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PRESENTATION

Editor

Operator: Ladies and gentlemen, thank you for standing by. Welcome to the KKR's second quarter 2014 earnings conference call. (Operator Instructions). I will now hand the call over to Craig Larson, Head of Investor Relations for KKR. Craig, please go ahead.

Craig Larson: Thank you, Stephanie. Welcome to our second quarter 2014 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 will refer to non-GAAP measures on the call, which are reconciled to GAAP figures in our press release, and this call will, also, contain forward-looking statements, which do not guarantee future events or performance. Please refer to our SEC filings for cautionary factors related to these statements.

This morning, we reported second quarter economic net income of $502 million, or $0.57 of ENI per unit, after taxes and equity-based charges. In the quarter, we were particularly active on the monetization front and are pleased to report record, total distributable earnings of $701 million, which is up 57% from last quarter and 74% from last year. On a per share basis, this equates to distributable earnings, net of taxes, of $0.85 per unit for the quarter.

This increase was driven by $333 million of net realized cash carry, also record figure, and in turn, we've announced a $0.67 distribution per unit for the quarter, which is up over 50% on a quarter-over-quarter and year-over-year basis. Before we move on, I would like to highlight the modified disclosure in our press release.

In this quarter, we changed our segment financials and Bill is going to cover how our new segment financials align with the metrics that we use to manage the firm, but at a high level, we've shifted the build to total segment revenues and total segment expenses to emphasize our three forms of revenue, that's fees, carry, and balance sheet income, and our two types of expenses, compensation and other operating expenses.

There are four main changes. First, we made our total segment revenue and expense line items all inclusive. This is true for page six, which is the total segment summary, as well as the individual segment P&L's, which follow on pages seven, eight and nine. Total segment revenues now include fees, carry, and balance sheet income; and total segment expenses now include the allocation of the carry pool.

Second, investment income, so the income from the balance sheet is no longer attributable to only our third segment and, instead, will span each segment based on the source of the income generated. Third, and this is important, we have added a new measure, fee and yield earnings, on the front of the press release and with further detail on page six. This item highlights the portion of our earnings that we think should be more recurring in nature, including fee-related earnings, plus more recurring net interest and dividend income from the balance sheet. And, finally, after-tax ENI per unit includes noncash compensation charges at the total segment level.

And with that, I'm now happy to turn it over to Bill.

William Janetschek: Thanks, Craig. Before I review our results, I want to explain our thinking behind the reporting changes that Craig just mentioned. Internally, we have focused on cash flow. We used total distributable earnings and distributions per unit to measure our performance as a firm, and the KFN transaction made us rethink the way we want to communicate our financial results.

In the KFN deal, we purposely gave up management fees in exchange for more permanent capital and more recurring balance sheet income. So, we've changed our reporting to better align our financials with the way we manage the firm. In addition to total distributable earnings, we care about investment performance, which is important across all of our businesses. And investment performance leads to ENI. We believe that today's ENI is tomorrow's distribution and both of these metrics impact our profitability, which we measure through ROE and cash ROE. And when we evaluate our performance, we consider both metrics. So with that, let's turn to results.

As of June 30, our assets under management, $98 billion, and fee-paying assets under management were $80 billion. Both figures were down quarter over quarter, mostly from the KFN transaction, as well as monetizations in our portfolio. However, those figures are up 17% year-over-year, with that growth coming, both, from organic and inorganic activity, through the capital we raised organically and inorganically through the Avoca acquisition. Keep in mind these figures do not reflect over $5 billion of committed capital that will be included in AUM once it is invested.

This capital comes from a number of different accounts, including two new carry-paying special sits mandates that closed in the quarter, accounting for $1 billion of that $5 billion. Turning to our segments. In private markets, our private equity portfolio appreciated 5% in the second quarter, up slightly from the 4.5% appreciation we had in Q1. This caused an increase in accrued carry quarter over quarter, but was offset by lower investment income. In the second quarter, our private market balance sheet investments were up only 2%, compared to 5% last quarter. Together, this translated into $376 million of ENI.

Moving to public markets, ENI in this segment was $106 million, up 8% from last quarter. A few things contributed to the quarterly movement in ENI. As I mentioned, when KFN closed back in April, our fee-paying AUM decreased more than $2 billion, which caused a decline in management fees and potential incentive fees. However, these lost fees really just moved geographies in the second quarter and are now part of KFN's investment income, which we are now reporting in our P&L since the transaction closed.

As a result of the KFN transaction, our public market's investment income is up significantly in the second quarter and includes $34 million of net interest and dividend income. This is, also, our first full quarter with Avoca running through our financials and the bump in management fees in that business helped to partially offset the impact of the reduction in KFN's management fee.

To give you a sense of the impact that KFN had on our second quarter ENI, we generated total investment income across all segments of $162 million, of which $56 million was generated by KFN for the two months that it contributed to our results. Touching on capital markets, we reported second quarter ENI of $20 million, down from $47 million in the first quarter. This decrease was primarily driven by lower capital markets fees in the second quarter. We reported June 30 book value of $12.52 per unit, which is up 30% on a year-over-year basis and takes into account the impact of the KFN transaction and the changing in the carrying values of our balance sheet assets.

Keep in mind, during the last year, we also made distributions off our balance sheet to unit holders totaling $1.56. In the second quarter, we also did a $500 million, 30-year senior note offering that we priced last month, with a coupon of 5 1/8. Our distribution in the second quarter will be $0.67 per unit, which includes $0.15 of fee and yield earnings, $0.05 of which came from KFN. Remember, this $0.05 represents only two months of results since KFN closed on April 30. The other two pieces of the $0.67 were $0.41 of realized carry, and $0.11 of realized balance sheet gains. Before I wrap up, I want to touch on one other point. We made great progress over the last couple of quarters on a percentage of our assets and position to pay cash carry, and as of today, all of our mature private equity funds are in position to pay cash carry on a meaningful realization event.

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

Scott Nuttall: Thanks, Bill. I'm going to hit three topics today; realizations, capital deployment, and our business model. Let's start with realization. We continue to monetize our private equity portfolio in the second quarter, returning over $4 billion of cash for our fund investment, for a mix of strategic sales, secondaries, and dividends.

We exited Avincis and Oriental Brewery at two times and five times our costs, respectively; and the secondaries at HCA and NXP in the second quarter were done at a 3.3 times blended multiple of invested capital. We, also, completed dividend recaps, at Capital Safety and Go Daddy. Additionally, the pickup in strategic exit activity continues. Since the start of the second quarter, we agreed to sell two businesses to strategic buyers; Biomet to Zimmer and WILD Flavors to Archer Daniels Midland.

We, also, agreed to sell a stake in Visma, a software services business in Europe. These announcements, combined with the pending sales of U.S. Foods, another strategic exit, and IPREO, which we're selling to Blackstone and Goldman Sachs, will provide a solid foundation for cash carry in the second half.

Now, let mow hit on capital deployment. We maintained our active investment pace in the second quarter in private markets, putting $1.5 billion of equity to work. This $1.5 billion includes our first investments in South America and Africa and we believe we will find more investment opportunities on these two continents as we continue to expand our global footprint.

We've also committed another $2.5 billion of equity to deals that have been announced, but not yet closed; of which, approximately, 60% will be put to work outside the U.S. We have, also, been busy in public markets. If you look at the gross assets invested across all of our accounts in mezzanine, direct lending and special situations, we deployed $1.8 billion in the first half of the year. These opportunities have been diversified by type and geography and we've been, particularly, active in Europe, where we continue to find some very interesting risk-reward opportunities.

And more importantly, these strategies continue to perform. To give you a sense, our special situations mezzanine and direct lending funds had gross returns of 41%, 24%, and 15% over the last 12 months. Overall, we continue to find opportunities to, both, buy and sell across Asia, Europe, and North America. As of June 30, we've distributed over $6 billion of cash to our fund investors, or 1.5 times the $4 billion that we've invested in private markets.

The last topic I want to spend time on is our business model. As we have explained before, we believe our business model is unique. We are focused on marrying third-party capital with our balance sheet and capital markets capabilities to grow our cash flow per share. We believe the combination of the three elements of our business model is quite powerful. Our goal is to double our cash flow by capturing maximum economics from the opportunities we see and the returns we generate. It is not that we don't care about raising third-party capital, we do. It is not that we don't care about AUM or fee-related earnings, we do.

We just believe that those two metrics tell only part of our story and looking at them in isolation can be misleading. Our model is quite different in that over 50% of our profits over the last 12 month have come from our balance sheet and our capital markets business. Neither of which contribute to AUM. We believe having our own capital invested in everything we would do and marrying it with third-party AUM plus capital markets allows us to increase alignment with our fund investors and drive a highly attractive ROE and a larger quantum of total cash flow. Ultimately, we believe that if we use all three aspects of our model to drive our cash flow per share higher and keep a high return on equity, all of us will benefit as shareholders, as we will grow our distribution and our book value.

We view the task as a simultaneous equation and are working to double our cash flow while keeping our ROE above 20% and limiting leverage and dilution. In effect, our business model allows us to make more money from work we are already doing in the firm. We believe this approach has inherently less execution risk, as we are increasing our participation rate in the underlying value our Teams are already creating. So, that is how we think about our model at a high level. Now, let me drill town on some of the finer points.

First, on the balance sheet. Our balance sheet is generating significant cash flow, approximately, $800 million over the last 12 months. This cash flow is becoming increasingly predictable with $5 billion of our balance sheet investments generating a current return that we are including in our dividend. As a result, our overall cash flow is growing and has a more recurring base. But it is not just about the balance sheet. We, also, have compelling growth opportunities. We have eight businesses moving from Fund 1 to Fund 2 and this dynamic should allow us to see significantly greater profitability from the new businesses that we've created over the last three to five years. Said simply, the expenses are already here, so the incremental revenues are high margin.

Finally, our cash carry is starting to increase rapidly. Our year-to-date cash carry was more than double last year's figure. I want to turn to how our business model actually works in practice and give you two recent examples, KFN and First Data. When we closed the acquisition of KFN at the end of April, we traded fee-paying AUM and fee-related earnings for a bigger balance sheet and more recurring balance sheet income. With more permanent capital inside the firm, we are better aligned with our fund investors, can accelerate our growth, and generate more total distributable earnings and, therefore, more distributions from everything that we do.

We, also, announced a large capital raise for First Data a few weeks ago. We let a $3.5 billion private placement for the Company. We invested $500 million from the 2006 fund and $700 million from our balance sheet. And our capital markets business was the sole manager of the capital raise. First Data Management and the Capital Markets Teams placed $1.8 billion of equity with new, third-party investors, including mutual funds, hedge funds, and sovereign wealth funds. The transaction closed earlier this month.

First Data is a good example of using our entire business model, third-party funds, our balance sheet, and our Capital Markets business to generate more upside for our firm and our fund investors, and more cash flow for all of us. It is this combination of implementing our business model, scaling our newer businesses, and monetizing cash carry that is driving our distribution up over 60% in the first half, and why we have a return on equity of 29%, and a cash return on equity of 22% for the last 12 months with no net leverage.

Stepping back, we have a strong pipeline of exit activity on the horizon. We have eight new businesses transitioning from Fund 1 to Fund 2, and the multiplier effect of our business model is starting to show up in our cash flow metric. When we look at the first six months, our total distributable earnings are up 65% year-over-year. The more recurring part of our distribution is up over 50% year-over-year. And our year-to-date distribution of $1.10 is up 60%.

In summary, we are pleased with the first half results, but there is a lot more to come in 2014. Thanks for joining our call.

Operator, please open the line.. Question and Answer (Operator Instructions).

Craig Larson: And, Stephanie, if we could, I would like to ask everyone to please focus on only one question so we can get through the queue and, then, re-enter the queue if you would like to follow-up on anything additional.

With that, Stephanie, we'll take the first question.

QUESTIONS AND ANSWERS

Editor

Operator: Thank you. (Operator Instructions). Our first question comes from Michael Kim with Sandler O'Neill. Your line is open.

Michael Kim: Hey, guys, good morning. So, my question, as you continue to build out the franchise, can you talk about how you approach, sort of, the build versus buy decision? And, then, related to that, when might it make sense to acquire firms like Avoca or Prisma versus, maybe, forming partnerships with others like BlackGold and Riverstone?

Scott Nuttall: Great. Hey, Michael, it's Scott. Thanks for the question. I think everything that we are looking at, we do, now, analyze whether it makes more sense to build it or buy it. As you know, historically, before a couple of years ago, we really geared very much to the build and everything we had done before Prisma, we had decided to build organically. What we found, though, there are some parts of the world, frankly, where an acquisition may be a more viable way to go to get us to scale faster, or some businesses, frankly, where we will be able to add talent at more scale quickly, through an acquisition approach.

So, we really, now, parallel path these efforts and analyze buying and building, quite proactively. We've created a Corporate Development Group inside the firm. We did not have that a few years ago. We have a dedicated team helping the business leaders do this calculus.

In terms of Avoca and Prisma versus BlackGold, just to shed some light on that part of your question, really, the question is, does it make sense for it to be strategically 100% part of the firm? With the Avoca and Prisma, we decided that it did make sense to bring them in strategically on a 100% basis, versus BlackGold, which is really a hedge fund stake where we, actually, felt it made sense for the owners of BlackGold to continue to own the vast majority of that business.

And, really, in that instance, with Prisma in the first instance, we felt that it was an important cornerstone to the hedge fund strategy that we wanted to build. We felt that we could build out the solutions part of their business, but leveraging the Prisma capabilities, we felt that we could build a broader stakes and seeding business using our balance sheet capital because we like the cash-on-cash returns and it made sense to have the Prisma Team as part of KKR, in total, to be able to affect that overall strategy.

BlackGold is an example of one of the hedge fund stakes that we took as part of that strategy. Avoca, similarly, we had been building out our credit business globally. As you know, we had business in the U.S. at the time that had private and public credit working side by side. In Europe, we only had private credit. Avoca brought us the public part. It made sense to make it more holistically part of the firm.

So, that's how we think about it. We'll continue to asses both paths

Michael Kim: Thanks for taking the question.

Operator: Our next question comes from Michael Carrier with Bank of America. Your line is open.

Michael Carrier: Thanks, guys. Maybe just on the model, and when we think about the distribution, I think when you lose management fees and, then, it goes to investment income, just one of those things that you know is sometimes viewed differently. When you think of the mix now, of your distributable earnings, is there a way to characterize, like what portion of it you would say -- I know you hit on it, in terms of it is more recurring, but is there a certain portion of the assets that have fairly consistent yields? Just trying to get some understanding on what can we start to think of as more, kind of, ongoing versus it is going to ebb and flow with the markets.

Scott Nuttall: I think, Michael, the way I would think about it, If you look at page six of the press release, you see we, now, have this new metric that we are calling Fee and yield earnings. Really, what we're capturing there is the historical definition of fee-related earnings. I think people have thought of "historically" as more recurring in nature, but we are now starting to include this net interest and dividends component of the balance sheet. That's the more recurring net interest and dividends that we get off our balance sheet. About $5 billion of our balance sheet assets, now, are generating what we would think is a more recurring dividend or yield. So, that's one metric you can look to to try to get a feel of that.

So, you can see in the first six months, and this is, obviously, without having KFN for the whole period--we only had it in for two months--you can see what that number looked like, that's the $317 million that we show on page six. But the other page that I point you to is page 15, which is the distribution calculation itself. And if you look at that page, you can see the last boxed line on that page, we actually show fee and yield earnings per unit. You can see that in the first six months was about $0.31. I'd expect that would continue to increase now that KFN is part of the fold completely. And as that rolls into the numbers for the back half, I think that number continue to grow on an apples-to-apples basis.

But the other thing to point to on that page is what KFN did to our payout ratio. You can see, last year, Q2 was 76% and it is, now, somewhere between 78% and 79% because we changed our distribution policy to pay out all of those earnings. So, the point that we are trying to make, though, is while if you look at the numbers, it is $0.31 in the first half out of $1.10 of distribution. I think it would be the wrong thing to do to say that carry and balance sheet income, otherwise, are not recurring. We've paid cash carry in each of the last 17 quarters and as you know, we now have the vast, vast majority, virtually all of our private equity funds, paying cash carry.

So, although it is harder to predict, specifically quarter to quarter, it has actually been quite recurring in nature, and given that our own biggest investor, when he would have cash-carry events, it generates balance sheet realization events, as well, which also contributes to the dividend. I view it is a spectrum. We have a lot of occurring income and we are excited to see it scaling significantly. As you know, the dividend was up 60% in the first half.

William Janetschek: And, Michael, just one follow-up. When you are thinking about the question at-hand, the more recurring nature of that income, keep in mind that KKR's balance sheet, traditionally, was heavy into private equity; now, private equity only makes up 40% of the balance sheet. As we diversify, you are going to see more recurring income come from the KKR part of the balance sheet.

Scott referred to page 15, and that $0.15 is really $0.09 of fee-related earnings, plus the nickel from KFN, plus only $0.01 from KKR. But, again, as that portfolio continues to diversify, we'll see more recurring interest and dividends come from that balance sheet and, hopefully, that number will go up.

Michael Carrier: Thanks, guys.

Operator: Our next question comes from Bill Katz with Citigroup. Your line is open.

William Katz: Okay. Thanks so much; appreciate you guys taking the question. Scott, you mentioned that you have eight different funds that could move from first to, sort of, second vintages, if you will, can you walk through where you see the greatest opportunity; whether it be private markets, public markets, U.S., non U.S., so we get a sense of what investors are looking for right now?

Scott Nuttall: Absolutely, Bill, thanks for the question. I think before I answer, I would say the overall fundraising backdrop is quite positive. We're seeing institutional investors get more cash back, frankly, from their alternative's portfolios, than they were expecting from us and others. At the same time, over the last few years, they've actually increased their allocation to alternatives. They are looking to put capital to work. The fact that we are raising money for all these second-time funds is, actually, quite positive for us. We think we got the timing right. So, that is a good backdrop. And in answer to your question, I think it is pretty broad-based. In terms of the different strategies where we are active from a Fund 1 to Fund 2, we are out with Infrastructure 2 right now. Our Infrastructure 1 Fund has performed quite nicely.

Direct lending, too, is in the market. Frankly, we are virtually fully invested on our first special sits fund, so we will be launching special sits two as we mentioned in the remarks. Our last twelve-months' returns in our special sits strategy were over 40% gross, so we're optimistic about that fund raised over time, as well. And there is a variety of other things on the Private Capital side, European direct lending. A lot of what I mentioned, I put in the more episodic, both, kind of real assets and originated credit buckets. So, there's a significant amount of activity with a good backdrop there.

But also, frankly, we are seeing opportunities to scale in the hedge fund and credit side of the businesses, the more continuously-raised vehicles as well. Prisma, the two credit funds that we have as part of the credit business, the stakes with the fill of BlackGold, et cetera, and, then, the credit side, we're raising CLO's and CCT continues to scale. So, I would say there is pretty broad-based opportunity to continue to scale our capital and I would be remiss, it is not a Fund 2, but our Europe 4 strategy is, also, in the market. A bit early, but so far, so good.

William Katz: Okay. Thanks.

Operator: Our next question comes from Patrick Davitt with Autonomous. Your line is open.

Patrick Davitt: Good morning, guys. There was a recent report on NPL sales in Europe, up, you know, [six-x] year over year, and a sense that you are really starting to see banks, kind of, spit stuff out. Curious, if you are seeing the same thing; and to what extent you can still get good deals in that kind of environment with the amount of capital that's already been raised for this kind of stuff, both, from you and your competitors?

Scott Nuttall: Good morning, Patrick. I think we are seeing more activity in terms of what banks are selling. Probably a year ago, there was a lot of noise, but the bid/ask spread was, frankly, quite wide. You are right, there has been more actual activity. A lot of those portfolios are, frankly, reasonably well-bid. While we have bought a few and those have, thus far, performed quite well, we're not spending the bulk of our time there.

Where we are really finding more interesting opportunity and, particularly, the case across Europe, and especially on the continent, is the derivative affect of the fact that the banks are internally-focused and are not customer-focused right now. So, what we're finding is that there is a number of good companies that have capital structures that are maturing that need help.

A lot of our activity is providing rescue capital or financing for those companies; that's really a consequence of the fact that the banks are going through what they are going through, so it's created an opportunity for us, as a result of the regulatory environment and the fact the banks are quite levered. And that's the primary opportunity; buying portfolios has been a secondary opportunity. Having said that, we are in discussions with a number of banks about helping them work their way out of some existing assets and creating partnerships to do that. It's hard to predict how that will play out, but the most activity, today, is actually working directly with corporates.

Patrick Davitt: Okay, thanks.

Scott Nuttall: Thank you.

Operator: Our next question comes from Luke Montgomery with Sanford. Your line is open.

Luke Montgomery: Okay. Thanks, guys. I was hoping you might clarify your relationship with Capstone? I guess, the key question here is whether or not they might be deemed an affiliate? I guess it's unclear, to me, whether this hinges on the technical use and definition of that term in your fund documents, or whether it is more about the economic relationship you have with them? So, I was hoping, maybe, you could touch on both of those aspects; and on the latter, clarify whether Capstone executives share in any of your revenues pools? And if you think the fact that they are captive and appear to be, at least, partially controlled by KKR has any bearing on whether they might be considered an affiliate somewhere down the road, as that term is generally accepted to mean?

William Janetschek: Okay. This is Bill Janetschek. At its core, Capstone is not an affiliate. Capstone is a consulting firm that provides services to KKR portfolio companies. When you talk about economics, the income that they receive for the services that they provide are paid to all of the KKR executives. In order to --

Scott Nuttall: Capstone. Capstone.

William Janetschek: Capstone executives, sorry. In order to supplement the economics for those KKR, those Capstone executives are not KKR, the carry pool that we have, which is shared throughout KKR, a portion of that is actually allocated to Capstone executives. That comes from KKR economics and not from our Fund economics.

Scott Nuttall: And, it's Scott, I just really -- simply, you are asking a legal analysis question. The punch line is KKR owns no equity in Capstone. Legal analysis, it is not an affiliate. We've been open about that with our investors from the get-go. It is actually in the Limited Partnership Agreements as to how the relationship works. We don't think that the people we work for have any confusion on the topic.

Luke Montgomery: Okay. That makes sense to me and it seems like you think the risk there is fairly low. The worst case scenario, maybe you could size the potential impact on unitholders, and what are the fees you are paying away to Capstone executives?

Scott Nuttall: Just so you understand the construct, today, the portfolio companies pay Capstone directly. So, the bottom line is we would not expect there to be any impact on KKR. It is, actually, not in our financial statements.

William Janetschek: Right. To be clear, none of the segment results that we provide have any Capstone economics running through it. Those fees that are paid by the portfolio companies go to Capstone and do not show up in our results.

Luke Montgomery: Right. But somebody has to pay Capstone, either the GPs or the LPs, so I'm just wondering if it is determined that the GPs are on the hook for it, then, what is the potential size of that, over some relative period?

William Janetschek: The GPs and the LPs are not paying Capstone. The portfolio companies are paying Capstone.

Luke Montgomery: Okay. I will follow up with you guys. Thank you.

Operator: The next question from Brian Bedell with Deutsche Bank. Your line is open.

Brian Bedell: Thanks. Good morning, guys. If you could talk a little bit about the growth in fee-paying assets under management from here, maybe if you can just give us a timeframe of when you think some of that $5 billion of committed capital can move into fee-paying AUM; and whether the new fundraiser's on Fund 2, whether you think they will be, roughly, in line with the raises on Fund 1?

And, then, just color, maybe, Scott, on -- you talked about the U.S. versus the non-U.S. deployment; the non-U.S. deployment increasing. If you can talk about, maybe, your footprint internationally and over the long-term (inaudible) in the deployment opportunities, longer-term being much more oriented outside the U.S.?

Scott Nuttall: Great. So, I think in terms of handling those in turn, in practice, Fund 1s take longer to raise and, historically, they have been kind of a billion, a billion-five or so in size. Because, obviously, as a first-time fund, you are telling more stories than showing actual results. And when you get to Fund 2, if you have investment performance, there is, actually, an ability to scale the assets under management quite materially. So, I guess, given that we have had the investment performance, our general expectation would be that the Fund 2 for each of these strategies, the Fund 2s would be larger than Fund 1.

In some cases, I would expect them to be a multiple of the size of Fund 1. So, that's one of the reasons we're quite upbeat about that opportunity. The other more important element of that is the economics and how it flows through our financial results. When Fund 1 is finished investing and Fund 2 turns on, we still collect a post investment period management fee on Fund 1.

So, you've got the Fund 2 new management fees turned on, Fund 1 still paying the trailer, usually at a reduced rate. And about the time Fund 2 turns on is about the time that Fund 1 carry starts to show up. The economics associated from this Fund 1 to Fund 2 move, that we mentioned, are quite significant, given the expenses are already here.

In terms of this shadow question, that is really going to depend by strategy. I think, as a general matter, we would expect that to come into the actual fee-paying AUM over the next two to three years, depending on the strategy. And in terms of our footprint, we now have 21 offices around the world. The vast majority of those are outside of the United States. If you look at the deployment year-to-date, 60-plus-percent of it has been outside the U.S.

And we have been particularly active in Asia so far this year, where we found a lot of opportunity resulting from the dislocation. But, frankly, we are seeing opportunities in real estate, special situations, infrastructure across Asia and Europe. I would say we are well-positioned. I mentioned Africa and South America, really, has become a very global opportunity set and we think we are quite well-positioned to capture it.

Brian Bedell: And sounds like based on this plus what you talked about with direct lending in Europe, that your proportion of deployment, that 60% number, could actually go up over the next, you know, couple of years given valuations in the U.S.; is that a fair estimate?

Scott Nuttall: It very well could. It is impossible to predict pause there is a lot of a play. We still see some value in the U.S., but valuations are, obviously, up and so it is getting harder to find value. We've had more success of late finding value in Asia and some of the other emerging markets.

Brian Bedell: Thank you.

Operator: The next question from Chris Kotowski with Oppenheimer. Your line is open.

Chris Kotowski: Good morning. I'm cycling back between pages 11 and 14 in the press release and I wonder if you could flesh out a little bit what is happening in the real assets business? You mentioned that you thought infrastructure was doing well, your Infrastructure Fund did real well, and that you are raising Fund 2, but if you just look at where it is marked at fair value, relative to cost, you know, both, real estate and infrastructure, look like they are all marked reasonably close to cost. Is that because it's a yield vehicle, or because they were dividend recaps, or what --

William Janetschek: Chris, this is Bill. If you are looking on page 14, when you are talking about the Infrastructure Fund, you can see that we got a cost of $780 and value of $819; plus, in addition, it's actually paid out $34 million. And that is the old component. When you think about where that Infrastructure Fund is right now, remember, it has only been investing over the past couple of years and so you will see an uplift, hopefully, prospectively.

But again, infrastructure is more a recurring yield play, as opposed to a capital depreciation play. You can see, though, the total value on infrastructure is, obviously, well above costs. When you are talking about real estate, we have a value right now of $400 million against a cost of $360 million, but we have already returned $129 million. So, that real estate fund has a multiple is 1.5 times our money; and keep in mind, that that fund has only gone live over the past year.

Chris Kotowski: Right.

William Katz: So, on real estate, again, there is a yield component to real estate, but there is, also, a significant amount of appreciation in the real estate portfolio so far.

Chris Kotowski: Right. Okay. But, I was wondering about that because what is shows is the total invested is 360.8 and the remaining costs $360.4 million, but $129 million has been realized. So, that does that mean you have realized $129 million on $400,000 of cost basis? Can't be right.

William Janetschek: What happens is, Chris, just to get a little technical, there is a recycling provision in real estate and so we get to return the costs and so that is why that number looks a little confusing to you.

Scott Nuttall: When we have early exits, Chris, we are able to use the capital again.

Chris Kotowski: Great. When I'm looking at page 11, I look at the real estate, it's only marked up 5% above cost. It seems like that it should, theoretically, be more.

William Janetschek: It is up, but, remember, this is only showing the cost and the fair value. This is not capturing any of the distributions. So, my point back to you --

Chris Kotowski: Got you.

William Janetschek: -- page 14 is the 360 to 402 is up only a little, but it is not showing on the balance sheet, again, is all of the distributions that have been made to date.

Chris Kotowski: Got it. Great. Thank you.

Scott Nuttall: We had an early, big win on Sunrise, which we sold for over five times our cost within 16 months, so what is happening is that capital is getting recycled and the gain doesn't show up. It is already in the cash sitting on the balance sheet. That maybe helps.

Chris Kotowski: And I meant to ask, the cash on the balance sheet, the way when you look at page, I think it was, 10 of the new balance sheet, the way to look at your net cash position, now, is the 3375 minus the billion-five of KKR debt obligations; right? So, in your view, you have a billion-875 on the balance sheet in cash; right?

William Janetschek: Correct. And then, remember, keep in mind, Chris, we've got that $3.4 billion in cash right now on the balance sheet, and we had mentioned that we are investing $700 million in first data, off our balance sheet. And when you take into account the $0.67 that we are going to be paying out in this quarterly distribution, that amounts to in excess of $500 million. So, cash has already found a home for 1.2 of that $3.4 billion.

Chris Kotowski: Okay.

Craig Larson: Chris, this is Craig, just one other point, just to highlight and, again, we are actually hesitant to give statistics like this, just recognizing that on a fund like real estate, we think it is actually an immature fund and we remain in a pretty early stage, in terms of the assessment dynamics in that fund. But if you were to look at the IRR on real estate to date, it is a number that exceeds 60%. So again, in terms of the performance of the real estate fund, we are, actually, very excited about the start that we have. And, again, using Sunrise as an example of a monetization that we've had very early in the life cycle of that, the ability to recycle it, so that from a performance standpoint again, it is off to a great start.

Chris Kotowski: Okay, great. Thank you. That is it for me.

William Katz: Thank you.

Operator: Our next question comes from Marc Irizarry from Goldman Sachs. Your line is open.

Marc Irizarry: Great, thanks. Scott, can you talk about the percentage committed by the general partner? I guess, on page 14, you show your general partner co-invest by fund, and I think you have a billion dollars in the release disclosed, not only just $76.9 million in uncalled commitments. But, on some of the newer funds, the percentage that you will commit side-by-side to those newer funds are bigger and, I guess, as you get to, you know, later in the fundraising stages for the -- for some of the newer funds, can you give us a sense of going forward, how should we think about the percentage that you commit side-to-side to particular funds versus using your own balance sheet capital to opportunistically deploy side-by-side with investors?

Scott Nuttall: Thanks, Marc. I think we are going to continue to do both. The way we do really look at it is back to this ROE concept and total cash flow. What we are focused on doing is keeping the ROE at a very attractive level and keeping our cash flow per share high and growing it. What we will do is we will actually look at the underlying investment opportunity and we will figure out how much capital we want exposed to that strategy in the fund. And a lot of instances, frankly, like we did with real estate, we find that if we are speaking for more of our own dollars, it makes the fundraising process faster and allows us to scale third-party capital more quickly.

And so we will go through that calculus, but, really, what we'll do is we'll say, All right, if it is a strategy where we think we can generate a 15% or 20% return, we review that is the first component to the return stream. The actual dollars we have invested in this strategy is the first piece of it.

Then, we look at it and say, All right, we can get fees and carry of X on top of that and there is capital markets opportunities, again, on top of that. And so, really, if you look at our business model, what we found is that if we can generate 15-plus percent on the balance sheet investments themselves, and we get another 500 basis points to 1,500 basis points of ROE from fee and carry, that is how you get to ROEs that we've generated with no net leverage. We are in the fund business and we will continue to have a percentage invested as a GP. As you can see, it is kind of ranged between a very small percentage to much higher. We, also, like to keep some capital free for more opportunistic situations, where there might be larger deals that we want to lean into. But what we do find, is because the funds go first in the waterfall, we, absolutely, want to have our capital in those funds, so we participate as our own largest investor.

I wouldn't think about it as a percent, especially going from Fund 1 to Fund 2. You can actually have a fund go from $1 billion to $2 billion or $3 billion. So, I think the percentage is not the right way to think about it. I would just think about it in terms of aggregate dollars that we want exposed to different asset classes. If you think about our balance sheet over time, part of the reason we show this disclosure is that is how we look at it internally, is how much do we want in real assets versus private equity versus credit versus hedge funds? And, so, we will continue to report on that basis and over time focus only making sure the ROE is 20-plus in each of those.

Marc Irizarry: Great, thanks.

Operator: The next question comes from Devin Ryan with JMP securities. Your line is open.

Devin Ryan: Good morning. Just a question on the current financing market. There is clearly discussion in recent months just around increasing regulatory scrutiny on banks that are providing financing or some of the more levered deals and it doesn't seem to be impacting the market or financing terms significantly at this point. A two-part question. Has the dialogue with banks changed at all in recent months, related to this; and, secondly, are you seeing any, maybe, opportunities to intermediate the banks where you create funds that are maybe focused on the financing strategy here? Just thoughts there would be helpful.

Scott Nuttall: Happy to take that, Devin. It's Scott. A couple of thoughts. One, you are right. It hasn't impacted our ability to get deals done to date. There's, clearly, more dialog on the topic now than there would have been over the course of the last couple of quarters. Clearly, more top of mind for banks. What we found, though, is we are casting a broader net in an environment like this, our capital markets business is a huge advantage for us because there is opportunities for us, given that we have direct relationships with a number of institutions around the world, some of which, frankly, are not subject to these potential limitations, so we have been able to get transactions done by just casting the broader net and using the Capital Markets Team to do so.

It, also, does create an opportunity for us, and the private credit part of our business. I mentioned our direct lending business, as an example. Our mezzanine business. The private credit markets will step in if there is a meaningful change in behavior. So, our perspective is we are well-positioned through capital markets to still get deals done on the private equity side; and our private credit business should benefit if the Fed guidelines get adhered to once people figure out what all of the rules actually mean in practice.

Devin Ryan: Got it. Helpful. And would your private credit business look at deals that you are doing as well, or does that create a conflict of interest potentially?

Scott Nuttall: It does with the private credit business. We will look at KKR deals. There is limitations as to the percentage of KKR deals that can be in individual vehicles. We have a wall and compliance procedures in place. There is an opportunity for those teams to look at those transactions, if they like the risk reward. The vast bulk of our business is not financing KKR deals.

Devin Ryan: Great, thanks. Helpful color.

Operator: The next question from Chris Harris of Wells Fargo. Your line is open.

Chris Harris: Hey, guys, just a quick numbers question for you, and I apologize if I missed it. It sounds like the second half of the year is shaping up pretty nicely from an exit perspective. It sounds like you have a few things in the pipeline. Any guidance you can give us around how much potential can cash carry we could be looking at some of the things that are kind of in process?

William Janetschek: This is Bill. The only thing I could give you is a little color on third quarter. Based upon the transactions we've announced and not yet closed, but expect to close in the third quarter, and this would be Ipreo and Visma, and we, also, actually had a secondary done, which is actually closed Jazz, right now the cash carry number for the third quarter is $0.14, and the balance sheet number is $0.80. That is $0.22 so far where we are today, based on expect closing, and obviously that does not take into account any earnings from fee income or any earnings from KFN.

Scott Nuttall: I would say more broadly on the topic, we (indiscernible) there is a lot of embedded value in the portfolio, as you think about our ability to generate cash carry going forward. As a reminder, 12-15 months ago, we had about 35% of our private equity funds paying cash carry, now it is virtually 100%. If you look at the makeup of the unrealized value in the private equity portfolio now paying cash carry, we have, boy, over $20 billion of its marked at one-and-a-half times or greater, and about 45% of it, of the unrealized value is from 2008 and prior vintages. And so, obviously, these companies are getting more mature. It is part of the reason you have seen our cash carry increase so significantly. The good news is, there is plenty left to go.

Chris Harris: Helpful. Thank you.

Scott Nuttall: Thank you.

Operator: Our next question is follow-up from Patrick Davitt with Autonomous. Your line is open.

Patrick Davitt: Hi, guys. On the idea of around KFN rolling into higher yielding assets and strategies, can you maybe help us with a framework for thinking about the timeline for that happening? Is it as easy as looking at the maturities of your scale loads and assuming those roll into some of the more bank-centered mediation type stuff you are doing or is that -- is it just too hard to even try to think about it that way?

Scott Nuttall: Patrick, it is Scott. It is hard to be precise. It will depend on a couple of things. One is how the portfolio rolls off, to your point, which is probably easier to model. But, two, also, what is the opportunity set in the market that we see where we can deploy more balance sheet capital against it? And some of that runs to Marc's question about how much capital we have committed to our funds. As we think about sizing our fund commitments to higher returning strategies, we are thinking about how use that KFN roll off to be able to do that. But, just to dimensionalize it for you, there are extremes. We mentioned when we announced the KFN transactions, that the return on capital there was about 10%, and we're run rating there, frankly, a little better than that so far. So far, so good.

As you heard even the originated credit strategies, the returns are generating, in those strategies between, 15% and 40%. It is hard to get specific, but I would say we are sitting here today, not long after the KFN close, still quite confident in what we shared with you that we believe we can redeploy the capital at materially better returns than the 10%, 11% it was generating before. And what we will keep an eye on is making sure that we continue to generate an attractive yield off the balance sheet as we focus on that fee and yield EBITDA and continue to drive up the more predictable aspect of our dividend. It is going to be a combination of all of those factors that will go into it. Very difficult to give you modeling guidance, however.

Patrick Davitt: Okay. And just real quickly, it struck me that you said, around the First Data transaction, that you had syndicated about $1.8 billion, which is clearly a pretty big number, relative to what you've been doing, you know, last six months. Does that portend a massive capital markets' fee? Or is that not the right way to think about it?

Scott Nuttall: No. I think, in terms of the first data deal, just to breakdown the numbers, I mentioned it was a $3.5 billion capital raise; recall that we -- KKR spoke for $1.2 billion, so there was a total of $2.3 billion raised from third parties, $500 million of that $2.3 billion was raised from existing investors in the first half. So, we're not going to get a capital market fee on that. The $1.8 billion will generate a capital markets' fee in the third quarter. Actually, the first data publicly disclosed, what that number would be, is a bit over $40 million from that transaction from our Capital Markets business in Q3.

Patrick Davitt: Alright. Thank you so much.

Operator: Our next question comes from Dina Shin with Credit Suisse. Your line is open.

Dina Shin: Hi. Good morning. Thanks for taking my question. We see most of the new funds in real assets in public markets are doing well, we were just wondering which funds are paying carry right now and which funds are closer to paying carry? Just trying to understand the in-carry ratio from the public markets section. Also, on the second point, the investment income seems like it was a little lighter than we thought, so what were -- were there any sizeable investments that had unrealized loses during the quarter? Thank you.

William Janetschek: This is Bill. If you are referring page 14, you can see that you are right, real assets right now, we've got committed capital of $7-plus billion in those strategies, as well as in the public markets' side, approximately, another $7 billion. All of those are like private equity-like terms where we have the ability to receive carries. These investments have just been made over the past couple of years. The good news is that in that most of these strategies, we are a true carry in running that through our P&L, visa our ENI, but we haven't had significant crystallizations in any of those mandates and haven't paid out much cash carry.

I do want to point out that in the first quarter of 2014, we did have a realization event, and one of the mandates we have on the public market side, where we had gross carry of $25 million. And as you continue to see the performance develop in those strategies, we will continue to have the ability to pay cash carry.

I, also, want to reference page 10, you can see right now, on our balance sheet, in public markets alone, we have about $78 million of carry that has been accrued in that portfolio of $7 billion that we're managing. That is ENI and it hasn't turned into cash carry, as of yet.

Scott Nuttall: I think in respect to the second part of the question, you know, nothing that, in particular, that we could point you to, that we're not going to break down the individual name performance on the balance sheet, but I'll just point you to the first half of the balance sheet of 8%; over the last 12 months, the balance sheet is up about 22%, so continues to perform quite nicely.

Dina Shin: Thank you.

Operator: Our next question comes from Chris Kotowski from Oppenheimer. Your line is open.

Chris Kotowski: Yes. I guess, just a follow-up on the opportunity in Europe, I guess I think it is a funny situation, right, in that the economic malaise there has been longer and harder than anybody would have thought a couple of years ago. So, that's led Europe 2 and Europe 3 returns to be fairly low, relative to your other funds. You can see the net IRs are trending up now, and that's nicely, but at the same time, Europe is one of the world's best investment opportunities, or, certainly, one of the more distressed and dislocated ones. And at the same time, kind of, you used most of the funds, or uncalled commitments in Fund 3. So, I guess, what is your strategy for raising a new fund in Europe before Europe 2 and Europe 3 has the kind of returns that you would like to show to raise the new funds?

Scott Nuttall: That's a good question. I give it a couple of perspectives. You are right. Europe 3 is up 33% in the last twelve months. Frankly, the markets are strong, creating attractive exits for us. Strategics are buying. I mentioned the ADM purchase of our Flavors business. So, we are returning a lot of cash to our LPs. So, liquidity is good. Really, what's happened, as you point out, Europe 3 is, now, fully invested, or certainly past its investment period. The deals we have been doing, frankly, we're now doing on the balance sheet, pending a first close of Europe 4. We've launched the fundraise for Europe 4 in February-March, so after we had year-end numbers. I would say, as a general matter, there is quite a bit of optimism about the investment opportunity in Europe, where twelve months ago, we have kind of sprung from fear to greed, as it relates to the European investment opportunity. So, the fundraising backdrop is much better than it has been. So, what we're doing is we're continuing to be active. We're, actually, adding talent in Europe. We opened a Madrid office earlier this year. Europe is not a monolith, right, so U.K. and Ireland are doing well. France, Netherlands, Italy are better, but still a bit weak. We are finding investment opportunities in private equity, although, evaluations we are watching very carefully. We are, also, finding opportunities in real estate and in special situations, which I mentioned previously.

So, we do like the investment opportunity. The liquid markets have roared back. The private-liquid markets are still yielding some very attractive opportunities for us. So, the way we're handling it from a capital standpoint is continuing to deploy, using our balance sheet in the intervening period to fill the gap on private equity opportunities. Then, we will drop some of those funded deals down into E-4 when it has its first closing, which we expect will be sometime late this year, early next/

Chris Kotowski: Okay. Very helpful. Thank you.

Operator: Our next question comes from Warren Gardiner of Evercore. Your line is open.

Warren Gardiner: Sorry if I missed this, could you guys just give us a breakdown between private and public marks and private equity? I guess, maybe, Ex-Biomet mark-up? I just want to get a sense of any EBITDA growth momentum there.

Scott Nuttall: Just to clarify the question, did you want, Warren, the mark or how the underlying businesses are performing?

Warren Gardiner: Well, I guess both. I mean, I was starting with the marks so I could get a sense, but I was assuming that, maybe, Ex-Biomet would be more EBITDA -driven, so (inaudible) really helpful.

Scott Nuttall: Okay. Let me see if I can take a shot at it. So, what we've seen is our private equity funds up about 24%, over the course of the last twelve months, 5% or so in the quarter. If you look at what is driving that, in our private investments, actually up more than our public investments over the course of Q2. Year-to-date, privates are up a bit more than publics.

If you look at what is contributing to that, we are still seeing some very attractive underlying grown; call it mid-single-digit revenue growth; high-single-digit EBITDA growth in those businesses. So, I think if you look at the market broadly, you see that the performance of the U.S. Stock Market last year, 70% of it was driven by multiple expansion, this year 70% of the market performance is driven by EPS growth.

I would say our underlying portfolio, we're kind of seeing a similar dynamic, that there is more of an uplift driven by earnings performance, as opposed to multiples so far this year. In terms of the public markets' businesses, it's a very different dynamic, frankly. Our mezzanine business is up a lot because we've had some good exits. We get warrants in some of those companies, so as multiples have expanded in some of those specific opportunities, we've benefited from that. The special situation returns, which are quite high is really driven by a lot of different things, but I would say it is really a combination of the recovery of the European markets, plus multiple expansion, plus quick exits, and some good investment decisions.

So, it is very hard to be too precise on that, but overall, I would say the overall tone feels like most of the returns are coming from an operating performance, as opposed to multiple expansion this year across everything we're doing.

Warren Gardiner: Okay.

Craig Larson: And, the only thing I would add to that, Warren, is that we go through a pretty exhaustive analysis at the end of every quarter. So, we look by geography in terms of the privates and how they're performing. We look at that on a constant-company basis to try to take out noise. We look at that for the quarter. We look at the LTM. Again, when you boil it down, kind of the high, single-digit EBITDA growth, it is a statistic that has been pretty constant for us over the last several quarters. So, that strength is something that we seem pretty convinced on.

Warren Gardiner: Okay. Very helpful, I got it. Thanks.

Operator: Thank you. That concludes the Q&A session. I will, now, turn the call back over to Craig Larson for closing remarks.

Craig Larson: Thank you, everybody, for spending this with us. If you have any follow-up questions, please feel free to follow-up with us, directly, after the call.

Operator: Thank you, ladies and gentlemen. That does conclude today's conference. You may all disconnect, and everyone have a great day.

Editor

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