflation make these long-dated, inflation-protected and current-return-oriented products attractive.

We raised approximately \$250 million during the quarter for these efforts. As investors continue to gain comfort with returning to illiquid assets classes, we are seeing increasing interest in these types of products. Second, we continued to build our Private Originated Credit effort, which includes Mezzanine and Capital Solutions. We raised a total of \$415 million during the quarter in these areas.

We continue to invest significantly in our relationships with our partners. This quarter, we were able to complete a first closing for our mezzanine fund, raise capital for our new oil and gas strategy, which we refer to as KKR Natural Resources, and raise additional capital for our Capital Solutions and broader asset management strategies.

We greatly appreciate the trust that investors have placed in us, and we're working hard at KKR to earn this trust every day. More broadly, how we interact with our limited partners remains extremely important. For our existing investors, we are focused on transparency and returning capital wherever possible. For new investors and prospects, we're focused on building trust, and special, more customized and broader relationships.

With that, I'll turn the call over to Bill.

Bill Janetschek - KKR & Co. (Guernsey) L.P. - CFO

Thanks, Scott. As Jon discussed on his comments, we think a sequential comparison is more meaningful for our business, so for the most part my commentary will compare the results of the first quarter of 2010 to the fourth quarter of 2009.

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As at March 31st, our assets under management were \$54.7 billion, versus \$52.2 billion as of the end of last year. AUM grew 4.8% over the last quarter, primarily due to the increase in the fair market value of our private equity funds, as well as new capital we raised across our businesses.

These increases were partially offset by distributions we made to our fund partners and redemptions in our public markets business. As of March 31st, KKR's fee-paying AUM was \$42.5 billion, versus \$42.8 billion as of the end of last year. Fee-paying AUM fell slightly, due primarily to the distributions we made to our fund partners, as well as the redemptions in our Public Markets business.

These downward adjustments were almost fully offset by new capital raised across mezzanine, capital solutions and real assets. As a reminder, for the older funds in our private equity business, when we are in the post-investment or harvesting period we earn management fees based upon remaining cost. So when we sell investments the remaining cost goes down, reducing our fee-paying AUM.

For the first quarter, fee-related earnings was \$90.4 million, compared to \$87.5 million for the fourth quarter of last year. Fee-related earnings increased over the prior quarter, primarily as a result of increased capital markets activity and an incentive fee in our Public Market segment.

These increases were largely offset by lower monitoring fees. We don't expect this level of capital markets activity or similar incentive fees in the Public Market segment to recur each quarter. As a reminder, in the fourth quarter of 2009, we received a monitoring agreement termination payment of \$46 million from Dollar General, which resulted in \$29 million of fee-related earnings. As we said last quarter, these types of payments will not occur on a regular basis.

Turning to economic net income, or ENI, there are really two drivers here beyond the impact of fee-related earnings; carried interest earned from invested fund capital and Investment Income from our balance sheet assets. Carried interest is driven by the change in value of our private equity investments from quarter to quarter.

Due to the fact that a large majority of our balance sheet represents investments in private equity funds and co-investment in specific transactions, the principal activities investment income will also largely be driven by the change in value of our private equity portfolio.

Total investment income for the first quarter was \$585 million. Total ENI for the quarter was \$675 million. ENI in the first quarter was higher than in the fourth quarter of last year due to a large increase in the value of our private equity funds. Our private equity funds were up approximately 10% in the first quarter, compared to a 7.5% increase in the fourth quarter.

There are two things I want to point out as they relate to investment income; first, as you will recall, 40% of the carried interest we generate is allocated to KKR executives. In the income statement we show it at detail.

The reason the allocation to the KRR carry pool is less than 40% of the gross carried interest has to do with net loss sharing. There is no carry pool allocation taken on income that arises from the reversal of net loss sharing liabilities because the liabilities are obligations to the public company and not the KKR executives.

Second, investors will note the line item Management Fee Refund, which accounted for an \$84 million reduction to carried interest in the fourth quarter. This is a result of how the waterfall in our private equity funds is structured.

As we recognize carry, we reverse up to 20% of the previously received management fees. This is because 20% of the management fees must be returned to our investors before we accrue net carry. The management fee refunds were unusually high this quarter due to the fact that the '06 fund turned positive in the first quarter and carry is now being accrued in that fund.



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The \$84 million figure in the first quarter leaves us with approximately \$78 million of management fees still to return across all of our funds. Importantly, we are only accruing management fees refunds when we are accruing carry.

Turning to our balance sheet for a minute, our book value per unit was \$6.93 as of March 31st, which is up from \$6.08 per unit as of the end of last year. As for liquidity, I want to provide you with a few key pieces of data.

As of the quarter end, we had cash of [\$621 million] (corrected by company after the call) and drawn debt of approximately \$350 million, up \$64 million and down \$383 million respectively from the end of last year. Our remaining uncalled commitments totaled \$1.1 billion as of the end of the quarter. We expect to fund these commitments using cash on hand, as well as cash from realizations that may occur in the future. We expect these capital commitments to be drawn over a multi-year time horizon.

Finally, we are making a first quarter distribution under KKR's distribution policy in the amount of \$0.08 per outstanding KKR Guernsey common unit. This distribution will be subject to withholding by KKR's corporate subsidiary of approximately \$0.024 a unit. The details of the calculation and its record date are provided in the press release.

We are very pleased that we're off to such a good start in 2010, and we thank you for joining the call. Operator, we can now open the call to Q&A.

QUESTIONS AND ANSWERS

Operator

Thank you.

(Operator Instructions)

We'll go first to Michael Kim with Sandler O'Neill. Please, go ahead.

Michael Kim - Sandler O'Neill - Analyst

Hi, guys. Good morning.

Jon Levin - KKR & Co. (Guernsey) L.P. - Treasurer, Head of IR

Good morning, Michael.

Scott Nuttall - KKR & Co. (Guernsey) L.P. - Head - Global Capital and Asset Management Group

Good morning, Michael.

Jon Levin - KKR & Co. (Guernsey) L.P. - Treasurer, Head of IR

How are you?

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Michael Kim - Sandler O'Neill - Analyst

Good. First, just in terms of capacity, you've got a fair amount of dry powder, but a majority of that I guess is outside of the US. So, I was just wondering how you're feeling in terms of positioning now that -- you talked about deal activity is starting to pick up here in the US and, more specifically, do you feel like the \$4 billion or \$5 billion that you've got left in the '06 fund gives you enough flexibility going forward?

Scott Nuttall - KKR & Co. (Guernsey) L.P. - Head - Global Capital and Asset Management Group

Hey, Michael, it's Scott. I'll take that one. We have approximately \$5 billion of capital left to invest in the North American private equity fund -- the 2006 fund. As you saw, we put about \$1 billion of the capital to work globally in the first quarter. I think that the bottom line is that we do believe that we have enough capital to conduct our business in private equity in North America.

At some point, we're going to start a fund-raising process for our North American private equity fund. But, as we sit here today we actually think we have enough capacity to conduct the business, and we'll see how that capital gets deployed. But, you're right; the opportunity set is increasing and our pipeline is full, and we're excited about the opportunities.

Michael Kim - Sandler O'Neill - Analyst

Okay. And then maybe to kind of follow up on that, any color on the financing environment? It seems like the banks are maybe more willing to finance bigger deals. So, just wondering if you're maybe starting to focus a bit more on larger deals these days just in light of that trend?

Scott Nuttall - KKR & Co. (Guernsey) L.P. - Head - Global Capital and Asset Management Group

It's Scott again. In terms of the financing environment generally, it has improved materially. About a year ago, as you know, the financing markets were generally shut for new transactions. We have seen a significant change in sentiment, and the high-yield and leveraged loan markets are open.

As a general matter, we've seen leverage move from four times debt to EBITDA, give or take, a year ago to six-plus times debt to EBITDA. We've also seen the aggregate amount of available debt increase as well. So, we are looking at larger transactions, but we also continue to look at transactions across this size spectrum.

I think people tend to focus on us as it relates to the larger deals as they get more media attention. But, it's important to remember that a significant percentage of the transactions that we've done, 90%-plus have been less than \$5 billion in total transaction size and 80% have been less than \$2 billion in total transaction size. So, we continue to be busy in the smaller transactions and are now seeing opportunities as well in the larger transaction front.

Michael Kim - Sandler O'Neill - Analyst

Okay. Then just finally, can you maybe talk a little bit about the fee structure of the new product set you've recently introduced? Then more broadly, what -- what's your outlook for fees and other fund terms now that maybe some of the LPs seem to be getting a bit more proactive on that front and particularly in light of your comment, Scott, earlier around kind of more customized relationships?

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Scott Nuttall - KKR & Co. (Guernsey) L.P. - Head - Global Capital and Asset Management Group

Sure. In terms of the types of capital we're raising, it really runs the gamut. There's some of the separate account relationships that will be more on the liquid credit side that will be fee-only with no carry potential that may be in the 50 to 100-basis-point management fee range. Funds as a general matter, Michael, are not a lot different than our existing funds, kind of 1% to 1.5% management fees, carry generally in the 20% range, so not a big change there.

I think in terms of the go-forward, we'll have a much better sense in terms of the environment when we launch the fund-raising process for our next private equity fund, and I'm sure that there will be a discussion on terms as a whole, including management fees, but we have not yet started down the path. I don't have a lot of color to give you as of yet.

Michael Kim - Sandler O'Neill - Analyst

Okay. Fair enough, thanks for taking my questions.

Operator

We'll go next to Sanjay Sakhrani with KBW Investments. Your line is open.

Sanjay Sakhrani - Keefe, Bruyette & Woods - Analyst

Thank you. Good morning. I just had a few questions. The first was, just to be clear on kind of the recurring core number going forward, it's probably fair to strip out the incentive fee because that was kind of one-time in nature and some of capital markets activities probably abnormally high.

Bill Janetschek - KKR & Co. (Guernsey) L.P. - CFO

That's right. When you think about our recurring fee streams as it relates to the management fee, that's pretty steady as well as recurring monitoring fees. The non-recurring items is, as you mentioned, the incentive fee in the Public Markets business this quarter as well as the robust activity that we continue to see in the Capital Markets business.

As you remember, last quarter we had commented that we thought \$20 million of revenue in the fourth quarter for Capital Markets was robust, and obviously \$25 million is quite exceptional this quarter as well. So, when you think about taking into account recurring, there are always going to be in each and every quarter some non-recurring items.

Case in point, in the fourth quarter of 2009 we had a termination fee that I mentioned earlier and that produced, as it relates to fee-related earnings, approximately \$30 million. So, when you think about recurring fees you would have to obviously strip out those non-recurring items.

Sanjay Sakhrani - Keefe, Bruyette & Woods - Analyst

Okay. Is there a level of capital markets income that you think is appropriate to use modeling out, or it's just really lumpy?

Jon Levin - KKR & Co. (Guernsey) L.P. - Treasurer, Head of IR

Hey Sanjay, it's Jon. I think there's really two things to think about, and I think generally you're right, that there is a high correlation between what we're seeing in the Capital Markets business and just, in general, the level of capital markets activity across our portfolio.

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But, the other thing to think about is this is still a reasonably new business for us, and so we're still gaining momentum in terms of just working with our teams across the portfolio. So, if you think about the 14 transactions that we participated in in the first quarter, that compares to probably four or five per quarter that we did in the third and fourth quarter.

So, there's -- you have that dynamic of getting to a normal baseline in terms of just -- in terms of the level of activity we're having across the portfolio. But then, you're going to have -- the non-recurring is going to come just from the broader level of capital markets activity across the markets.

Sanjay Sakhrani - *Keefe, Bruyette & Woods - Analyst*

All right. I guess the second question is just investment activity is pretty strong. You guys mentioned deal activity is picking up in the US. Is there a specific pipeline that you guys can speak to? Or -- I mean, how do we get a sense of how to think about it on a go-forward basis?

Scott Nuttall - *KKR & Co. (Guernsey) L.P. - Head - Global Capital and Asset Management Group*

It's really -- hey, Sanjay. It's Scott. It's really hard to give you any specifics. I think it's more going to be just color because, as you know, the hit rate in the Private Equity business in particular, it's hard to predict and it's a pretty low hit rate.

But a couple of things, one, we mentioned that we did get \$1 billion actually invested in the first quarter. I also mentioned that we've announced five transactions, which are yet to close. Just to give you a sense, that's \$800 million that's kind of already committed but yet not invested. So, that's one thing to think about as we are -- got only a month-plus into the second quarter.

But as a general matter, across our businesses Private Equity, Mezzanine, our Capital Solutions business, across all of our deal-based businesses, we're seeing a significant increase in activity generally. It's just hard to translate that for you into any specifics.

Sanjay Sakhrani - *Keefe, Bruyette & Woods - Analyst*

Okay. All right. Great. I guess the final question lies in the capital raise announcement, it seems like you guys are planning on staying a more balance-sheet-intensive model versus your peers. Could you maybe, Scott, talk through the thought process there and just talk about the opportunities to deploy that capital? Thank you.

Scott Nuttall - *KKR & Co. (Guernsey) L.P. - Head - Global Capital and Asset Management Group*

Thanks, for the question. In terms of the balance sheet intensity, I think we like being our own largest investor. Obviously, the vast preponderance of the value of the firm, we think, over time will be driven by our asset management activities and the fee and carry derived therefrom.

But, we do think there's a real benefit as we talk to investors in terms of having a significant amount of capital invested in what we do, and we think that will always be part of our model.

We also like having a balance sheet in order to fund new businesses for the firm. So, as we talked about the oil and gas strategy, we've talked about what we're doing in mezzanine and real assets more broadly, and we think it makes sense for us to be able to have a balance sheet to incubate new products and invest capital where we see the most attractive return opportunity.

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So, it will remain probably relative to some of the competition a more balance-sheet-intensive model but with a focus on making sure that we're really driving the bottom line profitability, both on the balance sheet but also critically from the Asset Management business and the carry and fees we get.

In terms of the general opportunities that we see, they really run the gamut. We're seeing opportunities to invest capital in private equity, mezzanine, real assets and the liquid credit efforts that we're pursuing, in addition to potentially incubating some new strategies over time that could turn into new businesses for us down the road.

We obviously are focused on funding the capital commitments we have to our private equity funds and we think those are going to be a great set of investments, especially at this part of the cycle. We do see an opportunity over time to think about new businesses that we could feed more broadly and fund our capital markets operation, which, as Jon said, is continuing to gain some momentum. So it's pretty broad-based, and as owners of 70% of the enterprise, we're pretty excited about the opportunities we see to deploy this capital.

Sanjay Sakhrani - *Keefe, Bruyette & Woods - Analyst*

Okay. Thank you very much.

Operator

We'll go next to Marc Irizarry with Goldman Sachs. Please, go ahead.

Marc Irizarry - *Goldman Sachs - Analyst*

Oh, great. Thanks. Hey, everyone.

Jon Levin - *KKR & Co. (Guernsey) L.P. - Treasurer, Head of IR*

Hey.

Scott Nuttall - *KKR & Co. (Guernsey) L.P. - Head - Global Capital and Asset Management Group*

Hey, Marc.

Marc Irizarry - *Goldman Sachs - Analyst*

Scott, a question for you on capital formation, obviously there's been a lot of capital formed in private equity. What -- when you think about the next big private equity fund that you're going to launch, do you need to draw down some of the existing capital first and/or have more material realizations from the funds before you can form funds anywhere near the previous vintage years?

Scott Nuttall - *KKR & Co. (Guernsey) L.P. - Head - Global Capital and Asset Management Group*

I think, Marc, we appreciate the question. We're actually focused, as you know, on returning capital to our investors because we actually think we've created value and we think there's an opportunity to do so.

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As a general matter, the way the private equity fund-raising cycle works, you tend to raise a successor private equity fund before you've returned a meaningful amount of capital from the prior fund. So, we don't see a lot of pressure to a give a lot of cash back. We're doing it because we think it's the right thing to do for our investors. But, we don't think it's a big precursor. In other words, we don't think we have to return X before we can go start the next fund raise.

What we're focused on doing is making sure that we drive the returns and evidence the value creation. As I said before, we think with \$5 billion left we've got plenty of dry powder to put to work over the course of the next several quarters. We'll have to see how that deployment continues before we think about the timing of the fund-raising for the next North American fund.

Marc Irizarry - Goldman Sachs - Analyst

Okay. Then obviously, you're in the market with a lot of interesting -- a lot of interesting sort of new strategies, if you will, mezzanine, infrastructure, et cetera. Could you sort of give a sense of the size of the funds that you're out there marketing right now, like what -- how much in capital formation we're talking about?

Scott Nuttall - KKR & Co. (Guernsey) L.P. - Head - Global Capital and Asset Management Group

It's a very hard, Marc, to give you a number on that, and given the private placement rules I'm not allowed to really comment on the specifics around any of the fund-raise efforts that we have ongoing.

I will say as a general matter we're pleased that it seems that investors seem to be rotating back to some of the illiquid asset classes in which we focus. We're finding significantly increased interest across private equity, mezzanines, distressed and increasingly infrastructure. So, our general view is that the environment is moving our way, and that's probably all I can say on that.

Marc Irizarry - Goldman Sachs - Analyst

Okay, that's helpful. Then in European Fund III, it looked like the commitments to the funds were cut back sequentially, so it was absolutely -- are we missing something there? Or, was there a cutback in the commitments to the Fund, to European Fund III?

Bill Janetschek - KKR & Co. (Guernsey) L.P. - CFO

He, Marc, it's Bill Janetschek. How are you?

Marc Irizarry - Goldman Sachs - Analyst

Great.

Bill Janetschek - KKR & Co. (Guernsey) L.P. - CFO

Marc, that's just with regard to -- the European III has a dollar investor base and a euro investor base, and we obviously take the commitments based upon spot rate each quarter. So, as the euro goes up or down the commitment numbers go to change quarter over quarter, and that's the subtlety on the total commitment size changing.

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Marc Irizarry - Goldman Sachs - Analyst

Oh, great. Then, that actually brings me to my next question, given what we're seeing with the euro here recently. What's your exposure -- your currency exposure within the funds look like? Then also at the firm level, Bill, how should we think about your exposure to euro?

Bill Janetschek - KKR & Co. (Guernsey) L.P. - CFO

What you should think about is with regard to our European funds we have dollar investors and we also have euro investors, and I mentioned that earlier. We take a very high level portfolio of price-hedging strategy, and so we hedge out a significant amount of our exposure as it relates to investing in the euro.

So to the extent the euro goes up or down, there's not going to be a significant amount of an impact as it relates to the performance of our funds, and that obviously extrapolates into the mark-to-market on our carry.

Marc Irizarry - Goldman Sachs - Analyst

Okay. Then just a real specific question on loss sharing, what's left in the LP loss-sharing commitments? Where are we in terms of the size of those loss-sharing commitments?

Bill Janetschek - KKR & Co. (Guernsey) L.P. - CFO

With regard to loss sharing in the fourth quarter, just to give you an idea, there's the one that was a significant number still was the '06 fund. I could tell you that as it relates '06 overseas fund, we mark-to-market that portfolio up.

Right now we're approximately \$65 million below cost, so we're going to have the mark the portfolio up to \$65 million. Once that happens, then we're in a 80/20 positive carry position. As it relates to the Millennium Fund overseas, which would be the other loss-sharing fund, that on a mark-to-market basis we're already positive.

Marc Irizarry - Goldman Sachs - Analyst

Okay. Then, just one more on public markets, can you talk about what it looks like the fee rate tick-down there? Can you just address that? And then just one quick follow-up on public markets.

Jon Levin - KKR & Co. (Guernsey) L.P. - Treasurer, Head of IR

Hey, Marc, this is Jon. There was a -- if you recall KKR giving a standby facility to KFN, and when we terminated it -- and there was commitment fees associated with that facility. So when that facility was terminated, given the overall improvement that we saw in KFN, some of those commitment fees went away. It's a small number, but given the small base it actually can drive it a little bit.

Marc Irizarry - Goldman Sachs - Analyst

Okay. Then, can you --? And then --.

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Jon Levin - KKR & Co. (Guernsey) L.P. - Treasurer, Head of IR

Accrued just the fee rates in terms of the capital raised. So, it's just a bit of an anomaly.

Marc Irizarry - Goldman Sachs - Analyst

And then just on capital raised. Could you give us a sense in the public markets the redemptions versus the raise-ups there of new money?

Scott Nuttall - KKR & Co. (Guernsey) L.P. - Head - Global Capital and Asset Management Group

Sure. The punch line -- Marc, it's Scott again. The punch line is it's a positive trade. Basically what happened is in our liquid credit strategies, high yields and leveraged loans, we had a couple of our investors in the separate account side that took some profits off the table during the course of the quarter.

So, that's generally the redemptions that you see. We replaced that with, frankly, a higher fee and carry-bearing capital, largely in the form of the mezzanine fund first close so it was a positive trade.

Marc Irizarry - Goldman Sachs - Analyst

Okay. Thanks a lot, guys.

Jon Levin - KKR & Co. (Guernsey) L.P. - Treasurer, Head of IR

Thank you, Marc.

Scott Nuttall - KKR & Co. (Guernsey) L.P. - Head - Global Capital and Asset Management Group

Marc.

Bill Janetschek - KKR & Co. (Guernsey) L.P. - CFO

Take care, Marc.

Operator

We'll go next to Michael Loungo with Liberum Capital. Please, go ahead.

Michael Loungo - Liberum Capital - Analyst

Hi, guys. One question on the -- at the portfolio company level -- we've seen a lot in the background about portfolio company debt restructurings specific to your company as well as a lot of your competitors.

Can you give us a sense, even if it's a very high level, where you are in the balance-sheet restructuring process at the portfolio company level, what sort of leverage you had going in, what you have now, and where you're looking to be? And -- as well any discussion about pushing out duration to the extent you've been able to extend the maturities at the portfolio company level?



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Scott Nuttall - KKR & Co. (Guernsey) L.P. - Head - Global Capital and Asset Management Group

Great. Thanks, Michael. It's Scott. A couple of things, one, as a general matter we don't disclose our overall portfolio company leverage levels. But what we do look at is, to your latter question, how we're doing in terms of managing the debt maturities. The punch line is we've done quite well and made a lot of progress with our deal teams working with our capital markets effort at KKR pushing out maturities.

So the general statistics, 89% of the maturities that cross our private equity portfolio are in 2013 and after, and 75% are actually 2014 and after. So, we have made -- we made good progress pushing out maturities, and that needs to be a focus.

Michael Loungo - Liberum Capital - Analyst

Okay. I appreciate the disclosure on the portfolio company leverage levels. Without being specific, any way to give us sort of a sense of magnitude? Is it 20% less than it was, 40% less, about what it was and just an extension of maturities?

Scott Nuttall - KKR & Co. (Guernsey) L.P. - Head - Global Capital and Asset Management Group

It's hard to give you specifics. We actually don't track them on a total portfolio basis, but we have made a lot of good progress. As you can, with the companies that we have brought public most of those proceeds have been used to delever those companies.

Michael Loungo - Liberum Capital - Analyst

Yes.

Scott Nuttall - KKR & Co. (Guernsey) L.P. - Head - Global Capital and Asset Management Group

So, the general takeaway I think you should have is that we are deleveraging out of free cash flow. We're delevering out of equity capital markets activity where it's possible and, at the same time, we're accessing the capital markets to push out maturities. As a result, we're making good progress both on the maturity front and the overall deleveraging front.

Michael Loungo - Liberum Capital - Analyst

Okay. Then on the capital raise, assuming that as the document -- stick on the document raise, you raised \$500 million in the IPO. You'll have what looks it's about \$2.8 billion in total liquidity at the GP level. You folks have been experiencing correcting balance sheet inefficiencies at the portfolio company level. What can we expect from the GP? It seems like the balance sheet will become pretty inefficient pretty quickly at this rate, especially with the capital raise.

Jon Levin - KKR & Co. (Guernsey) L.P. - Treasurer, Head of IR

Hey, Michael. It's Jon. A couple of things on that point, Bill talked about a couple of the key pieces of data, the \$620 million of cash, the \$350 million of debt, but we are in a net cash position. The one thing to think about is we've got the \$1.1 billion or so of commitment still remaining to our funds, and so we like the position we're in with respect to our net cash and expected realizations to meet those commitments.

But, similar to what Scott said in answer to a question a couple of questions ago, we also want to be kind of forward-looking and aggressive with respect to making new commitments as we grow our business. We do have that -- what you're mentioning,

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and the much larger figure is obviously the revolver capacity. Those revolvers are January of or, February of -- June -- July of '12, sorry, and February of '13 respectively.

Ideally, we would use that revolver capacity to meet kind of working capital changes in our business as opposed to funding kind of long-duration illiquid assets. So, I think you've got to think about the commitment as it relates to our balance sheet and then also think about our raising capital so that we can continue that strategy going forward.

Michael Loungo - *Liberum Capital - Analyst*

On the capital raise, you break down on page 12 of the release -- the cash across your segments. Whatever amount is raised in the IPO, where will we see that cash come in, to what segment of the business?

Jon Levin - *KKR & Co. (Guernsey) L.P. - Treasurer, Head of IR*

Obviously, from a -- how we run the business is cash fungible across the segments, but just given that most of our balance sheet activity occurs in the Capital Markets and Principal Activity segments, that's likely where you would see us in the interim until it gets invested.

Michael Loungo - *Liberum Capital - Analyst*

Okay. Then, this quarter there's no evidence of transfers out of fee-paying into non-fee-paying assets under management, but we did see it in the last quarter. What typically prompts those sorts of transfers? And what do you foresee going forward in that sort of transfer activity?

Scott Nuttall - *KKR & Co. (Guernsey) L.P. - Head - Global Capital and Asset Management Group*

Yes. Hey, Michael, it's Scott. I think the transfer that you're referring to last quarter was really the Annex Fund --.

Michael Loungo - *Liberum Capital - Analyst*

Yes.

Scott Nuttall - *KKR & Co. (Guernsey) L.P. - Head - Global Capital and Asset Management Group*

In which we had some of our investors shift some commitments from their European III fund commitment to the Annex Fund. That was more of a one-off situation, and it's not something that typically occurs.

Michael Loungo - *Liberum Capital - Analyst*

Okay. That's all I had. Thanks, guys.

Scott Nuttall - *KKR & Co. (Guernsey) L.P. - Head - Global Capital and Asset Management Group*

You bet.

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Scott Nuttall - KKR & Co. (Guernsey) L.P. - Head - Global Capital and Asset Management Group

Thank you.

Jon Levin - KKR & Co. (Guernsey) L.P. - Treasurer, Head of IR

Thanks, Michael.

Operator

We'll go next to Doug Rothschild with Scoggin. Please, go ahead.

Doug Rothschild - Scoggin Capital - Analyst

Good morning, guys.

Jon Levin - KKR & Co. (Guernsey) L.P. - Treasurer, Head of IR

Good morning, Doug.

Scott Nuttall - KKR & Co. (Guernsey) L.P. - Head - Global Capital and Asset Management Group

Good morning too, Doug.

Doug Rothschild - Scoggin Capital - Analyst

Could you explain the -- sequentially, there's a pretty big change in the net cash, going from net debt to net cash. Could you just explain how that happened -- where all that came from?

Jon Levin - KKR & Co. (Guernsey) L.P. - Treasurer, Head of IR

Sure. The largest drivers were the settlement of the Sun investment that we made. So, when Oracle bought Sun our convertible investment there was settled. So, that contributed over \$300 million of cash. And we also had -- HCA paid a dividend, and so that contributed a lot to the cash change. Those are the two main drivers.

Doug Rothschild - Scoggin Capital - Analyst

Did -- the Sun debt piece was also consolidated if I remember?

Jon Levin - KKR & Co. (Guernsey) L.P. - Treasurer, Head of IR

That's --.

Bill Janetschek - KKR & Co. (Guernsey) L.P. - CFO

That's correct.



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Jon Levin - KKR & Co. (Guernsey) L.P. - Treasurer, Head of IR

That's correct.

Doug Rothschild - Scoggin Capital - Analyst

So, that's why the debt went down?

Jon Levin - KKR & Co. (Guernsey) L.P. - Treasurer, Head of IR

That's right. So, it showed up as a \$700 investment with \$350 million of debt against it, so both of those go away and convert to approximately \$300 million-plus of net cash.

Bill Janetschek - KKR & Co. (Guernsey) L.P. - CFO

And fortunately, you'll continue to see that activity in the second quarter. In April, we sold a secondary position in Legrand and that equated to approximately \$20 million to the balance sheet.

In addition, Dollar General had a secondary in the fund, and KKR's balance sheet participated in that and that amounted to an additional \$80 million. HCA just recently announced another dividend, and that payment will come in next week and that's going to be approximately \$25 million. So, you'll see cash come on our balance sheet from realizations in the second quarter right now as of today of approximately \$125 million.

Doug Rothschild - Scoggin Capital - Analyst

Okay. But, I just want to make sure I'm not double counting when I look at your \$4.2 billion first quarter balance on your capital markets and principal activities. That \$4.2 billion of mark-to-market value is in addition to your net cash, or am I double counting?

Bill Janetschek - KKR & Co. (Guernsey) L.P. - CFO

No. That is in addition to the net cash of the \$410 million we're showing in the Principal Activity segment.

Doug Rothschild - Scoggin Capital - Analyst

Okay. Then the \$4.2 billion of total investments, are there are any offsetting liabilities against those that are not in the net debt or cash number?

Bill Janetschek - KKR & Co. (Guernsey) L.P. - CFO

No.

Doug Rothschild - Scoggin Capital - Analyst

Okay. So, the total was about \$4.5 billion of value. Then on the filing process with SEC, can you just -- I know that you're in a quiet period, but can you say just in terms of the magnitude of comments that you're getting from the SEC on the first go-round,

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is it -- do you think you've addressed most of them? Or, is this a -- are you still seeing lots of comments from them? Or, how would you describe it?

Jon Levin - KKR & Co. (Guernsey) L.P. - Treasurer, Head of IR

Hey, Doug. We're not going to comment on that, just given the SEC quiet period rules. We filed the second amendment on May 10th, and we're going to leave it at that.

Doug Rothschild - Scoggin Capital - Analyst

Okay. Thanks, guys.

Jon Levin - KKR & Co. (Guernsey) L.P. - Treasurer, Head of IR

Thanks, Doug.

Operator

We'll go next to Mark Sunderhuse with Red Rocks Capital.

Mark Sunderhuse - Red Rocks Capital - Analyst

Hi. Good morning, guys.

Jon Levin - KKR & Co. (Guernsey) L.P. - Treasurer, Head of IR

Hi, Mark.

Scott Nuttall - KKR & Co. (Guernsey) L.P. - Head - Global Capital and Asset Management Group

Hi.

Mark Sunderhuse - Red Rocks Capital - Analyst

If you could just spend a moment on the balance sheet, on the valuation side, and speak generically tying it back into your opening remarks about the macro environment and where you're seeing changes in marks. I'll just -- I'll point out a couple that are pertinent, ProSieben, things like PagesJaunes coming back up. NXP, we've seen obviously some of the other news out of the semiconductor world, including comments from Freescale and Intel.

But, can you talk a little bit about -- just generically changes in marks of things up or down on the balance sheet versus something that you had highlighted, I would think about four quarters ago, where companies are meeting plan versus where the marks may be just changing based on comps and the differentiation of kind of how you see the valuation policies to give us a better idea if things are coming back up on the balance sheet, based more on comparables or based more on business trends?

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Scott Nuttall - KKR & Co. (Guernsey) L.P. - Head - Global Capital and Asset Management Group

Thanks. It's Scott, Mark, I have a couple of thoughts on that. First, it's hard to talk about any specific companies, so I'm not going to go there. But just to give you some color, it's really all of those factors that are combining to yield the increase in the value of the portfolio, which was about 10% in the first quarter across our private equity funds.

Just to give a comparable, the S&P was up 5.4% during the quarter, so one way to think about it is the -- we do have about a 50/50 blend when we do our valuations between discounted cash flow and comparable company metrics. We're seeing both a benefit from an increase in the value of the public markets, and that flowing through the marks is the comparable components of our valuation.

Plus, we're also seeing a number of our companies continue to increase their profitability and generate free cash flow and, therefore, the forward-looking projections for those companies have improved. That, obviously, benefits the discounted cash flow analysis.

So, we're seeing really the benefit of both in an improving economy, and really the net of the all of that is the overall portfolio was up about -- not quite but close to two times the rate of the market improvement in the quarter, which gives you a sense as to how much is coming from market and how much is coming from specific company improvements.

Mark Sunderhuse - Red Rocks Capital - Analyst

Okay. Then just two more quick questions, is Capmark written off, or is it written down at this point?

Bill Janetschek - KKR & Co. (Guernsey) L.P. - CFO

Right now, Capmark is written down but not off, only for the fact that we still own an investment in the company and as it's working it's way through bankruptcy we'll see where we end up coming out. But right now, we're carrying it at zero.

Mark Sunderhuse - Red Rocks Capital - Analyst

Okay. Approximately, what percentage do you -- will you retain of that once it's settled -- is it settled yet, or do you have a rough estimate?

Bill Janetschek - KKR & Co. (Guernsey) L.P. - CFO

No, no estimate at all.

Mark Sunderhuse - Red Rocks Capital - Analyst

Okay. Then last, the change from March 31, 2010 on capital markets versus the December 31 reporting period on other investments, is that just things like you mentioned earlier, the realization of Sun, or is that made up of something else -- the 195 versus 163?

Bill Janetschek - KKR & Co. (Guernsey) L.P. - CFO

I'm sorry, Mark. What number are you referring to?

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Mark Sunderhuse - Red Rocks Capital - Analyst

Other investments at the very bottom, 195,212 and --.

Bill Janetschek - KKR & Co. (Guernsey) L.P. - CFO

Yes. Oh, sorry. You're talking about on page 13?

Mark Sunderhuse - Red Rocks Capital - Analyst

Yes.

Bill Janetschek - KKR & Co. (Guernsey) L.P. - CFO

That's just a combination of other investments that are ten-plus deep and are just too small to mention.

Mark Sunderhuse - Red Rocks Capital - Analyst

Okay, thank you.

Bill Janetschek - KKR & Co. (Guernsey) L.P. - CFO

Mark, I just want to point out one other thing that Scott had mentioned, that our fund performance was up 10%. Just to give you an idea of the breakdown between our private marks and public marks, our public investments were up over 14% and we wrote up our private companies 8.5%.

To your point about the \$4.2 billion of value and how we mark that value, 30% of the value is level one and level two, so what we call readily ascertainable marks. So --.

Mark Sunderhuse - Red Rocks Capital - Analyst

Right.

Bill Janetschek - KKR & Co. (Guernsey) L.P. - CFO

That -- it is probably a higher percentage than you thought, and so 30% of the underlying value is literally just mark to market.

Mark Sunderhuse - Red Rocks Capital - Analyst

Great. Thank you so much, guys.

Scott Nuttall - KKR & Co. (Guernsey) L.P. - Head - Global Capital and Asset Management Group

Thank you.

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Operator

We have a follow-up question from Michael Kim with Sandler O'Neill. Please go ahead, sir.

Michael Kim - Sandler O'Neill - Analyst

Hi, guys. Just a couple of quick ones here, in terms of the investments on the balance sheet, the \$4.2 billion included the \$700 million going away related to the Sun investment. Is that correct?

Bill Janetschek - KKR & Co. (Guernsey) L.P. - CFO

Well, as of March 31st, the investment is gone and so we had roughly, from that sale, approximately \$700 million in gross proceeds and we -- that investment was held on swap of \$350 million. So, we realized net cash proceeds of \$350 million and, as Jon had mentioned earlier, that \$300-odd million was used to pay down debt from the fourth quarter to the first quarter.

Michael Kim - Sandler O'Neill - Analyst

Great. So just all else equal, assuming that that transaction didn't occur, the investment number would have been \$700 million higher? Is that correct?

Bill Janetschek - KKR & Co. (Guernsey) L.P. - CFO

Yes, on a net basis \$350 million higher.

Jon Levin - KKR & Co. (Guernsey) L.P. - Treasurer, Head of IR

Yes. And just to add what Bill has said, we were showing it net in the investments line, in the -- at 12/31. So, if you look at the \$4.1 billion of investments that had a \$350 million net number in it.

Michael Kim - Sandler O'Neill - Analyst

Got you.

Jon Levin - KKR & Co. (Guernsey) L.P. - Treasurer, Head of IR

It wasn't being shown in the -- the debt against that investment wasn't separately being shown in the debt obligations of \$733 million on the balance sheet. That's where we had the revolver draws.

Michael Kim - Sandler O'Neill - Analyst

Got you.

Jon Levin - KKR & Co. (Guernsey) L.P. - Treasurer, Head of IR

So just -- I want to make sure that you have that piece in terms of how it was showing up in the balance sheet.

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Michael Kim - Sandler O'Neill - Analyst

Yes, understood. Then just more broadly as it relates to kind of thinking about broadening out the franchise, are you open to maybe entering new businesses where you're currently -- maybe don't have a presence? Or, is it more focused -- or, are you more focused on kind of just enhancing scale in areas that you're already in? Then, are there just specific markets that you're focused on from a geographic standpoint? Thanks.

Scott Nuttall - KKR & Co. (Guernsey) L.P. - Head - Global Capital and Asset Management Group

Sure. Michael, it's Scott. I think a couple of things. One, we're clearly focused on enhancing scale in the businesses that we're in. But as part of that, we are focused on new areas that are adjacent to areas that we're already operating in.

So, as an example, we are increasingly active, as you know, in China and India across our investing platform. I think you'll continue to see that happen. We are also entering adjacent businesses where we think we have a real competitive advantage.

So, this quarter you saw the Oil and Gas business be created. You know that we've created the Mezzanine business and the Capital Solutions efforts. Really, what we're focused on doing is creating capabilities that are complementary to our existing skill sets within the firm.

So, where we find opportunities to invest capital that we think we can -- and think we can do so in a differentiated way and with people that we have a lot of faith in that we will do it, but our focus predominantly is to continue to build scale in what we are already in and adjusting those adjacencies where we think we really have a differentiated advantage.

Michael Kim - Sandler O'Neill - Analyst

Okay. That's helpful. Thanks, yes.

Scott Nuttall - KKR & Co. (Guernsey) L.P. - Head - Global Capital and Asset Management Group

Thanks.

Operator

And with no other questions in queue, I'd like to turn the conference back over to Mr. Levin for any additional or closing remarks.

Jon Levin - KKR & Co. (Guernsey) L.P. - Treasurer, Head of IR

Okay. We appreciate the questions and everyone's involvement on the call, and we'll be talking to you all over the next quarter or so.

Operator

That does conclude today's conference call. Thank you, for your participation. Have a great day.

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