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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to KKR's Fourth Quarter and Full Year 2018 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 ***KKR & Co. Inc. - Head of IR***

Thank you, Sydney. Welcome to our fourth quarter 2018 earnings call. Thanks for joining us. As usual, I'm joined by Bill Janetschek, CFO; and Scott Nuttall, our Co-President and Co-COO.

We'd like to remind everyone that we'll refer to non-GAAP measures on the call, which are reconciled to GAAP figures in our press release, which is available on the Investor Center section at kkr.com. The call will also contain forward-looking statements, which do not guarantee future events or performance, so please refer to our SEC filings for cautionary factors related to these statements. And like previous quarters, we've posted a supplementary presentation on our website that we'll be referring to over the course of the call.

This morning, we reported our Q4 and full year 2018 results. The fourth quarter rounded out a very strong year for us. Beginning on Page 2 of the supplement, you see our traditional key metrics slide that profiles the year, and we continue to make good progress across all 4 of these metrics. For the year, our AUM increased 16% and both management fees and our after-tax distributable earnings increased 18%. As of 12/31, if you look in the lower left-hand slide, you see that our book value per share was marked at $15.57, up from $14.20 a year ago. And it's worth noting that the $15.57 is before meaningful increase we've seen in some of our more sizable public balance sheet holdings since 12/31.

Looking with a little more granularity, let's turn to Page 3. We reported after-tax distributable earnings of $460 million for the quarter or $0.55 on a per adjusted share basis. Despite all of the volatility experienced across markets in the quarter, this marked one of our strongest quarters on record.

We had record quarterly and annual fee-related earnings. FRE for the quarter was $331 million bringing full year FRE to $1.1 billion. For the quarter, FRE came in 40% above the figures reported for the same period a year ago. And for the year, FRE increased 23%. This was driven both by growth in management fees, which were a record $1.1 billion for the year, as well as continued strong results within our Capital Markets business.

As we evaluate our performance overall, there are 5 things that we need to do well to succeed. We talked about these on our previous calls. We need to generate investment performance. We need to raise capital, find attractive new investments, monetize existing investments and then finally, we need to use our model to capture more economics across everything that we're doing. I'll update you on our progress on the first 2, and Bill will cover the remaining 3.

Beginning with investment performance. We all experienced significant volatility across asset classes in Q4. To give you a sense of this, from the beginning of 2018 through September 30, so for the first 9 months of the year, the MSCI World appreciated 5.9% on a total return basis, only to see all of this and then some reverse in the fourth quarter as volatility spiked and the index declined 13.3% to finish the year down over 8%. In the fourth quarter, the U.S. High Yield Index declined 4.7%, and the LSTA was off 3.4%.

In terms of KKR, broadly we saw mark-to-market declines given this backdrop, but outperformed relative to benchmark. For example, for the quarter, our flagship private equity funds declined 5.2% and the overall private equity portfolio was off 8.3%, compared to the 13.3% decline in the MSCI World.

Focusing on the year, you see many of these statistics on Page 4 of the supplement. Our flagship private equity funds appreciated 2.5% and the overall PE portfolio appreciated 5.0% compared to the 8.2% decline in the MSCI World and the 4.4% decline in the S&P 500. In real assets, our more mature Real Estate, Infrastructure and Energy flagship funds were up 8.7%, 7.7% and 7.5%, respectively. And in credit, our flagship alternative credit funds and our leverage credit funds were up 7% and 1%, respectively.

Now while all of this is interesting, given the strong start we've seen in 2019, it also highlights why we don't run the business based on mark-to-market movements over any 90-day period. As we reflect on Q4, what's noteworthy to us isn't that the S&P declined 13.5%. But instead, in a quarter, where you saw this volatility, we generated over $500 million in realized performance and investment income and record management fees, Capital Markets activity and fee-related earnings, and ultimately, reported $460 million of after-tax DE, the second-highest quarterly figure for us over the last 3 years. The beauty of our model is that we get to time our entries and exits. We're not forced sellers during these periods.

Moving on to fundraising and our AUM roll forward. We reported $11.3 billion of new capital raised in Q4, that's our strongest quarter of the year. In a particular note, we held a $5 billion first close on our next flagship European private equity fund. We've spoken for some time about the benefits of scaling subsequent funds across strategies and this announcement certainly fits squarely within that framework.

And in public markets, inflows into our leverage credit strategies and CLOs were the key drivers of new capital raised. Public Markets AUM also did see the impact of both the Nephila sale as well as the incremental 5% Marshall Wace purchase, which resulted net in an outflow of approximately $1 billion as we discussed on last quarter's call. And AUM, of course, reflects the impact of the mark-to-market volatility over the quarter.

Looking at the full year, our AUM increased 16% year-over-year, and our fee-paying AUM increased 20%, given our organic fundraising activities as well as the FS Investments transaction that closed earlier in 2018. And critically, we've been able to mainstream attractive terms as approximately 80% of our AUM has the ability to earn performance fees. These inflows contributed to $58 billion of dry powder at year-end, and we now have over $23 billion of capital commitments that become fee-paying as that capital is either invested or as it enters its investment period and that's at a weighted average rate of just over 100 basis points, helping provide direct line of sight towards future management fees.

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

William J. Janetschek ***KKR & Co. Inc. - CFO***

Thanks, Craig. Moving on to new investment opportunities. We had an active quarter, investing $6.3 billion across businesses and geographies with an additional $4 billion of syndicated capital, bringing total activity in the quarter to over $10 billion. In Private Markets, we invested $4.3 billion. The largest contributors were 2 private equity investments, BMC and Envision, both of which had meaningful equity syndication alongside our fund capital. We also invested over $800 million across a handful of investments in Asia private equity as well as $600 million in a French telecom tower investment out of our infrastructure strategy.

Looking at deployment over the course of the year, we invested $13 billion in Private Markets, with just over half of that coming from traditional private equity. The rest came from a combination of our real assets, growth equity and core equity platforms showcasing the growing diversity of our firm. In Public Markets, all the volatility experienced across credit markets in the quarter was quite helpful to us as we deployed a record $2 billion, primarily from our private credit and special sits strategy.

Shifting to monetizations. We saw a healthy level of exit activity in the fourth quarter. As mentioned in our intra-quarter press release, strategic sales in 2 secondaries drove $420 million of gross realized carried interest and realized investment income we reported this morning. And on a blended basis, the PE exits were done at over 3x our cost. Looking at full year, our private equity funds distributed over $10 billion of capital to our investors which, in turn, contributed to roughly $1.2 billion of realized carry.

And to give you an update on monetizations, as we stand here today, based on transactions that have closed or signed transactions that are expected to close in the first half of 2019, gross realized carry and total realized investment income is expected to be approximately $400 million. And just to be clear, First Data is not a part of that $400 million figure. Post quarter-end, in mid-January, it was announced that First Data is to combine with Fiserv. This pending transaction would not be a realization event for KKR as our shares in First Data would be exchanged for Fiserv at close.

Since December 31 through last night, First Data's stock price has gone up by about $7.50 per share or a 45% increase. All else being equal, that increase represents $0.55 per share of KKR after-tax book value.

And finally, the last thing we need to do well is use our model of AUM, Capital Markets and balance sheet to capture greater economics for our investors and our shareholders. Like Upfield last quarter, which was discussed in detail, BMC, Envision and the French telecom tower investment were similar worldwide transactions. They all required a global effort across multiple teams to collaborate and execute. BMC and Envision together generated approximately $140 million of Capital Markets transaction fees.

So in summary, 2018 was a strong year for us. Our AUM, management fees, fee-related earnings and after-tax distributable earnings were up all between 16% and 23% compared to 2017. We used our model well, we continue to scale, and in July, we completed our conversion from a partnership to a corporation. Page 5 of the supplement lists the 5 fundamental drivers of the firm. And we saw continued progress against all of them, and we're really excited about the opportunities we have ahead of us.

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

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

Thank you, Bill, and thank you, everybody, for joining our call today. I'd like to spend a few minutes outlining 3 of our key priorities for this year. The first priority is Asia. Today, we are the leading private equity franchise in the region with a strong and distinguished track record. In addition, for a number of years now, we've been hiring local talent and building integrated teams across non-private equity strategies, like real estate, infrastructure and alternative credit, and making investments through our funds, separate accounts and the balance sheet. The next step for us is the direct expansion of these non-PE strategies in Asia, all of which we've launched or plan to launch in 2019.

Second is scaling real estate more broadly. Real estate is one of our youngest businesses with an enormous end market. Since launching the platform, we've made a lot of progress building out the foundation. Today, the business is global, with over 65 professionals based in 9 offices across 7 countries. And we're managing about $6 billion in AUM through debt and equity-focused funds and permanent capital vehicles. Our focus is continuing to scale the platform with additional pools of capital, both debt and equity across the U.S., Europe and Asia. In 2019, we expect to see fundraising for strategies across all 3 geographies, largely comprised of first and second generation funds. Stepping back, we see significant runway in this asset class and many different ways to grow the business and create value over time.

Our third priority is investing aggressively into dislocation. We've been seeing valuations drop in Asia and parts of Europe over the past couple of years, and we may be seeing the beginning of a similar dynamic in the U.S. In Q4, as Craig noted, U.S. High Yield indices declined 5% and the S&P 500 declined 14%. The last time U.S. equity markets underperformed to this extent was in the third quarter of 2011. The growth of our firm and business model has been significant since then. You see some of these stats on Slide 6 of the deck.

In Q3 2011, we had $13 billion of dry powder. Today, we have $58 billion. And today's dry powder is more global, more diversified and more flexible. Also, cash and investments on our balance sheet have more than doubled over this time frame, and our Capital Markets team is more integrated across the firm and has expanded globally.

We're focused on ensuring the entire firm is working together to use the model we've built to invest aggressively into dislocation when and where it arises, and creatively provide capital to companies in need. We'll keep you updated on these priorities and our progress over the course of the year.

And with that, we're happy to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Glenn Schorr with Evercore ISI.

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

Just to get a little follow-up to Scott's comments on scaling real estate more broadly. Obviously, we're all for a big huge market for you to tap into. Could you talk about where you think you are in terms of having the performance to be able to go to market in all 3 geographies? Is the distribution network there? And then, in a first or second generation fund, what type of opportunity are you looking at it in '19 and '20 in terms of for these capital raises?

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

Thanks, Glenn. Let me try to take those in turn. I'd say for our real estate business, it's still very early innings. Most of these strategies under our real estate platform have been launched in the last 2 or 3 years and really, the business itself was launched about 6 years ago, and we continue to add new strategies in new geographies every year. In terms of your questions, the performance has been great. We've seen really strong performance across the entire platform, both equity and debt. Yes, we think our distribution network is in place to allow us to scale those businesses. And in terms of the third part of your question, the first to second generation funds, the answer varies depending on the market. The first business that we created was really opportunistic equity in the U.S. And so, we're on our second fund, there our REPA fund, and over time, we'll continue to scale that. We think that platform can be a lot bigger in time. We've also created an opportunistic equity strategy in Europe and are in the process of raising capital for our first such fund in Asia. So the first bucket is opportunistic equity broadly defined. And we're also in the equity side looking at other opportunities, like core plus, which we think could be an interesting growth opportunity for us over time, and a variety of other strategies that are equity facing. We're starting to talk to investors about those as well. So think about it as globalizing, but we started in the U.S. and now we're taking the efforts to Europe and Asia and looking to scale there too. In addition to what we're doing, on the equity side, there's a lot happening in the real estate credit part of the business, which we don't talk about as much. We have a whole loan business on the mortgage side, that today we execute largely through our public REIT, which is called KREF. We also have a CMBS B-Piece business, which we call RECOP, which is out raising money for its second fund, and we're launching new strategies over the course of this year in real estate credit too. So when you put all that together, we think this can be a very large business for us and some very large multiple of the $6 billion or so we manage today, and we're really pleased with the performance to date.

Operator

Our next question comes from Patrick Davitt with Autonomous Research.

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

The press over the last week has been reporting on a number of senior departures, particularly in the Public Market side. I'm curious on your thoughts on the drivers of this, if you think it's outsized relative to history. And then, as we think about Public Markets growth going forward, do you remain comfortable that this hasn't impaired the fundraising capability?

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

Patrick, it's Scott. The short answer is, don't believe everything you read. We're always -- have -- we always have been, we always will be a meritocracy and an entrepreneurial place. I'd say it's very natural for us to see some year-end departures and promotions. And in fact, in our business, it's critical and really healthy to make room for people and on occasion to upgrade talent. So periodically, you're going to see people retire or leave, and we also see as others get promoted and new people join. But just to put it in context, we have about 13 -- approaching 1,300 employees, of which about 160 are partners and managing directors and both figures have been growing as we build for the future. So the bottom line is I wouldn't overreact to a couple of departures. We've got a really deep bench of talent and feel great about the talent in the firm. And we view all this as ordinary course and healthy for a firm like ours.

Operator

Our following question comes from Alex Blostein with Goldman Sachs.

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

I was hoping you guys could help just kind of bridge some of the balance sheet moves we saw in the quarter. So I guess, looking at total investment balances and then sort of the quarter-to-quarter decline, so call it, $9.9 billion total versus $10.3 billion. How much was the mark versus kind of net sales and deployment? And then specifically, maybe just zoning in on credit business, specifically, that's where some of the bigger declines sequentially came from, again, just help us break the mark versus any sort of activity.

William J. Janetschek ***KKR & Co. Inc. - CFO***

Alex, this is Bill. I'll take that question. When you're looking at the balance sheet on Page 9, you're going to see some of the activity with the reduction in value just from exiting some investments that weren't replaced, so depending on strategy. But a good amount of that was, again, just on the mark-to-market basis, some write-down in the portfolio. So when you look at the balance sheet, one of the biggest investments we have is First Data. First Data was down 30%. Again, on a mark-to-market basis, we report that based upon the closing stock price. But as I mentioned in prepared remarks, we actually saw First Data rebound and it was actually up 45%. And so had it closed on December 31, you wouldn't actually see as much of volatility, which is, again, one of the reasons why we're happy that we don't report on an ENI basis anymore. We're still going to do the valuations and report intrinsic book value like we do. But, as you know, the beauty of our business is that we time exits. And so in market volatility, we're not sellers, we're holders, and we wait for recovery, and we sell at the prices we want to sell at. As it relates to credit, in particular, you asked me to just focus a little more on that. When you think about performance on a quarterly basis, those assets were marked down. But when you look about and take a look at the credit portfolio on the balance sheet for the entire year, those positions were actually up. And so, again, on credit, you might see a reduction in value, a portion of that is just sales of some of the assets, and we rotated that into other places on the balance sheet and some of it is, again, just on the mark-to-market basis. The last point I'll mention is remember about exiting when we want to exit. The good news is when you take a look at -- on Page 6, realized investment income, we actually had net gains of roughly about $80 million from those balance sheet assets.

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

Got it. Great. And then, just my follow-up question is around the Capital Markets business. Again, very strong results in the quarter. Was hoping you can talk to how the Capital Market business performed, specifically in December, and really sort of your ability to intermediate transactions at a time of dislocation? Obviously, there is a question mark how stable this could be in a more challenging market backdrop. So I was wondering if there's something we could learn from the December activity.

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

Alex, it's Craig. Let's just start broadly and think about the business as a whole and then can at least help frame how we think about the business and in the portion of that to may be the baseline versus those more event-driven things. But I think one of the things that's critical to understand stepping back is the growth we've seen in the business as a whole really reflects a few things. It certainly reflects the growth in the firm, but it reflects so much more than that. For the first 5 years, Capital Markets revenues were really only driven by our private equity business and it was heavily U.S. centric. Today, the revenues are meaningfully more diversified, it's not just private equity, it's across all our strategies. It's not U.S., it's global. And it's not just KKR, our third-party business at this point is also a real contributor. And at the same time, we've just become much, much better at integrating Capital Markets into everything that we're doing and capturing a higher share of that activity. Now in terms of your question in thinking about the business and how to frame the revenue profile, it might be lumpy from 1 quarter to the next, but if you think of this on a trailing 12-month basis, there is a baseline business and then added to that baseline business are these larger events. Now these events typically surround deployments, not exits, but they can be meaningful as evidenced this quarter, as Bill touched on, by Envision and BMC. So to try to help frame the magnitude of these events, when you look at 2018, transactions where we earned fees of $20 million or more, that represented a little over half of our total revenue. So there's a baseline amount of activity. That baseline amount should be growing for us over time and then there's the opportunity for that to be supplemented by these events that can be quite additive to the revenue line in any specific way. So hopefully, that helps frame how we think about the business.

William J. Janetschek ***KKR & Co. Inc. - CFO***

And Alex, I'd just add a little more color around the numbers on just Capital Markets, just to give you an idea of the breadth of the business. Number of transactions during 2018, over 200, and in that -- in the fourth quarter, 50. And when you think about the breadth, again, in the business, roughly 20% of the very large revenue number came from our third-party business and about 1/3 of the economics from Capital Markets came from outside the U.S.

Operator

And our next question is from Robert Lee with KBW.

Robert Andrew Lee ***Keefe, Bruyette, & Woods, Inc., Research Division - MD and Analyst***

Just kind of curious, I mean, certainly, it wasn't evident in your fundraising, but given the fourth quarter volatility, and I guess, concerns at least at the very start and maybe not the last couple of weeks, whether it was around credit or trends or whatnot. I'm just curious if LPs or perspective LPs or even if they're still investing kind of how their thought process may have been impacted by the events in the fourth quarter or the types of questions they're asking, just trying to get a sense of how maybe their appetite has shifted subtly or not? And then maybe a second part of that, can you also update us on kind of LP expansion in terms of number of LPs that you're now seeing take up multiple strategies and kind of the broadening of your LP base?

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

Sure. Rob, it's Scott. I'll take that. The -- on the LP appetite question, didn't -- haven't really seen a change. I think there was a few weeks there where people were just trying to figure out which way the world was going. But I think the reversal that we've seen so far this year has abated that kind of a question or discussion. So the bottom line is to date, no real change in LP dialogue. If anything, I think, the LPs take a longer term perspective and the general view is that we're entering a lower-return environment for the markets more broadly. And in that context, we have a lot of discussions around clients feeling like they're going to need more alternatives, not less, in order to hit their target. So kind of -- the idea is if beta is going down, you got to go find alpha elsewhere and alternatives have, historically, been the main generator, and we think that's good for us. We also think as the overall market return drops, the illiquidity premium that we're able to generate actually increases as a percentage of their overall return. And so that's meaningful for us too. So the LP appetite has not seen any change to date and if anything, we're having some conversations where they recognize there is even more that we should be doing together. In terms of the second part of the question, broadening of the LP base, that continues to be a key and strategic focus for us. We've got today about 965 investors to be precise. On average, we are kind of selling 2 KKR products to each investor. But importantly, we only have 40% of our LPs in more than 1 product. So if you look at the largest investors we have, they tend to average about 4.5 products. So we see upside across everything I just said. We think the number of investors can continue to grow, we think our cross-sell metric can continue to grow, and we think there's material opportunity to penetrate newer markets that we've talked about in the past and grow further in insurance, retail, sovereign wealth, et cetera.

Operator

Our next question comes from Gerry O'Hara with Jefferies.

Gerald Edward O'Hara ***Jefferies LLC, Research Division - Equity Analyst***

Maybe picking up on that retail idea there for a moment. Could you perhaps give us a little bit of an update as to how you see the outlook there into 2019? And of course, appetite and demand as well would be helpful.

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

Gerry, it's Craig. So we've got several approaches here. The first is within our client and partner group. We have a team that's dedicated and spends all their time talking to family offices and high net-worth individuals. So we have that direct approach where we're working with families around the world, and they are investing with us across a variety of strategies. We also have a long list of platform relationships. So think of this as banks, high net-worth third-party platforms where we'll sell our products through their sales force. That's also been growing nicely. There's -- so there is the direct component, there's the platform piece, and again, both of those are global. We also will work with partners. So we have a desire certainly to only have inside the firm what absolutely needs to be inside the firm. I think the relationship and partnership we have with FS is a great example of how we work with partners. FS has built out a lot of capabilities that we admire and have a few hundred people that spend their time focused on being best-in-class as it relates through to their channel. And they're much better at raising funds to hundreds of thousands of individual investors probably than we ever could be. And I think that the opportunity set for that expands also beyond just the -- in the long-term just simply BDCs. So I'd say when we think of where we were really from a standing starting this effort around 6 years ago, it now probably is 10% to 15% of the money that we raise quarter in and quarter out. And I think as we think of that opportunity, in particular, with FS, the opportunity for us is even greater.

Gerald Edward O'Hara ***Jefferies LLC, Research Division - Equity Analyst***

Great. And maybe as a follow-up for Bill, and I apologies if I missed it. Could you give us a sense of where the FRE margin kind of shook out in 4Q or for the year? And then perhaps, what the outlook there might be with the puts and takes around investment in the Asia platform, real estate, et cetera, kind of going forward?

William J. Janetschek ***KKR & Co. Inc. - CFO***

Well, I'll take it first and I'll let Scott follow up on the second one. But as it relates to fee related earnings margin, when you take a look at Page 6, it's quite robust. And when you take a look at the way we defined fee related earnings is that those margins are roughly about 58%.

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

Yes. In terms of the second question, we will be continuing to invest in growth, but as we do that, we've got a number of the investments that we've made in growth over the last 3 to 5 years starting to reach some maturity and generate incremental revenues. So we don't see a reason to believe that there's going to be a significant amount of downward pressure on that. We think we can fund the growth with the -- in terms of CapEx spending, with the revenues that we're expecting from newer efforts.

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

And then Gerry, it's Craig. Just one final definitional point. If you look on that incentive fee line in -- for the year 2018, we had about $140 million of incentive fees, approximately $50 million of those came from the BDC platform. So I think some of our peers when they defined FRE, include the incentive fees from the BDC platform. We do not, in our definition of FRE. So just, again, wanted to highlight that as you think about that apples-to-apples across the group.

Operator

Our following question comes from Mike Carrier with Bank of America.

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

Given some of the concerns just in the market during the 4Q and credit, can you provide maybe a little color if you saw much of a change in the portfolio fundamentals versus the mark-to-market? And Bill, I think you mentioned $2 billion deployed in credits, and maybe any color on those opportunities, has the backdrop to deploy gotten a bit better with the 4Q scare?

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

Mike, it's Scott. The short answer is that really no change in portfolio fundamentals in Q4. I think there are some sectors, which had been seeing some kind of pull back in revenue growth over the prior several quarters. And no -- nothing I would point out as materially different in Q4 versus the prior 3 quarters. I think to some extent, our perspective is the market ended up getting quite anxious at the end of the year and pulled forward a number of concerns about whether a recession was coming sooner rather than later. And then in a number of the markets, there seem to be a bit of an overreaction to that anxiety, especially in the U.S. So we did see a pullback in the liquid credit markets, particularly in December, and we did see opportunity to lean in even more on the private credit side. But I don't think I would tell you that a lot that was due just to the markets getting disrupted for a couple of weeks. Some of these deals had been in process for a long period of time. And a lot of what we're seeing from a deployment standpoint, especially out of private credit, is really just using the model that we've now built with our partnership with FS, the ability to lean into larger transactions and we are underwriting now much larger deals where we find that there's less competition and more attractive terms. So no fundamental difference and we continue to be busy on the large end.

Operator

Our next question comes from Bill Katz with Citigroup.

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

So 2 questions from me. One is on the performance fees and the incentive fees. I appreciate how you defined it, by the way, in the FRE. That's great. But just how do we think about pacing and the magnitude? Was there anything unusual this year? Just trying to sort of think through the addition of Franklin Square versus performance in the year versus more of a run rate to try and get this more of a trend for process on that?

William J. Janetschek ***KKR & Co. Inc. - CFO***

Sure. Hey, Bill, I'll take that question. When you look at incentive fees overall for the entire year, it was about $140 million, roughly $80 million of that came from Marshall Wace. And when you think about it, just a clarifying point, Marshall Wace incentive fees are crystalized on October 1. So they're on a fiscal year basis. And so you're going to actually see that number come through and as it has in the fourth quarter. When you think about Franklin Square and the BDCs, as Craig mentioned, the incentive fees actually have to get calculated every single quarter and it's driven by performance. Whereas management fees are usually based just on invested capital or committed capital. And so that's why we actually report that in incentive fees. But if you go back over the last 4 quarters, that number from the BDCs is anywhere in between $12.5 million and $15 million. So I don't want to say that's a run rate number, but since that transaction closed in April, that incentive fee both from CCT and Franklin Square is, again, anywhere in between $12.5 million and $15 million. Keep in mind that you would also have seen incentive fees come through prior to that from BDCs when we were just managing the CCT capital pool, but now on a combined basis, that number has actually been elevated.

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

Okay, it's very helpful. And then just the follow-up from me. Just in terms of capital management, you've been working down your authorization, I think you have a couple hundred million dollars left. So just sort of stepping back, just given all the growth opportunities that Scott articulated in the momentum of the business, how are you thinking about maybe capital return at this point in time? And I was wondering if you could sort of address maybe the dividend policy as your fee related earnings and committed capital grow versus buyback?

William J. Janetschek ***KKR & Co. Inc. - CFO***

Okay. On the buyback, you can see that during the quarter, we've actually been pretty busy. And so if you refer to Page 3 in the press release, we've actually put together a table, which we think is quite helpful. And you could see that really from October 1 all the way through January 25, we've been in the market either buying back shares or actually canceling shares that vested to our employees. But again, the magnitude of that number is $160 million. When you think about the dividend, remember, we just changed our dividend policy when we went to a C Corp. And so the stated dividend policy was $0.125. We just enacted that 2 quarters ago, and so I wouldn't expect to see much movement there anytime soon. But keep in mind that what we did communicate is that, overtime, to the extent that the business can continue to grow and we continue to grow our management fees and more stable revenue from the balance sheet, that it is expected that, that dividend number would continue to grow. One other thing though, I just want to highlight that when you take a look at the share count, I just wanted to call out the fact that what we had done historically was issue anywhere in between 1.25% and 1% -- 1.5% of the total shares outstanding. At the end of 2018, as far as compensation is concerned, we only issued on a net basis, roughly about 3 million shares compared to that 13 million. And so what we're doing is we are making sure that what we said was that when we change our capital allocation policy in the fourth quarter of 2015, we would make sure that there wouldn't be share creep with regard to our share count based upon issuance to our employees, and we're trying to make sure that we honor that commitment.

Operator

Our following question comes from Devin Ryan with JMP Securities.

Devin Patrick Ryan ***JMP Securities LLC, Research Division - MD and Senior Research Analyst***

First question here, just a quick follow-up on operating expenses, just given they were a bit elevated in the quarter. Not sure if that's seasonal or elevated capital markets revenue related, but when we look at the full year relative to kind of total revenues, it's in a similar ballpark as prior years at about 9%. So I was just trying to think about whether that's an appropriate level moving forward and just -- also had to just think about the aggregate level of growth in 2019 over '18.

William J. Janetschek ***KKR & Co. Inc. - CFO***

Sure, Devin. You are right. If you look at the fourth quarter numbers, it's elevated. And what happened in the fourth quarter is that across several of the mandates was private equity across all 3 regions in infrastructure and real estate. We ran after a couple of investments that we ended up not doing and so you see an elevated level of broken deal expenses in that number. In addition, capital markets, as I mentioned, was quite busy, 50 mandates. We actually ended up incurring some syndication expenses, which show up on this line, and so that's elevated. So I wouldn't focus on the fourth quarter as the new run rate number by any means. You should probably look at the third quarter as something closer to the reality of the expense base. One other thing that we'd like to mention is that when you think about what we've communicated, we said that we've got 3 income streams and really 2 expense bases. One is compensation and the other is G&A and occupancy. And as you could see, we were trying to strive for a margin of about 50-plus percent. As we've communicated, the compensation number is -- we said it would be in the low 40s. And if you take a look this quarter, it was down about -- a little less than 37%, but for the entire year, it was about 40%, and the occupancy and G&A is roughly anywhere in between 7% to 9% depending on the quarter. As we continue to grow the business, you should see margin improvement in that OpEx line overtime.

Devin Patrick Ryan ***JMP Securities LLC, Research Division - MD and Senior Research Analyst***

Got it. Appreciate all that color. And then just a follow-up is the point in question, kind of bigger picture. In Asia, valuations have been pressured at least to some degree probably because of slowing growth, and I think that was also one of the factors that drove some of the volatility kind of in the U.S. or at least perceptions of slowing growth in the fourth quarter. So to the extent that we are later in the economic cycle, from a timing perspective, how are you guys balancing the opportunity to find kind of some more attractive long-term valuations today? I know you're quite excited about a number of things in Asia. But also balancing that versus kind of the potential risks that could come with slowdown in growth in the short term. And really just trying to think about, are you guys shifting kind of what you're looking at or what are some of the considerations? Because I think there's always some concern that a lot of capital is going to get deployed right at the kind of the end of an economic cycle.

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

Yes. Devin, it's Craig. Let me spend a minute, really, I think on the 2 things we'd highlight as it relates to levels of activity and then can just speak very briefly geographically, and this through a private equity lens. I think the -- when you look at our investment activity, you really see 2 things. And the first is you see us leaning into complexity. So we're focused on those opportunities where we can really bring our operational expertise to bear and either help reposition an investment or in some case, even restructure these investments. And so what are some of examples of these? Last quarter, we talked about the Unilever transaction. Carve outs are complicated and global carve outs may even be -- probably even more complicated. We have had a global team in that instance that evaluated this business. It operates in both developed and undeveloped markets. It's, again, just very complicated, there's a lot of complexity in terms of executing on an opportunity like that. Envision is an investment where we're going to be focused together with management on a series of operational improvement initiatives. And BMC, the mainframe industry, again, is certainly an industry with complexity. So complexity and operational improvements, that's the first thing. I think the second thing you see is really our activity in health care that we view as being a more defensive sector. So in the U.S. certainly it's an enormous market. Health care spending accounts were around 18% of U.S. GDP. It's growing, it's fragmented and we've been active. In private equity investment this quarter, again, would include Envision, if you think more broadly over the last 18 months or so, Internet Brands acquired -- acquisition of WebMD, we acquired Nature's Bounty. Air Medical acquired a company called American Medical Response. We formed a partnership with Walgreens to acquire PharMerica. There's a pending additional investment as PharMerica announced a transaction with BrightSpring. So again, I think all of that helps give you a sense of how busy our team's been. Activity's not limited to just private equity, so in our core strategy in 2018, we acquired a company called PetVet in Q1, Heartland Dental in Q2. It's also not limited to just the U.S. We have a pending investment in Genesis

Health Care, it's one of the largest providers of cancer and cardiac care in Australia and Europe, is, again, it's within a core. We've created a company called SinoCare in China. Again, I think you get a sense of the level of activity in that sector for us. So I think where we are, broadly, in going by geographies, in the Americas, I think the area of emphasis for us are going to be companies and sectors that are more defensive. Not every investment's going to fit this profile, but certainly accurate in terms of what you've seen from us broadly. Asia, you're right, 2018 was an active deployment year for us and our backlog here is actually pretty healthy. Our team in China's busy. We've been seeing more control-oriented investments, which is exciting for us. And we're also seeing a greater number of conglomerate and carve-out opportunities. So it feels like some companies have expanded into China, have found it's competitive, a unique environment and are now considering whether to rationalize and sell those businesses. So that's interesting for us. And in Europe, broadly, we're being disciplined given valuations, but we are seeing -- we're seeing dislocation in the U.K., most specifically. So hopefully that, again, gives you a sense of where we're active.

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

The only color I'd add, Devin, is that we have been investing for the last 3, 4 years. Assuming that the investments that we've been making, we will need to hold through some kind of an economic pullback. So if you look at how we've been pricing assets in the U.S., we're assuming that there's going to be some form of recession in our hold period, largely assuming we get out at a lower multiple than where we get in. So we've been kind of pricing in. And of the environment that's coming for a while, so to the extent we're closer to it, it's not really a new fact for us. We've kind of been assuming, given how long we hold assets, that we would have to ride through anyway. But at a really high level, I mean, we've got $58 billion of dry powder in terms of third party capital, we have a liquid balance sheet. We are getting our special situations and distress teams even more integrated alongside their private markets, colleagues, private equity, infrastructure, real estate, so everybody can work together and use the flexibility that we have in our vehicles. And all tools at our disposals to invest into dislocation and complexity where we find it. So we actually are quite upbeat in terms of the opportunity that can be coming our way. And to your point, Asia and Europe have already seen a lot of that repricing.

Operator

Our next question comes from Chris Harris with Wells Fargo.

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

So when I look at your investment performance information on Slide 4, there's a lot of good detail here but one of the things that really jumps out at us is the energy business being up 7%, while the S&P E&P index was down 28%. So can you guys elaborate and discuss a little bit about how you're able to achieve that level of outperformance in what was a really challenging year for that industry?

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

Chris, it's Craig. Within the energy income and growth strategy, the type of opportunities that have been most interesting to us are acquiring, for instance, non-core assets, so investments where you were in the midst of the decline curve in partnership obviously with the very strong management teams. And in those investments, we'll hedge out a very healthy percentage of your near term production. So over the first number of years, 2, 3 years of those investments, we'll have hedged out the vast majority of whether it's crude or natural gas production so that allows us to -- for the valuations we have to be a lot more insulated. So if you look at commodity prices in Q4, you're right, you saw a meaningful downdraft in crude prices, much less though as it relates to natural gas. We're pretty equally split between crude and natural gas production, but it's that hedging program and action that you see there that really was -- is a real contributor relative to something like the E&P index.

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

Okay, very good. And a quick follow-up for Bill. Hey Bill, how should we thinking about the tax rate for this year?

William J. Janetschek ***KKR & Co. Inc. - CFO***

That's a good question. And when you take a look in the fourth quarter, the percentage was 9%. Last quarter, it was 12%. And when we communicated to you all, when we made the conversion to C Corp, we said that our tax rate at that time was roughly about 7%. We were fortunate enough to have made an election where we've got a very big step-up in our assets and also we're able to amortize goodwill. And so that benefit we said would come to fruition over the next 5 years. So 5, 6 years out, our corporate rate will be 21% at the federal level. And it's really hard to predict what it's going to be year-to-year, never mind quarter-to-quarter. But the simple rule of thumb is you should assume that the tax rates going to escalate roughly 3% a quarter [sic: year]. The reason why it was down this quarter is that one of the assets that had gotten a very large step up when it was sold. The taxes paid on that were minimal, which actually drove the tax rate down. So the punchline is, for modeling purposes, you should probably use a tax rate of anywhere in between 11%, 12% for 2020 -- sorry, 2019. And as we mentioned, we'll keep you updated along the way to the extent that something changes.

Operator

Our next question comes from Michael Cyprys with Morgan Stanley.

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

So just hoping you could give us an update on the fundraising pipeline. I know you mentioned last quarter that you'd expect to have 6 funds in the market for 2019, I believe. Which funds are those that you expect to be in the market with for 2019? And any color on how we should think about sizing?

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

Mike, it's Craig. Let me just review the -- our current initiatives. So we're currently fundraising across European private equity, impact, energy, Europe credit as well as one of our growth strategies. In real estate, we're fundraising for an Asian equity strategy and a U.S. credit strategy, with fundraising for an additional 2 strategies expected to be launched in the coming weeks. At the same time, there are the areas where we look to raise capital on a more continuous basis that would include the CLO business. We actually priced our first CLO of the year roughly a week ago, leveraged credit platforms in the U.S. and Europe and the BDCs and the hedge fund partnerships. And then finally, just tying the fundraising to management fee growth. Again, as we mentioned, we have over $23 billion of capital in our AUM that will become fee-paying as that or the capitals invested or funds are turned on at a weighted average rate of just over 100 basis points. So I think you put that all together and our fundraising team is busy.

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

Great. And just as a follow-up question. Circling back to Asia, an area you guys are targeting for expansion and growth. If you could just kind of flesh out -- Hoping that you can flesh out a little bit more around how you're thinking about approaching the expansion of the business in Asia, which countries do you see the most growth in? And if you could just talk a little bit about how you're approaching distribution across those different countries understanding it could be a different?

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

Michael, it's Scott. So I'd say a couple of different aspects to the Asia story. First is, as we mentioned, the focus on building the non-private equity businesses and creating dedicated strategies for what has been some ongoing investment activity there already. So just give you a sense for the footprint, we have 8 offices in Asia. About 270 people on the ground today. And we have a very integrated platform and approach. So we have country teams throughout the region. And so what we're doing is building our non-private equity businesses in a very integrated way, alongside and with their private equity colleagues. And so what we're really focused on now is scaling and infrastructure, real estate and credit. And as you've seen, we've been making some hires in the region with a focus on those areas. And kind of the answer to the which parts of the region are most interesting kind of depends a little bit on which of the strategies that we're talking about. As we see more opportunities for credit in the kind of more Southeast Asia and Australia parts of the market, real estate, more opportunities perhaps in North Asia and infrastructure is kind of a mix. In terms of the overall private equity efforts in Asia, we continue to see a lot of opportunity for growth there too. In particular, recently, we've been busy in Japan where we're seeing significant opportunities to buy non-core subsidiaries. We think that wave is continuing and gaining pace. And we think there's even more for us to do in Japan on the private equity side and also in areas like real estate overtime. In terms of distribution of these new non-private equity strategies, it is not just an Asia distribution story. We're finding investors all around the world are under allocated to Asia. And so our distribution approach for all of our Asia strategy is a really global one. And in fact, there are not that many alternative providers in Asia. So when we're talking to them about things that we're doing, private equity, infrastructure, real estate, credit relative to what we see in terms of the competitive landscape in the U.S. and Europe, there's just fewer players. So we have a team on the ground raising money in Asia, of course, and they will focus on these products and others, but we're using the global team to distribute.

Operator

We have a follow-up question from Patrick Davitt with Autonomous Research.

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

It looks like the consensus realized carried expectations are still well above the current guided amount, and obviously, there will be more stuff announced and completed as we go along. Do you think that's achievable now that markets are back up and more open? And then in that vein, as we look into the second half, are there any restrictions on your selling the Fiserv shares once the FDC sale closes?

William J. Janetschek ***KKR & Co. Inc. - CFO***

Look, Patrick, we could only give you as much information as we know today. We're not going to project what the second half of the year looks like. Nevermind, even the second quarter. And so based upon the vision and the visibility we've got right now, we've communicated what we've got and signed and closed and what we've gotten signed and yet to close. So I wouldn't want to even comment on anything around what future expectations would be. But when you think about quite simply on the public securities that we have, when you take a look at private equity, roughly about 30% of the remaining value was in public security. So to the extent that there was a rebound in the public markets and those stock prices get to attractive enough levels where we've already previously exited, you would expect to see us continue to do that, again, if the market is there. And again, I said this earlier, the one good thing about our model is we get to time our exits. And so we will certainly time it appropriately.

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

And are there restrictions on the Fiserv shares once it closes?

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

Once the transaction closes, there is a 3-month lockup on the shares. But that's the only contractual restriction. But I'd say Patrick, we expect the transaction to close in the second half of this year, so we'll be talking about that over the long-term. But I wouldn't expect any activity this year.

Operator

We have another follow-up question from Robert Lee.

Robert Andrew Lee ***Keefe, Bruyette, & Woods, Inc., Research Division - MD and Analyst***

Great. Maybe guys, just going back to kind of the pipeline of potential management fees. Obviously, you have $23 billion of dry powder, call it $230 million potentially of incremental fees, which is almost 20% of what you've earned this year. But how about other pockets? Does that -- for example, you now have a pretty big BDC platform of -- I forgot the numbers, $14 billion, $15 billion or so, leverage rules changed on that effective shortly going forward. And any thought about how you kind of adopted some of the change of leverage rules there? What incremental management fees potential could be over the next several years from that just pocket of assets?

William J. Janetschek ***KKR & Co. Inc. - CFO***

Rob, this is Bill. There's nothing to call out specifically. What we did want to make clear, and Craig mentioned this earlier, is that we do have that $23 billion, and so that's going to turn on probably over the next 2, 3, 4 years. But remember, our business, if you follow the AUM growth over the past few years and the growth certainly more importantly, as it relates to management fees and the fee-paying AUM growth, as we continue to raise capital and bring that capital online, you should hopefully expect with the tailwinds we've got, with more capital coming into the alternative asset space, an increase in management fees.

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

Yes. And on the BDC platform, we'll let the management team for those entities speak for themselves on their call, Rob. But you're right, there is latent potential there, but we'll let them articulate their leverage strategy.

Operator

I'm showing no further questions at this time. I would now like to turn the call back to your speakers for any closing remarks.

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

Okay, great. Thank you, Sydney, and thank you, everybody for joining us. Please, of course, follow-up with anything as you reflect on the quarter. Thanks, again.

Operator

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

Editor

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