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KKR - Q2 2012 KKR & Co. L.P. Earnings Conference Call

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PRESENTATION

Operator

Welcome to KKR 2012 second quarter earnings conference call. During today's presentation all parties will be in a listen-only mode. (Operator Instructions). I will now hand the call over to Craig Larson head of Investor Relations for KKR. Please go ahead, sir.

Craig Larson - *KKR & Company L.P. - IR*

Thank you, Cynthia. Welcome to our second quarter 2012 earnings call. Thank you for joining us. As usual I am joined by Bill Janetschek, CFO, and Scott Nuttall, Global Head of Capital and Asset Management. We would like to remind everyone that this call will 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. We will also refer to non-GAAP measures on this call which are reconciled to the GAAP figures in our press release.

This morning we reported quarterly economic net income of $546 million compared to $727 million last quarter and $315 million in the second quarter of 2011. This translates into $0.74 of after tax economic net income per unit more than double than we earned in the second quarter last year. The big driver of our strong results was a 5.1% increase within the carrying value of our private equity investments this quarter, which outperformed the S&P 500 and MSCI World Index by about 800 basis points and 1,000 basis points respectively. And even greater appreciation in our balance sheet investment which were up 7% this quarter and 16.5% year-to-date. Over the first 6 months of the year our private equity portfolio has appreciated by about 14.5% meaningful ahead of the S&P 500 which is up 9.5% and the MSCI World Index which has increased approximately 6% year-to-date.

We are happy to review with you three exciting pieces of news for the firm. The first of these is the strategic partnership between Walgreen's and Alliance Boots in which Walgreen's will acquire a 45% stake Boots creating the first global pharmacy-led health and well-being enterprise. This transaction is a great reminder of how meaningful strategic exists can be for us and while our work is certainly not done here we think this is a wonderful first step. Bill is going to spend a few minutes reviewing the impact this transaction has on our financial.

In addition there are 2 strategic events this quarter we are excited to review. First as announced in June we have agreed to acquire Prisma Capital Partners a leading provider of customized hedge fund solutions. Second this morning we have announced the formation of a partnership with

Stone Point Capital to help further our third party capital market efforts. Scott will provide more details on both of these strategic initiatives and their growth opportunities.

Finally before we move on, I want to touch on something we introduced in our last earnings call. We decided to provide additional detail around our distributable earnings metric. As we have defined and reported this metric historically it is excluded income generated from the balance sheet since it has been our intention to reinvest that capital in the business. However as we have seen some investors focus on this metric across the industry distributable earnings under our historically definition did not represent the total cash earnings profile of our franchise as any realized gains from the $5 billion of investments on our balance sheet would not be reflected in our reported distributable earnings.

To help better frame this we have introduced two new lines in our press release. You can find them on the bottom of page 6. The first is net realized principal income and it includes realized investment gains from our principal investments net of any realized losses plus dividends and net interest income. This combined with our legacy distributable earnings equals the second new line total distributable earnings. With the new disclosure we hope to reflect the overall cash earnings profile of our enterprise on a comparable basis with others in the industry. With that, I will now turn it over to Bill to walk you through the drivers of our performance and give an update on netting and then we will have Scott discuss the environment and what we have been focused on across our different business.

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

Thanks, Craig. Good morning, everyone. Our assets under management was $61.5 billion as of June 30, down slightly from both last quarter as well as the same time last year. Our AUM was positively impacted by the appreciation of our investments and the capital we raised in the quarter, but this was offset by large distributions to our L.P. as we continue to monetize our private equity portfolio. We ended June with over $47 billion of fee paying assets under management flat from last quarter but up 2% from a year ago. The year ago increase was driven by capital raising in both the private and public segment markets. This figures do not factor in almost $11 billion in capital raise through closing to date from our first close in our North America fund, our first close in Asia 2 which occurred this quarter, the portion of the Texas Teacher's mandate that has not yet been allocated to specific funds and some other vehicle that pay fees only when capital is invested.

Turning to our segments. In private markets fee related earnings were $36 million down slightly from both last quarter and last year. We do not have any termination payment this quarter which are generated by portfolio company exits and can therefore cause spikes in our fee related earnings. In the first 6 months of 2011 our fee related earnings were augmented by $40 million of net termination fees associated with of Seven Media, HCA, and Nielsen. This is the main reason for the year-to-date decline in fee related earnings. The 5% write up in our private equity portfolio outweighed lower fee related earnings in the quarter translating into ENI of $175 million. This is up over 35% from the second quarter of 2011, but down from last quarter when our funds were up 9% compared to 5% this quarter. Touching on public markets. Fee related earnings were $12 million compared to $15 million last quarter and $21 million last year. The decline versus the prior periods were driven by lower incentive fees which more than offset any increase in management fees as we continue to grow our fee paying capital in the segment.

Moving to capital markets and principle activities. Fee related earnings were $21 million for the quarter up 5% from last quarter and up 20% from the second quarter of 2011. Despite the lower level of private equity transaction activity we are seeing our capital markets business still performed quite well. We have benefited from this business is global footprint about a third of our revenue this quarter came from outside of the U.S. Additionally almost 40% of revenue was derived from third party initiatives. We reported ENI of $365 million in the segment driven by the performance of our balance sheet investments which appreciated by 7%, outperforming our portfolio by 200 basis points. The out performance of our balance sheet relative to our portfolio is largely due to significant appreciation in Alliance Boots, Dollar General and HCA where the balance sheet had additional exposure through its coinvestments. This strong performance translated into book value per unit of $9.28 at the end of June up 7% from last quarter and the highest book value figure we reported as a public Company. In total our book value has increased 14% since the beginning of the year including a 57% increase in unrealized carry to $660 million.

Total distributable earnings were $406 million for the quarter which is the largest it has been in any quarter since we went public up $570 million year-to-date up 27% from last year. As Craig mentioned earlier these numbers now include income from our balance sheet. Total distributable earnings have more than doubled since last quarter and last year as we have started to significant sales from investments on our balance sheet.

This translates into $300 million of realized balance sheet gains this quarter alone which we plan to reinvest in our new business initiatives. Keep in mind this $300 million does not include the impact from Alliance Boots as that transaction has not yet closed.

This was an active quarter for us on a realization front. That our distribution benefited from carried interest we receive from these exits. We fully existed Hilcorp and also closed on the sale of El Paso joint venture. Because of the type of income these investments generate they were structured in a separate investment vehicle in the '06 Fund so we were able to pay cash carry. In addition we earned some carry from coinvestment accounts that invested Dollar General alongside the '06 Fund. Approximately $0.02 of this distribution relates to these accounts.

We also completed a Nielsen secondary offering at around two times our money which is in the Millennium fund and therefore generated cash carry. In total this translated into $0.06 of cash carry for the quarter, marking the 9th consecutive quarter where we have seen cash carry in the distribution. That carry combined with $0.07 of fee related earnings equates to a distribution of $0.13 per unit.

Given the significant realizations we have had this year, the tax distribution we would pay based on activity year-to-date would be approximately $0.20 per unit. In addition the first step of the Alliance Boots transaction will result in about another $0.10 per unit. So if there were no other realization for the rest of the year except for Alliance Boots the year end distribution would be around $0.30. This figure can go up or down by year end, but given the size of the number we thought it was worth giving you an update on where it stands based on what we know today.

Now on to netting. Since the timing of cash carry remains of topic where we know there is a lot of interest, I wanted to give you an update on netting holes and the progress we have made since last quarter's call. As we explained last quarter there is separate partnerships in the '06 Fund for domestic and foreign investments each of which have their own netting hole. As reminder we refer to the netting hole as the aggregate amount by which a fund's investment are marked below cost net of cash profits from sales of other investments. Back in April we disclosed the size of the '06 Fund netting holes. At the time of our call the domestic partnership netting hole and the overseas partnership netting hole stood at approximately $1.3 billion and $125 million respectively. Remember none of our active private equity funds have a preferred return, so has long as fund is marked above cost in total and a netting hole has been filled we are able to pay out cash carry when the investment is realized.

Let's walk through how this applies to the '06 Fund. The '06 Fund continues to accrue carry because it is marked well above cost. 1.4 times our cost the end the of the second quarter or 3.5 times on a realized and partially realized basis; however, as of June 30th there is still some netting holes to be filled due to write downs in certain investments in the fund.

The domestic partnership netting hole has been reduced from $1.3 billion to about $1 billion when you factor in all the activity this quarter. This decrease was primarily driven by the gains from June Dollar General secondary offering. Put that in perspective the '06 Funds remaining public positions at June 30th prices were valued at $3.3 billion. $2.5 billion of the $3.3 billion is profit. To have a $1 billion hole versus $2.5 billion of embedded profits in our public investment alone if we sold just 40% of the public positions the domestic netting hole would be filled. Remember this doesn't factor in the privately held companies that make up about two-thirds of the remaining value in the '06 Fund domestic investment.

Turning to the '06 Fund overseas partnership. The netting hole was slightly north of $100 million as of June 30. The netting hole however does not reflect the impact of the Alliance Boots transaction which we expect to close in the third quarter. Given questions on this transaction and the potential impact this can have on netting I want to give you a little more color on this. If you apply the expected cash proceeds from step one of the Alliance Boots transaction, not only would fill the 06 overseas netting hole on June 30 valuations, but would have approximately $500 million of excess gains. So we would actually payout about $100 million of carry or about $0.08 an unit net of the carry pool. In addition we have some carry pay coinvest vehicles that are invested in Alliance Boots from which we would earn about $0.02 a carry. In short if step one of the Alliance Boots transaction closes, we would not only fill the '06 overseas netting hole but we would expect to pay out a total of approximately $0.10 of cash carry per unit and we will have returned approximately $2 billion of cash back to our investors.

We also wanted to help you think about netting as it relates to our second European Fund or Europe 2, since the fund is now valued above cost. At the end of the second quarter is E2 is marked at 1.1 times cost . It is therefore accruing but not paying cash carry. As of June 30th, the Europe 2 netting hole is approximately $1.3 billion, and if you included the expected proceeds from step one of the Boots transaction to this Fund the number would be reduced to about $1 billion. In summary we feel good about our continued progress across our Funds, and remain focused on increasing the percentage of our assets that are in position to generate cash carry, distributable earnings and ultimately cash distribution through our unit holders.

I will now turn it over to Scott.

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

Thanks Bill. Well, it certainly has been an interestingly last few months. As we look around the world, we have seen the U.S. consumer pull back, European sovereign concerns continue and slowing growth in Asia. This economic and market backdrop is tough to navigate, but it is providing us with compelling investment and business development opportunities. Like past quarters, I thought it would be helpful if I take you on a quick walk around the firm to give you a sense of the activity we are seeing across our businesses. What you are going to hear are a lot of consistent themes from the last few quarters with a number of transaction and strategic announcements that help support these themes.

Let's start in private equity. If we look across our private equity businesses transaction activity continues to vary by region. Asia remains busy continue as our private equity team continues to find attractive investment opportunities. In the second quarter we invested over $100 million in 2 investment; TVS a logistics company in India and China Chord Blood. We also announced an investment Genesis Care an Australia medical services company.

In Europe we continue to be more active in the UK, Germany, and northern Europe relative to southern Europe. Last quarter we closed on $150 million investment in Fotolia a provider of digital services. Also since quarter end we have announced the acquisition of majority stake WMF a German consumer product business.

In North American we announced $100 million investment in Sonos last quarter. Overall though transaction volumes in North American remain low. CEOs and Boards are focused on the uncertain global economy and questions on areas like tax and regulatory reform. We have however seen a pickup in activity over the last few months and are actively looking at a number of opportunities. In addition the capital markets are open for the right types of transactions, but it remains difficult to predict how many of these deals will actually get done.

On the private equity business development front this last past quarter we established a presence in Latin America with the appointment of Henrique Meirelles, former Governor of the Central Bank of Brazil, as a senior advisor to the firm. We believe that his knowledge and expertise will add tremendous value to our global portfolio. We are excited about the prospects for the region as we build out our efforts beginning with a planned office in Sao Paolo, Brazil.

Now turning to our private equity portfolio. Upon (Inaudible) we continue to focus on growing revenues and improving operating margins and on a trailing 12-month basis the revenue and EBITDA of our companies grew 7% and 6% respectively. And if you actually weight the performance by the amount of equity exposure we have to each company, revenue is up 10% and EBITDA is up 9%. And the progress we have made at the company level is translating in fund performance. In aggregate our contributed private equity funds are currently marked at 1.6 times cost and it is 2.8 times cost on a realized and partially realized basis. Our funds have appreciated 14.5% year-to-date significantly out pacing the MSCI World by 800 basis points.

In terms of realization we have a saying internally if our portfolio companies perform exits tend to take care of themselves. Dollar General and Alliance Boots are great examples of this. Last month we executed our fourth Dollar General offering in the last 9 months. All of which were priced higher valuations than the last. with the most recent transaction at over 5 times our cost. This quarter we also executed some strategic exits, most significant was the announcement of Walgreen's acquisition of a 45% interest in Alliance Boots. Boots is the second largest investment in our funds with over $2.1 billion invested in our '06 Fund and Europe 2, plus approximately $400 million in carry coinvest vehicles and an additional coinvest from our balance sheet.

The Company has a strong management team who has driven exceptional performance since the 2007 acquisition growing EBITDA at a 10% annual growth rate. This is a meaningful transaction for us. Last quarter we held Alliance Boots at 1.1 times our cost. It is a very complicated transaction structure. The bottom line is that this quarter we are marking Boots at 1.9 times our cost. As a result of the transaction being announced but not yet closed we are accruing income in our financial statements this quarter based on the 1.9 times valuation.

The two main consequences of this write up of Boots. The first is that our funds have been marked up meaningfully by $1.6 billion, and when you combine that with the carry paying coinvest vehicles it is around $2 billion. This results in accrued net carried interest of more than $200 million in the second quarter. The second is that our balance sheet has increased in value by over $250 million. Said simply Boots contributed approximately $450 million of pre tax economic net income in Q2. This is all on a non cash basis since the transaction has been announced but has not yet closed.

We expect step one of the Boots transaction to close in the third quarter which will have a substantial cash impact in Q3. We expect the two main components of the cash impact to be first as carry distribution of about $0.10 per unit which we expect to pay as part of the third quarter distribution. The second is significant cash coming back to the balance sheet of approximately $250 million representing $130 million of realized gain which will increase both our total distributable earnings as well as our cash balance. This all relates to step one of the Alliance Boots transaction, and we will keep reporting back over time as we get closer to step two.

We also closed on the sale of the El Paso joint venture to Kinder Morgan this past quarter. This JV focused on midstream investments was establish in December 2010. And like some other recent private energy investments of ours namely East Resources and Hilcorp was sold at an earlier stage in its lifecycle than we anticipate but at an attractive return. After only 18 months we filled the JV to Kinder Morgan at around 2 times our cost generating an INR in excess of 60%. From a fund raising standpoint in private equity we have added $3 billion in our Asia 2 Fund. A terrific start to a fund raise that was launch in back December of last year, and we remain focused on fund raising for NAXI.

Now in to energy and infrastructure. Here we continue to be activity on the investment front. Back in April we purchased proved developed producing properties from WPX Energy in Texas and Oklahoma. We invested over a $130 million in this transaction which was 6 investment by the KKR Natural Resources Fund or KNR. In addition we have closes in our KNR and infrastructure funds in the quarter. At this point including the funds and separately managed accounts we currently manage $4billion of AUM across these strategies that did not exist 2 years ago. We remain focus on scaling our energy and infrastructure businesses. Most recently we have created an energy income strategy that will invest in less developed oil and gas fields plus royalty in energy related Mezzanine transactions all with a meaningful yield component.

Now turning to our public market segment. Our tradable leverage credit strategies maintain top quartile performance since inception and our Mezzanine fund and special situations vehicle have posted gross IRRs in the range of 13% to 18% since inception. Our solid track record here has enabled us to continue to raise capital. Adding an additional $500 million across various strategies this quarter. This includes an additional close for the KKR lending partners fund during the second quarter bringing the total fund size to approximately $300 million.

Fund raising dialog with our investors remains focused on our leverage credit strategy and bank loans and high yield as well as our special situations and direct lending strategies in particular. In an effort to further expand our credit platform we recently announced that we filed with SEC to offer two new products in our public markets businesses; a high yield mutual fund and a close end credit opportunity fund. Upon effectiveness these new products will provide retail investors including registered investment clients an opportunity to invest in alternative assets. Our firm's most recent experience in the retail market is with Corporate Capital Trust or CCT a business development company that we sub advise which was launched last year. We are pleased with CCT's progress to date as we have seen AUM grow from approximately $250 million at the end of Q1 to approximately $425 million at the end of Q2. We are excited about this opportunity for us to offer our growing suite of liquid alternative products to individual investors.

Finally in our public markets segment I want to spend a few minutes on the liquid alternative space and the Prisma transaction. We are been interested in the hedge fund to fund space and expanding our liquid alternatives for several years now. We think this is a business where you can benefit from having immediate scale. Prisma's $8 billion in AUM will allow KKR to further penetrate the over$2 trillion hedge fund market which is benefiting from growing institutional allocations. The team's track record is quite impressive and their ability to deliver strong returns and differentiated customized solutions to their clients has translated into AUM growth. Prisma's assets under management have nearly doubled since 2009. We feel very good about the deal construct.

We expect to pay some up front consideration most of which will go to take out AEGON, and all after tax proceeds received by management team will be reinvested in the funds and subject to a 5 year lock up. This insures a longer term management commitment and aligns the team's interest with their clients. There is also a earn out component payable 2 and 5 years after the closing the has been structured to be accretive to the firm. All this is subject to the transaction closing which we anticipate in the fourth quarter. The growth avenue Prisma provides are very interesting. It increases our breadth of the liquid product offerings supplementing our current direct hedge fund effort through KES and our liquid credit products. It creates distribution opportunities through introducing Prisma to KKR client base as well as cross selling KKR products to Prisma's clients.

Just to give you some statistics as of July KKR has approximately 425 clients. When you look at Prisma's client base and focus on the institutional portion they currently have about 120 clients. There is very little client overlap with KKR. To give you a sense of Prisma's 50 largest clients only 2 are KKR investors. This cross sale opportunity which goes in both directions is exciting for us. It just gives us another way to win. Perhaps most importantly the transaction leverages a strong cultural fit between our 2 organizations. We have a shared vision about how to build our hedge fund platform overtime by offering our clients solutions that cut across the entire liquidity and risk spectrum. When we think about our hedge fund businesses today we have a direct investing platform that consists of our KES team which is our long short equity strategy.

We are also analyzing other potential direct hedge fund opportunities. Hedge fund of fund is the next part of our platform and the addition of Prisma is integral to achieving our hedge fund vision. We believe the Prisma team can help identify and diligence other hedge fund teams and platform for the firm and help us grow in this space. What does all this mean? Well, our $8 billion in hedge to hedge funds will complement our existing $16 billion of credit AUM yielding $24 billion in total AUM in our public market segment. We will now have a scale offering in liquid credit, alternative credit, direct hedge funds, and fund of fund hedge funds and will be well positioned to help our clients interested in getting exposure to liquid alternatives.

The other recent piece of strategic news is our partnership with Stone Point Capital to capitalize and scale our third party initiative within our capital market business. We continue to see dislocation in the capital markets as regulatory concerns heighten and markets remain volatile. Dodd-Frank, Basel III Volcker all impact the ability of banks to extend capital. We are committing $150 million from our balance sheet together with $150 million from Stone Point Trident 5 fund to jointly form a partnership to provide capital market services to third party companies and sponsors to help them achieve their objective. We will manage and operate the partnership on a day-to-day basis and will share Board and governance rights with Stone Point.

It has been a busy quarter. When you look back on all that has happened we see three things of note. First, we continue to create value within our private equity portfolio which is leading to more carry and more distributions. Alliance Boots is a great example of this and demonstrates the power of carry in our business model. Second, the Prisma acquisition increases our scale and relevance in the hedge fund space which has been an important part of the KKR's longer term strategy. This development plus the introduction of two investment products for individual investors will help us further scale our public market platform. Lastly our JV with Stone Point will allow us to further develop our third party focused capital markets efforts in a capital efficient manner. So against the uncertain macro backdrop we feel good about the progress we are making and great about the opportunities in front of us. Thanks for joining the call, and we are happy to take any questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). And we will take our first question from Howard Chen with Credit Suisse. Please go ahead.

Howard Chen - *Credit Suisse - Analyst*

Good morning, everyone. Thanks for all the detail in the call. You had some great monetization and realized you still have a lot of significant embedded gains associated with those positions, Scott. But how do you think the next tier of the monetization pipeline, maybe some thoughts on some of the more recent vantage and how close you see them to an event and monetization? Thanks.

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

Sure. Thanks, Howard. I break it down in to a couple of buckets in terms of access to liquidity and exists. The first is we obviously have a meaningful size public portfolio in our private equity funds. We have about $9 billion of our private equity portfolio is in companies that are already public many of which we have already started to execute second offering. I think that is the most visible form of liquidity coming back. Secondly and we talked about it in prior calls we are seeing some pickup in strategic activity Boots is a great example of that. But if you think back we have had Hilcorp we have had East Resources we have Seven Media in Australia.

There have been a series of strategic exists. If you thing about our portfolio we are getting into the more mature phase for a good portion of our assets under management and our private equity business. So the transaction that were done 3 to 6 years ago are getting to the phase where we can start to think about monetization. The reason we share the EBITDA and revenue growth statistic every quarter is that we keep an eye on. We find that if we can keep EBITDA we are able to find exists for those companies. So it is hard to be precise to timing, but we feel like we are making progress.

Howard Chen - *Credit Suisse - Analyst*

Understood. Thanks, Scott. My second question the firm has been less aquisitive than some of your peers clearly Prisma is a change in that. I'm just curious where else do you see opportunities where it may make sense to do something via an acquisition versus pursue it denova?

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

Just to be clear it took us about 36 years to do our first acquisition. Prisma is the first one we have actually done as a firm. All the other growth has been organic and hiring talent into the firm. The way we think about this, Howard, is if you think about KKR today we have private equity platform, we have energy, we have real estate, credit, hedge funds, and capital markets, and as we continue to look across our platform really the one scale business we have continues to be private equity. Everything else we have opportunities for meaningful growth, and a number of those businesses have been started in the last few years.

Our tendency will continue to be organic growth across those different platforms, but as we look to scale globally across those different business we will look at acquisitions from time to time and we will consider growing both inorganically and organically. But it has taken us a bit of time to do the first one. There is nothing eminent in terms of the second, but we will look across all those other platforms and see if there is anything interesting out there that is a good culture fit and a good strategic fit.

Howard Chen - *Credit Suisse - Analyst*

Great, thanks. Finally for me on Stone Point maybe I just need to learn a bit more about it. I'm curious what does the JV bring or accelerate that you couldn't do on your own?

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

I think it is a couple of things. One we were finding a lot of opportunity in the middle market power to provide capital to both companies and sponsors. Frankly what we hear from our clients in that space is the banks have pulled back meaningfully from the standpoint of providing capital. So as we have been out with our Mezzanine business, direct lending business and our capital markets business we hear that as a recurring frame. The first thing the JV will provide is a dedicated and incremental capital to provide services and balance sheet to that part of the market.

So you will see us underwriting debt, you will see us underwriting equity, you will see us providing other services to those companies. A lot of this frankly we were already doing as part of KKR, and Bill mentioned 40% of our capital markets revenue in the quarter were actually from third parties. This joint venture will allow us to have a dedicated pool of capital and a dedicated effort against that third party space. We will be putting $150 million in. We are partnering with Stone Point and they will do the same. And we will seek to grow the business together. I think the other thing it provides us is a great partner.

Stone Point has a lot of access to sponsors and companies in the middle market space. They have built financial service firms over their long history. So I think they will be able to bring their own relationships and business to bear as we seek to grow the third party business further. We view it as an opportunity to have a great partner, have a dedicated effort in the space, and provide more capital and services to the middle market which is sorely in need of it right now.

Howard Chen - *Credit Suisse - Analyst*

Great, thanks for the all the detail and nice quarter.

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

Thank you.

Operator

We will take our next question from Michael Kim with Sandler O'Neill. Please go ahead.

Michael Kim - *Sandler O'Neill - Analyst*

Hi, guys, good morning. Just first on the marks this quarter can you talk about the different moving parts under the surface as it relates to the public companies the privates as well as the Alliance Boots transaction.

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

Sure Michael. This is Bill Janetschek. How are you?

Michael Kim - *Sandler O'Neill - Analyst*

Good, how are you?

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

To drill down on the details when you take a look at our public portfolio we were actually up about 0.3%. So even though the S&P was down 2.8% we still even just on our public marks over performed. When you take a look at the privates if you actually excluded Boots, for the most part our private portfolio would be relatively flat to a little bit down. So overall the way to think about it is we got a significant up lift in this quarter from the Boots write up from 1.1 to 1.9 which Scott mentioned earlier as well as a little bit of up lift on our marks on our public position.

Michael Kim - *Sandler O'Neill - Analyst*

Got it, that is helpful. More of a bigger picture question but as you start to increasingly scale some of your newer complementary businesses like hedge funds, energy and infra, real estate and the new retail funds, how much success are you having getting existing clients to invest with you

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for a new strategy? Are they comfortable with your ability to generate returns across businesses where you might not have had a track record or historically expertise?

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

Thanks, Michael, it is Scott. We have had quite a bit of success on that front. And one of the things we monitor is our cross sale statistic which continues to move up but we have been quite pleased. What we used to do historically, frankly, before we expanded into these newer businesses it has been 8, 9 years ago now is we used to just talk to the private equity staff within institutional investor. And what we have done now is we have moved up meaningfully and now are talking to Chief Investment Officers, we are talking to heads of fixed income real assets, equity, real estates, the public side and the private side.

We have been able to share our expertise and perspective with institutional investor in a much broader fashion. The conversation has really changed. Whereas before it was solely PE, now it is how should they think about assets allocation, where is the world going, and we have our macro team which is spending a lot of time with investors on that. And then we really plugged them in to all of KKR. We have been really pleased with respectively of our investor base to several of these newer businesses and as we have scaled capital across credit, energy and infrastructure, hedge funds, et cetera we have seen quite a bit of support from that client base.

Michael Kim - *Sandler O'Neill - Analyst*

Okay. Great. And just finally haven't talked about it in a couple of quarters but can you give us an update on KES in terms of fund raising and performance trends you are seeing there?

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

Sure. KES the reason we didn't mention not a lot new this last quarter. There is not a lot to report. Frankly given the choppiness of the market we decided a quarter ago to pull back a bit from third party marketing. As you know we started with our balance sheet capital and raised some external capital and then decided to focus on performance. We have been really happy with the performance so far. The team is meaningfully outperforming the equity long short peers in what has been a really choppy market. As we get back in the market mode in future quarter we will give you a more fulsome update, but our perspective on this is if we have the performance dollars will flow and that has been the focus the last few months.

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

Michael just to put a number on that right now as of June 30 capital that is managed by KES is a little north of $400 million.

Michael Kim - *Sandler O'Neill - Analyst*

Great thanks for taking my questions.

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

Thank you.

Operator

And we will take our next question from Bill Katz with Citi Group. Please go ahead.

Bill Katz - *Citi Group - Analyst*

Thanks. Most of my questions have been asked but just curious as you think about where you are now in the last cycle of platform and these external additions plus some of these other (Inaudible) businesses what is your thought process on the growth of (Inaudible) earnings? Is there some still heavy lifting to do on expenses or should we anticipate little margin improvement for FRE?

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

Well, I will tackle the expense question first and then maybe I will flip it over to Scott as it relates to revenue growth. If you take a look on where we have been on expenses year-to-date we are actually for the first 6 months down slightly. That is with bringing on a lot of people in 2011 and 2012, so we have been pretty deliberate on managing expenses. I don't think you are going to see a lot more on margin improvement as it relates to expenses. Fee related earnings obviously we just launched a lot of these platforms, so when you take into account a few years from now we are hoping the second fund is going to be bigger than the first fund.

Take for example Mezzanine fund or infrastructure. You know how it works, Bill, in that you have an existing fund once you go through the investment period you are going to receive a post investment period fee on that fund as well as then taking on to your fee related earnings a new fund at an investment period fee. We hope to see significant growth on the new initiatives that we have launched. Another point is we brought on a real estate team and the goal is to eventually launch a fund right now. There is no income being generated from the real estate team as it relates to fee related earnings, but again where we are optimistic that we are going to be able raise a fund and bring that strategy online and that will actually increase fee related as well.

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

It is Scott, the way I would think about it is we have invested a lot in establishing these new platforms, so we have a significant amount of expense running through our income statement with the associated revenue not there yet. So most of that has been done. We are still investing in some areas we are still focused on building our distribution team and our client and partner group. We are continuing to look for new direct hedge funds, we are continuing to invest in areas like real estate, but I would tell you the vast preponderance of the investment ahead of revenue is done, and as we raise first time funds to Bill's point critically second and third time funds we would expect there to be positive operating leverage.

Bill Katz - *Citi Group - Analyst*

That is helpful. A big picture question so the push into retail. Could you talk a little bit how that came to pass. Whether that was sort of a pull forward from the retail distributors or your decision and what kind of growth would you be thinking for there?

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

It is hard to get specific on growth. The way I would characterize it, Bill, the way we think about our strategy for distribution generally is historically we focused exclusively on institutions. And the way we think about the world there is $35 trillion give or take of third party managed assets held by institutions. So that is predominately been our focus and trying to be more relevant to that group. There is also over $20 trillion in retail hands. Historically KKR had not spent time talking to individual investors. About 18 months ago we started a high net worth and family office platform, and started the process of actually talking to individual investors directly for the first time, and that has proven to be quite successful so far.

So that has been a very good experience. So that is part two is high net worth, family office has been a more recent focus. We spent a lot of time thinking about the retail space as part of that because the vast preponderance of that $20 trillion that is out there is actually in individual hands. You heard us talk on prior calls about why we want to have more liquid alternatives. One of the reasons we think it is of interest to institutional investors but we think it is also highly of interest to individual retail investor.

What really drove this broader thinking of where pools of capital are in the world and what those pools of capital need right now in this very low rate environment and this volatile stock market environment and we think a lot of the products we offer in the alternative space could be quite relevant and helpful to those individuals. That is what drove it. This is an initial foray. It is hard to predict where it is going to end up for us, but we think it is a big market and we are going to work away and we will keep giving you updates.

Bill Katz - *Citi Group - Analyst*

Thanks for taking all my questions.

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

Thank you.

Operator

We will take our next question from Chris Kotowski with Oppenheimer. Please go ahead.

Chris Kotowski - *Oppenheimer & Company - Analyst*

Good morning. Maybe I missed it, but I was wondering if you could give us an update on the commitments to NAXI. In the beginning you said something like there was $11 billion of committed funds that is not yet in fee paying AUM. Did I get that right? And is that including NAXI, what was that?

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

Sure. Hi, Chris, this is Scott. The $11 billion we reference was made up of 4 components. The first is the $6 billion initial close we announced in NAXI earlier this year. Then there is the $3 billion first close we had for the Asia fund. The third components the $1 billion or so of the Texas Teacher's strategic partnership has not yet been committed.

Chris Kotowski - *Oppenheimer & Company - Analyst*

Okay.

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

The fourth component is an accumulation of a series of mandates that we have that we don't get paid economics until the dollars are actually invested. So think of that as committed funds and as we make investments the fees will turn on.

Chris Kotowski - *Oppenheimer & Company - Analyst*

Okay.

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

That is the $11 billion. On top of that once we close the Prisma transaction there will be another $8 billion on top of that number.

Chris Kotowski - *Oppenheimer & Company - Analyst*

Okay.

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

That is kind of what you can think of as AUM that is coming on a gross basis. But more broadly maybe across fund raising generally I would say the we look at the world right now the people want Asia, they want energy, and they want yield. So if you think about what has happened this quarter energy business we had KNR and infra close. We now have $4 billion in that platform quite a bit of institutional receptivity to what we are doing in the energy space. Credit we continue to scale that business and you can see the fee paying AUM continue to grow there, so it is all consistent.

Our Asia fund we had a $3 billion first close after 6 months. It was frankly a faster and larger close than we had anticipated. So just to give you a sense we are really happy. 45% of the investors in that first close are brand new investors to KKR period. With only about 13% of the capital but it is 45% of the number of investors. So the Asia 2 Fund is off to great start because we have a lot of folks working behind that.

But your question on NAXI we had our first close in February. We were quite pleased with that first closed given the challenging environment for this type of fund. We have until February 2013 for a final close, so we are working our way on that. Our perspective is it is a great time to be investing in North American buyout but the selling process is a bit prolonged because we are still investing the 2006 Fund. So as investors think about making commitment there is no rush per say. There has been no material close since February, and we will give you an update next quarter. It is just hard to predict where things will end up.

Chris Kotowski - *Oppenheimer & Company - Analyst*

Okay. Thanks. Do you ever have interim closes before the final close between the first and the final, or is our next date in February 2013?

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

The next date of the point where we will communicate a number to you will be for sure on September 30th, because September 30th that is when the investment period will end for the '06 Fund and the NAXI fund will turn on. So just to give you some clarity on what the fourth quarter is going to look like we will report to you what the NAXI number is as of September 30th.

Chris Kotowski - *Oppenheimer & Company - Analyst*

Okay. Great. I wonder so you have about $1.5 billion uncalled commitments left in the '06 Fund. Is that primarily there for other newly initiated transactions or is some of that reserved for follow on transactions in companies you may already be invested in?

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

Chris, this Bill. You are right. You are referring to on page 19 we have about $1.5 billion of dry powder in '06. About half of that we are going to keep for reserve. And the other half we are going to use to make 1, 2, maybe 3 investments between now and the end of the investment period.

Chris Kotowski - *Oppenheimer & Company - Analyst*

Okay. And then are there any updates you can give us on some of the companies that are marked below cost either in terms of fundamental or refinance efforts on some of them, if you can't, you can't?

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

I don't think there is a lot of incremental detail we can provide, Chris. Some of those companies will be reporting their own earnings in the next couple of weeks.

Chris Kotowski - *Oppenheimer & Company - Analyst*

Okay. All right. That is it for me. Thank you.

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

Thank you.

Operator

We will take our next question from Matt Kelley with Morgan Stanley. Please go ahead.

Matt Kelley - *Morgan Stanley - Analyst*

Good morning, guys. Thanks for taking my question. I just wanted to ask as you think about how to fund future growth beyond, obviously you have been busy in the last quarter or two and with today's announcement but how do you think about your balance sheet investment how mature they are, and could we see another wave of potential future growth once some of those investments get into exit mode especially from the KPE investments?

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

Hi Matt, this is Bill. Obviously, if we take a look at our balance sheet we have about $5 billion invested in predominately private equity investments but that percentage has come down quite significantly since we have gone public. Over the next several quarters we would hope and anticipate more realization off our balance sheet and that would give us more liquidity, but right now if you take a look at where our balance sheet stands at today we have about $1.2 billion in cash and we have reported commitments in the press release of about $600 million.

When you think about all the other things we mentioned either today or on prior calls where we have committed $300 million to real estate, we made a significant commitment to NAXI that isn't reported in that number same holds true for Asia 2 as well as commitments to special situation, as well as making a commitment to the energy strategy. That number tallies anywhere from $1.6 billion dollars to $1.7 billion. So although on our balance sheet it looks like we are liquid, we are liquid but with a lot of commitments. What I will tell you is we have monitored the liquidity on our balance sheet, and to the extent if it ever got to a point where we couldn't deploy capital at a very attractive rate of return, we would think about making a tweak to our distribution policy. But for what we have in the pipeline right now, we don't think that policy is going to change any time soon.

Matt Kelley - *Morgan Stanley - Analyst*

Okay, great. That is all I had. Thank you very much.

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

Thanks, Matt.

Operator

We will take our next question from Marc Irizarry from Goldman Sachs. Please go ahead.

Marc Irizarry - *Goldman Sachs - Analyst*

Great, thanks. Just sticking with the balance sheet for a second can you help us understand obviously it is filled with a lot of the capital you have at the GP level. In some of the new strategies do you expect you will start off with bigger coinvestments in the new strategy such as real estate are you going to start off with bigger coinvestments and more of your own capital devoted to those strategies, and how should we think about the returns you can generate on that capital versus returning it to shareholders?

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

Sure. Marc, it is Scott. I think the answer is yes. The newer strategies we are dedicating more balance sheet capital to them. For example real estate we committed $300 million off the balance sheet ahead of having a fund basically to build a portfolio and start to build track record in that space and then we will go out at some point talk to third party capital in joining us in that endeavor. Same thing in energy we committed $300 million to a variety of different energy strategies to continue to scale the energy and infrastructure business.

And as we have launched new credit funds you have seen us do the same thing. So we do view the balance sheet as a real competitive and strategic advantage for us, and we have been using it to scale a number of our businesses organically. And it does make a big difference. When you go talk to institutional investor and you tell them we are going to commit $300 million do they want to commit $100 million it is much more compelling than if we ask them if they commit $100 million and we commit $3 million. So we have found that it is helping to drive this new business formation and accelerate our growth. In terms of how we think about the returns we really like the returns we are getting off our balance sheet. You heard in the first half our balance sheet is up 16% plus and that is just in 6 months.

So we have a number of investment there that are still seasoning. We think there is a lot of up side on those balance sheet investment. And frankly when we look at the ROE we are able to get from seeding new business if you think about just seating a new fund with $100 million capital and if you only raise $1 billion of external capital and you work through math the ROE is something like 40% or 50%. So we really like those economics both from what we already have and what we are doing with the capital which is why we are pursuing this strategy.

Marc Irizarry - *Goldman Sachs - Analyst*

Great. A question maybe for Bill we got a good taste of what the gross AUM would look like in terms of the $11 billion in shadow AUM if you will. What about the outs from some of distributions how should we think about what the fee paying AUM would look like net of the Boots transaction? How do you sort of enter this quarter in terms of fee paying AUM?

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

Marc, you are right. When Scott gave you the AUM and fee paying AUM that isn't brought online with both NAXI and Asia 2. What will also happen is when Asia and '06 goes from the investment period to the post investment period, we are going to be getting paid not on the investment capital rate but the post investment capital rate, and it will be on just the capital that is invested at that time. Just to give you an idea on NAXI in particular. When NAXI comes on line based upon what we have disclosed to you of the capital rate to date of about $6 billion and the '06 Fund rolling from the investment period to the post investment period that will happened in the fourth quarter 2012 you are going to see fee related earnings stay relatively flat on that cross over.

With regard to Asia we have already mentioned we have already raised $3 billion on our first close, and that fund won't actually come online until we invest the rest of the Asia fund that could happen maybe in the fourth quarter or the first quarter 2013, but there we haven't sold many investments in Asia so the step down of the fee paying assets under management isn't going to be a significant drop. And what we are going to do is pick up the entire capital commitment to in Asia 2 in the quarter that, that cross over takes place.

Marc Irizarry - *Goldman Sachs - Analyst*

Understood. When you said flat for the fourth quarter, the '06 Fund does that assume the Alliance Boots cost basis is out or that Alliance Boots is out of the '06 AUM?

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

Marc, I don't want to get too granular on the question. What I am seeing with you is just directionally that would be taking into account Boots.

Marc Irizarry - *Goldman Sachs - Analyst*

Okay.

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

I think, Marc, to be really clear what Bill is taking about is the management fee impact, the revenue impact of the '06 Fund rolling into the NAXI fund. We are not suggesting to you that we think fee related earnings are going to be flat in the fourth quarter we don't know what they are going to be in the fourth quarter as we sit here right now given transaction activity is going to drive a lot of that. It is purely a management fee revenue point based on the $6 billion that we have announced as closes so far.

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

Clearly just on the impact from '06 and '06 going from the investment period to post investment period and NAXI turning on.

Marc Irizarry - *Goldman Sachs - Analyst*

Understood. And then, Scott, can you give us a little more on Prisma. Any financial details you could share with us the transaction itself. Just trying to get a sense of with all the capital you do have at the GP how you think about maybe structuring these deals or what your tolerance is on how much capital you want to spend on acquisitions?

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

Sure. Marc, we haven't disclosed the details of the acquisition so I am not going to be able to give you any economic numbers per say. But the way we think about it is in some of our businesses acquisition can be an interesting way to get some scale. The Prisma acquisition is one that frankly we have been working on for the better part of 2 years. There was a historically relationship between the principle of Prisma and some of the senior folks here at KKR, so there was a real familiarity with the individual and frankly a culture similarity that made this feel quite good to us.

The way think these transactions should generally be structured is with a lot of value on the back end as opposed to a lot up front. That is generally the construct we have come up with. So a lot of the value is in the earn outs which have been structured to be highly accretive to us. As we think about growing the rest of KKR through acquisition I think you will find that we will probably pursue a similar approach, some up front value but more in the back end so there incentives are in line with all of ours.

Marc Irizarry - *Goldman Sachs - Analyst*

Great. Thanks.

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

Thank you.

Operator

(Operator Instructions). We will go next to Roger Freeman with Barclays Capital. Please go ahead.

Roger Freeman - *Barclays Capital - Analyst*

Hi, good morning.

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

Good morning.

Roger Freeman - *Barclays Capital - Analyst*

Good morning, can you hear me better. Just to come back to the cash balance commitments, et cetera. As you look forward as the KPE investments liquidize the way you are thinking about this is you will be growing new funds et cetera that eventually you will have $5 billion plus maybe less some capital used for up front payment on acquisitions, but the bulk of that is going to be sitting along side various funds that you have launched or are launching?

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

I think that is generally right Roger. I would say probably three uses. The first is to seed new businesses and invest alongside our institutional and other partners in our vehicles. The second would be to support the growth of our capital markets business where we do selectively take some capital risk to drive the fee growth. And the third would potentially be to the prior discussion acquisition. I think you will see the balance sheet probably overtime look more like the distribution of our AUM. Right now it is highly private equity focused because of the legacy KPE strategy, but over time I think you will see it be far more diversified and our hope is also start to generate a more recurring yield.

Roger Freeman - *Barclays Capital - Analyst*

Okay.

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

You have seen that to date from when we public I mentioned this earlier. If you take a look at the components of our balance sheet we are much more diversified today away from private equity than when we were when the transaction closed, because I think when we closed the transaction 97% of our balance sheet was in private equity. Now we have provided the details to you. You can see that percentage away from private equity has increased significantly.

Roger Freeman - *Barclays Capital - Analyst*

Okay. More broadly speaking on (Inaudible) opportunities you mentioned in your Stone Point comments reminded me of something I was thinking about with Blackstone last week. Some of the other traditional businesses within the dealer space I am thinking commodities for example other structured business are getting a lot tougher given Basel 2.5 and 3. I am wondering if any of those types of business can be of interest to firms like yours that can be structured inside of funds. And one of the things that Tony James had said which was a fair point is putting a business inside of a fund in the traditional sense you have sunsets on those and how do you put an ongoing business in to a fund. I am wondering how you think about that, or if that is something you think about and whether you could do it if you could provide some sort of secondary liquidity to investor that you would provide or facilitate a secondary market and actually have a fund that continues to run?

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

Roger, it is Scott. The way we think about this consistent with how we think about all our strategies as a firm. The first question we ask is can we do it well by having it integrate with the rest of KKR and what we are good at. So providing capital to middle market corporate and sponsors up and down the capital structure is very straight forward, something we understand. We have been providing capital to companies for 36 years. That is something that is right down the middle of the fairway. When you get into some of these more (Inaudible) businesses, different trading businesses, commodities, other things frankly it stretches the strategic logic to such an extent that I don't think you will see a lot of activity from us there. We are going to continue to stay focused on things that go back to those core principles that I mentioned.

Roger Freeman - *Barclays Capital - Analyst*

Okay. That is helpful. On netting holes just quickly when you cross those say in an European fund do you automatically does the cash carry automatically kick in, or is there a discretion if you are kind of close but yet over where you decide to hold back on the distributions just to keep a buffer?

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

No, it is quite mechanical. What we have is based upon a partnership agreement. When we sale an investment you take a look at the portfolio and if any portfolio investment is carried below costs, you have to return capital to our L.P. rather until that number goes to zero. Once you cross over that point the rest of the profit is going to go 80/20. So we know exactly what the netting hole is each and every fund to the end of each quarter. As long as when we have a realization we satisfy that netting hole the remainder goes out 80/20 and that turns into cash carry.

Roger Freeman - *Barclays Capital - Analyst*

Okay. And lastly you mentioned Brazil and establishing a presence there. How are you thinking about that opportunity set? Could we see a Brazil fund in the next year or two?

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

It is hard to predict nothing planed in the near term, Roger. I think what you will see us do is in invest in that part of the world out of the North American Private Equity Fund. So NAXI is predominately going to be investing in that part of the world for us in the near term.

Roger Freeman - *Barclays Capital - Analyst*

Great thanks a lot.

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

Thank you.

Operator

We will take our next question from Robert Lee with Keefe, Bruyette & Woods. Please go ahead.

Robert Lee - *Keefe, Bruyette & Woods - Analyst*

Thanks, good morning, everyone.

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

Good morning.

Robert Lee - *Keefe, Bruyette & Woods - Analyst*

Most of my questions have been asked. I am just curious to know with the Alliance Boots transaction has that at all impacted or changed or influences any of conversations you have had with whether it is fund raising in the NAXI or is it really just kind of that is what the prospective L.P. expect of it, so it is kind of business as usual. Or has that somehow influence how people are thinking about the space and return profiles and opportunities?

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

Hi, Robert, it is Scott. I think people were pleasantly surprised would be my characterization. We have been giving our investors updates on how Boots was performing operationally, but as I said it was held at 1.1 times cost last quarter. It is a 2007 investment a very large investment. We have been saying for the last several years to our investors that we feel quite good about the investments we made in the 2006, 2007 period certainly relative to the market and even on an absolute basis. If you think about Dollar General, HCA, Nielsen, now Boots we have had a number of very good investments from those periods. I think they have been pleased with that.

The biggest source of capital for the Boots was the 2006 (Inaudible). As we talk to investors about NAXI, one of the things I mentioned is investors like Asia, they like energy, they like yield. North American buyouts has not been as in favor as some of those other asset classes, but as we have had our conversations continue with investors in NAXI it helps to the underscore the point we have been making to them that we see a big opportunity buyout. I think it is going to be ultimately somewhat helpful as we continue those discussions. You have seen the '06 Fund move from 1.3 times cost to 1.4 times this quarter. The other thing I would say cash back helps a lot in fund raising. We are giving a lot of cash back to investors, so we think that will ultimately yield positive results for us overtime as well.

Robert Lee - *Keefe, Bruyette & Woods - Analyst*

Maybe just one follow-up on the energy yield strategy you mentioned just wanted to clarify is that a separate fund you are out starting to fund raise for or was that a component of the recently raised energy strategy?

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

This a newer strategy it is bit of a different approach than what we had in KKR. The KKR natural resources fund was really kind of more proved developed producing assets. So think about it as you have already developed the underlying opportunity and you are just extracting the commodity. This strategy energy income is going to be royalties which is somewhat different space. We have a joint venture there that we are so far funding off our balance sheet and through KKR financial and also proved undeveloped producing. So think of it has as field that are in an earlier stage in their lifecycle, so higher potential returns but meaningful cash yields. It is different than what we are doing in KNR.

Robert Lee - *Keefe, Bruyette & Woods - Analyst*

Great, that was it. Thank you.

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

Thank you.

Operator

Will we take a follow-up question from Bill Katz with Citi Group. Please go ahead.

Bill Katz - *Citi Group - Analyst*

Tough to think I have one but I actually do, actually two questions. First is in terms as you talk to your institutional clients has there been any sort of structural shift in their appetite for alternatives at this point in time? And secondly coming back to your discussion on the balance sheet. I was just sort of looking through it during the Q&A here. Is a there a point, and I appreciate what Bill saying about in terms of near term cash (Inaudible), but is there a point where you reach that you could actually get to a self fulfilling recycling of GP commitments to the point you could actually transfer some of the yield to unit holders if you will rather than early investing into (Inaudible) initiatives?

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

Hi, Bill, it is Scott. I would say in terms of the question about structural shift in appetite for alternatives, we think there is a structural shift. So of the $35 trillion of intuitional assets I mentioned that are managed by third parties by our accounting about $4 trillion of that is alternatives. So we think we are going to continue to see the other $30 trillion some portion of that shift into alts. If that happens, you don't need a lot to shift on a percentage basis to have a meaningful impact on the $4 trillion figure. So we do think that there is an on a structural shift and on a weekly basis we are seeing institutions increase their allocation to alternatives as they seek ways to generate return.

That shift to alternative is broad based it is private equity, it is real assets, it is variety of different credit opportunity, it is real estate and it is hedge funds. We have seen a meaningful shift, and we do think that alternative asset allocations are going to grow from institutions that are already in the space, and frankly we are also finding that institutions that don't invest in alternative are starting to. Because they look over the last 10 years and they have had no returns from their public equity strategy and their fixed income bucket maybe has generated 2% or 3% from the last decade and their liabilities are growing at 8% and the math doesn't work. So we think that is going to result in a pretty meaningful shift in assets overtime.

At least as it is relevant to the $4 trillion that is currently in the market. So we are excited about that, and that is why you see us positioning ourself to get in the way of those flows. Because as we look around the firm we have had quite a few offerings in the liquid space and now with Prisma and KES and a lot of what we are doing in credit. We have more offerings in the liquid space and that is where a lot of the flows are going we think in the near term. With respect to your question on the balance sheet it is hard to predict how things are going to evolve over the long-term. Right now the balance sheet is pretty fully invested and very fully committed and invested.

So that is not something we are thinking about today, but over time if the balance sheet generates a meaningful yield and we have uses for the capital that aren't as high return as they are right now we will consider whether or not it makes sense to pay off some of that yield to investors but that is down the road. We are not thinking about that right now given all the opportunities we have to grow the firm.

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

Bill, we talk about this on occasion keep in mind that 65% of KKR is owned by KKR executives, so to say that we are not focus on this point would be an understatement.

Bill Katz - *Citi Group - Analyst*

I wasn't afraid you were. Thanks guys for taking my extra questions. I appreciate the patience.

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

Take care Bill.

Operator

And gentlemen at this time there are no further questions. Mr. Larson, I will turn the conference back over to you for any further comments.

Craig Larson - *KKR & Company L.P. - IR*

Thank you, Cynthia. And thank you everyone for joining our call. We appreciate your interest. Bye.

Operator

Ladies and gentlemen, this will conclude today's conference call. We thank you for your participation.

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