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KKR - Q1 2014 KKR & Co. L.P. Earnings Conference Call

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PRESENTATION

Operator

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

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

Thank you, Tanya. Welcome to our first quarter 2014 earnings call. Thank you for joining us. As usual I am joined by Bill Janetschek, our CFO, and Scott Nuttall, Global Head of Capital and Asset Management.

I would like to remind everyone to begin that we will refer to non-GAAP measures on the call, which are reconciled to GAAP figures in our press release. This 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.

On the call we will also be providing estimates on cash carry and its impact on future distributions. These estimates are based on March 31 valuations as well as unit counts prior to the KFN closing. And for anything about the KFN transaction, please do refer to the proxy statement and other SEC filings that both KFN and KKR have made because they contain important information about the transaction.

This morning we reported first quarter economic net income of $630 million, which equates to $0.82 of after tax economic net income per unit. Fee related earnings for the quarter were $152 million, which is highest we have ever reported as a public Company, representing approximately a 26% increase from last quarter and an increase of over 70% from the same time last year. This growth was driven by higher management fee revenue across the firm as well as strong transaction fees that were generated by our Capital Markets business. We continue to be active on the realization front so I would like to highlight some of our cash metrics.

Total distributable earnings were $447 million which is up over 50% from the first quarter of 2013. This growth was driven both by the jump in fee related earnings as well as $116 million of net realized cash carry in the first quarter which is more than double the $53 million we reported in the first quarter last year. And on the distribution we announced a distribution per unit of $0.43 for the quarter. If the KFN transaction closes before our record date, the distribution will not change and it will be paid out to all record holders.

Before I turn it over to Scott and Bill, as we have discussed for some time on point I would like to highlight. We have a unique business model. Alongside third party capital, we have the largest balance sheet among the alternative asset management firms, which we use to support our growth as well as to invest behind our ideas as well as a capital markets business that is unlike any other in the industry. And from a financial perspective you can perhaps best see how powerful our platform is through our cash flow focused metrics, total distributable earnings, which again were $447 million, as well as total distributable earnings per unit and our distribution per unit which were $0.64 and $0.43 respectively in the quarter. And finally we were pleased to have finalized our K-1 by the end of March thanks to the hard work of Bill and his team for the eighth consecutive year.

And with that, I will now it turn it over to Bill.

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

Thanks, Craig. We ended the first quarter with assets under management of $102 billion up 8% from last quarter and 30% from the same time last year. Distribution to our fund LPs offset investment appreciation and new capital raised which was true for both our Private and Public Markets segments. The majority of our AUM growth in the first quarter was due to the closing of the Avoca acquisition, which brought $8.4 billion of AUM online.

As of March 31, our fee paying assets under management were $84 billion also an increase of 8% from last quarter and 34% from last year. Similar to AUM the addition of Avoca drove the increase in our fee paying AUM. In the first quarter total fee revenue of $328 million was up almost 50% year-over-year and the majority of this increase was organic, with only $5 million of fee income coming from Avoca. Fee related earnings were a record $152 million up 25% from last quarter and over 70% from the first quarter 2013. The quarterly increase was driven by higher management and transaction fees across all of our segments. Total distributable earnings were $447 million in the first quarter, up over 50% from the $291 million we reported in the first quarter 2013.

Turning to our segment results, Private Markets. Our private equity portfolio appreciated 4.5% in the first quarter outperforming the MSCI World and S&P 500 which were up 1.4% and 1.8% respectively. This was less than the 8% appreciation we had in the fourth quarter in 2013 though. So despite higher fee revenue in the first quarter the $241 million of ENI was down from the $369 million we reported last quarter.

Moving to Public Markets. The ENI in this segment was $68 million down 7% from last quarter but up about 40% on a year-over-year basis. A few things contributed to the quarterly movement in ENI. We saw significant increase in management fees as we continue to scale fee paying AUM in this segment. However this was offset by a decrease in incentive fees as the fourth quarter is a more active incentive quarter for most of our public market accounts. That said, we did have $17 million of incentive fees in the first quarter $12 million of which came from KFN. Most importantly our private credit strategies continued to perform.

In the first quarter our direct lending mezzanine and special situations fund posted gross returns of 4%, 6% and 11% respectively. And as a result of this performance our Public Market segment has begun to contribute to cash carry. We reported $25 million of cash carry in the quarter and as of March 31 we have over $60 million of net unrealized carry on the balance sheet in this segment. We expect the potential for cash carry in Public Markets to increase as our carry eligible funds, which now stand at over $5 billion, continue to mature and perform.

Touching on capital markets and principle activities. Capital Markets fee income was up three-fold in the quarter versus last year. However our balance sheet was up 6% this quarter compared to 7% both last quarter and last year. Because of this decrease ENI was $321 million in the first quarter down slightly from last quarter and last year. The increase in the carrying value of our balance sheet assets resulted in a March 31 book value of $11.18 per unit, which is up 13% on a year-over-year basis and includes a 35% increase in unrealized carry bringing that total figure to about $1.3 billion.

As Craig mentioned earlier our distribution in the first quarter was $0.43 per unit, which is up about 60% from the same time last year. The $0.43 is comprised of $0.15 of fee related earnings,$0.17 of realized carry and $0.11 of realized balance sheet income.

Before I wrap up, we want to give you a preview of the second quarter distribution based upon where we are today. Since March 31, we have announced six realization events that we estimate will contribute approximately $0.40 to the second quarter distribution, which includes $0.34 of proceedings that are already in the bank and another $0.06 from Avincis which is expected to close later this quarter. [$0.25] (corrected by company after the call) of that $0.34 came from OB which closed in early April, and the balance will come from realizations at Capital Safety, Aricent, Pets at Home and the sale of Sunrise Senior Living, which is the first exit in our real estate fund. We expect to exit our Sunrise investment at over 5 times our invested capital and with a holding period of only 16 months. Additionally, this $0.40 does not include Ipreo or U.S. Foods two other pending sales that we expect to close later in 2014. Keep in mind these numbers reflect our current share count.

With that, I will pass it over to Scott.

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

Thanks, Bill. We have had a good start to the year. I am going to briefly hit on three items; monetization, the level of activity in Europe and KFN. Let's start with monetizations. We have been active on the private equity exit front, returning cash to our fund investors through the public markets, strategic sales and dividends. In Q1 we took Pets at Home and Santander public. We also did secondaries at Jazz, KION, ProSieben, NXP and Nielsen at a blended multiple of 2.4 times our cost.

In 2014 we continued to see a pick up in strategic exit activity. We recently agreed to sell two businesses Avincis, a European helicopter services firm, at 2.3 times cost and a Ipreo, a capital market services provider, at approximately 3 times cost. These combined with the strategic exist of Oriental Brewery, U.S. Foods and Sunrise Senior living will provide a strong pipeline of cash carry in the distributions over the next two quarters.

Year-to-date we have had over 12 realized or pending private equity monetization events out of 6 different funds across the U.S., Asia and Europe. Together these exits generated over $5 billion in actual and expected distributions to our fund investors so far this year. And we have had additional good news this morning as we agreed to sell Biomet. Biomet is a 2006 fund investment and we have an additional co-investment on our balance sheet. The implied transaction value would suggest around a 40% to 45% improvement in Biomet's valuation relative to where we held it as of March 31.

Now let me discuss Europe for a few minutes. We think it is a great time to be investing in Europe as the recovery continues. First in European private equity we have had strong results, with our portfolio up about 50% in 2012 and 25% in 2013 and off to a good start in 2014 outperforming the MSCI Europe by about 300 basis points in the first quarter. In the last several months we have taken Pet at Home, KION and Tarkett public and the value of our remaining stakes across these three companies is over $2 billion marked at approximately 2 times our cost.

Capital deployment has also been healthy. Europe accounted for over 30% of our equity invested in Q1, and we have begun fund-raising for our European private equity strategy. On the alternative credit side we also have been busy, deploying approximately $1 billion of capital in the first quarter across all of our accounts. And if you look an at special situations for example, over 40% of that capital was put to work in Europe. And finally we closed on the Avoca acquisition in February, which brings our European credit assets from $4 billion to $12 billion and expands our European credit footprint to be more consistent with the business that we have created in the U.S.

The last topic I want to spend time on is KFN. As we said in December, we expect that KFN's recurring balance sheet income will increase our distribution per unit over time and materially increase our recurring distribution per unit. Additionally, the KFN transaction will bring us more capital to grow our firm and more flexibility to pursue outside opportunities when we find something we like. The shareholder vote is next Wednesday, and we hope to close shortly thereafter.

In summary we are pleased with the quarter. Over the last year we have been talking about how our business model and approach are a bit different. We are focused on monetizing our investments and ideas by marring third party capital our balance sheet and our capital markets capabilities in a unique manner. As a result of this approach, we generate very attractive returns on equity; 26% in the last 12 months with no net leverage at our Company.

About a year ago we changed our distribution policy to make it clear that all of us as unit holders will participate in the outcomes we generated through a high and transparent payout ratio. Our perspective is the best way to judge our results is by looking at the cash flow we generate and the distributions we pay, and our view has been as carry kicked in and the balance sheet performed our cash flow and distribution had a lot of upside. A year later we are starting to see this come to our results. Our Q1 total distributable earnings are up over 50%, and our distribution is up 60%. And on a LTM basis our distribution is up 30% to $1.56.

In short, the model is starting to yield the results we envisioned and with the addition of KFN, Avoca and the increase in exit activity plus the evolution of our newer businesses from fund 1 to fund 2, we are optimistic about the future. Thanks for joining our call.

Operator, please open the line for any questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Our first question comes from Christian Bolu of Credit Suisse. Your line is open.

Christian Bolu - *Credit Suisse - Analyst*

Good morning and thanks for taking my questions. Your (inaudible) strategy continues to payoff very nicely, returns at almost $193 million of cash carry. I would just be curious on some more color around exactly what you sold or just more color in terms of understanding what drove that.

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

Chris, this is Bill Janetschek. As it relates to the balance sheet earnings, we had had several co-invest position like Nielsen and KION that were sold through secondary offerings that participate along side our funds. So for the most part a lot of the realized gains in the first quarter off our balance sheet come from those co-invest positions.

Christian Bolu - *Credit Suisse - Analyst*

Okay. Any thoughts on trajectory going forward ?

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

It is really hard to predict what the earnings and cash earnings more importantly are going to be off the balance sheet. We did give you some color as to what we expect in the second quarter. I will tell you that of that $0.40 I gave you the predominate amount of that is coming from cash carry and not so much cash earnings off the balance sheet because of those secondaries or exits that I mentioned we don't have significant co-invest off the balance sheet. But again it is really hard to predict what that number will be next quarter or for the remainder of the year.

Christian Bolu - *Credit Suisse - Analyst*

Okay. Thanks. In terms of your retail strategy you closed down two retail funds a couple of months ago, just to push a bit more color on position to close those funds and then more broadly get your updated thoughts on go forward strategy with regards to retail.

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

Sure. Christian, it is Scott here. What I would do is bring you to our strategy in terms of distributing our products to individuals broadly. And if you look last year we raised about $21 billion in aggregate about 23% of that, about $4.7 billion, actually was distributed to individuals across a number of different strategies. If you look at thus far this year, it has been about a third on the capital raised was actually raised from individuals and that is across a number of different approaches. We have a direct high net worth effort, we have a relationship with a number of platforms through whom we distribute our product. We also have our BDC, which is Corporate Capital Trust that raises money from individuals. So just to give you a sense of the $4.7 billion we raised last year those two funds that got a little attention were about $33 million. So it continues to be a significant component of our strategy to continue to reach out to individuals, but I wouldn't get too distracted by those two funds. We have several other vehicles. I think we raised capital through 15 or 16 vehicles last year across most of the major strategies we raised capital for. So it continues to be an area of focus. I will tell you that $4.7 billion we raised last year from individuals is up from virtually nothing three to five years ago.

Christian Bolu - *Credit Suisse - Analyst*

Interesting. Thanks for the color on that, and the congrats on the very strong quarter.

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

Thanks very much.

Operator

Our next question comes from Matt Kelley of Morgan Stanley. Mr. Kelley, your line is open.

Matt Kelley - *Morgan Stanley - Analyst*

Thanks. Good morning, guys. I am hoping you can help me with understanding, Scott, you mentioned the second generation fund, so just curious if we go down the list of real assets and even some of your Public Market vehicles where you are more in the market consistently. Where are you seeing strong enough opportunity to invest that you think you may be back in the market relatively soon whether it be real estate or some of the other strategies.

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

Sure. Matt, I would point you to a few different areas. One are situations where we are nearly out of capital today. And somewhere in the press release we have our commitment schedule which gives you a sense of how much is committed versus invested. But if you look there, what it will tell you is we are obviously in the market with our European 4 Fund on the private equity side, but infrastructure too is a vehicle we are actively out working to raise. Direct lending too is also a vehicle that we are actively fund-raising form and then private capital more broadly. Our mezzanine fund is nearly fully invested. So those three would be more in the very near term or right now. And then you have other strategies like special situations where we recently raised capital, but frankly that monies getting to work quite quickly. So we continue to see opportunities perhaps over time to get to a successor fund perhaps faster than we had initially anticipated. So a variety of different strategies both on the Public and the Private Market side. It really spans real estate which is relatively younger, but at the pace we are going right now it will get to work quite quickly. Real assets and credit I think there is a lot of different areas.

Matt Kelley - *Morgan Stanley - Analyst*

Okay. Following up on that. So within credit with the Avoca transaction closing anything you are not doing in Europe and Avoca is not doing either that you think this will help you from a distribution or getting into that market whether it be NPLs or anything else over in Europe that we should be thinking about ?

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

No. Look the integration of Avoca is proceeding quite nicely and the teams are working very well together. And as you know what we had in Europe before Avoca was largely on the private side, private capital side. We had special situations, mezzanine and Avoca as you know is largely more in the liquid credit side interesting transaction. So we have capabilities to do rescue capital, we have capabilities to do NPL, we can obviously do loan to own working across our private equity and Capstone teams. So we have significant capabilities there. The way I would think about Avoca is it brings us team that has covered about 1,300 credits across Europe for a long period of time, and the two teams working together is pretty powerful. So that has been proving out quite nicely in the early days. There is not a lot we are not capable of given the opportunity set that we see today in Europe. One thing we are spending time on is European direct lending, which as you know our business in direct lending really started in the U.S.. We do see an opportunity in Europe for direct lending. So that would be one strategy I think now with the combined capabilities is something we are likely to prioritize in the near term.

Matt Kelley - *Morgan Stanley - Analyst*

Okay, great. And last one from me and I will jump back in. On the real estate front you mentioned significant opportunity to invest and it may not be that long till you are back in the market. I am curious if there is plan or thought behind doing real estate debt separating equity and debt in to different funds or doing more any debt in real estate going forward ?

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

I would say no immediate plans. We are focused on getting fund 1 invested. We had a nice recent exit there in getting that portfolio to perform, so no immediate plans but we will keep you up to date.

Matt Kelley - *Morgan Stanley - Analyst*

Great. Thanks, guys.

Operator

Our next question comes from Chris Kotowski of Oppenheimer. Chris, your line is open.

Chris Kotowski - *Oppenheimer & Co. - Analyst*

Good morning. A couple of things, one is the realized cash carry on the private equity side was also larger than what we would have thought looking at the publicly announced transactions. Was there something else that either dividend recap or something like that, that our searches wouldn't have turned up ?

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

Chris, this is Bill. To give you a little more color on this when you think about cash carry during the first quarter it was quite active. You probably knew about Santander and that going public and us participating in the secondary. We did announce secondaries in Nielsen and NXP and ProSieben and Jazz as well as KION, and lastly we did do a small dividend recap in Academy in the first quarter which added about a penny or two. The one thing that you did not probably (inaudible) is again when I mentioned earlier in prepared remarks on the public market side with that $25 million of cash carry that actually equated to another $0.02 in cash carry in the first quarter.

Chris Kotowski - *Oppenheimer & Co. - Analyst*

Okay. Next I wonder if you can comment on the indicated value of the Biomet transaction how does that compare with the March 31 marks?

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

Just to give you a high level, Scott had mentioned earlier in his prepared remarks, based on where we are carrying it as of March 31 and what the announced price is that is about a 40% uplift. And when you think about it, we really have Biomet in two places, one is through our fund and to give you a little color that number is about $1.1 billion of capital in our (inaudible) fund. Plus you might remember we have about $150 million on our balance sheet. So those two will probably equate to an increase in ENI based on the announced price of June 30 of approximately $100 million.

Chris Kotowski - *Oppenheimer & Co. - Analyst*

Okay, that is very helpful. Thank you. Next you mentioned you had realizations out of the real estate fund already. Is that something you can or are inclined to recycle or would you rather just distribute the funds and raise a new one?

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

That is a very good question, Chris. And in real estate fund we can have our cake and eat it too, because we will actually have that realization, we will pay that our to investors, but because it is in the recycling period because that investment is less than 18 months we get to redeploy that capital again.

Chris Kotowski - *Oppenheimer & Co. - Analyst*

Okay. Lastly for me it looked like you had tremendous appreciation in Europe 3 this quarter that really seems to be the biggest driver of the appreciation, and that had been a fund obviously that had struggled through the aftermath of the financial crisis. And I am wondering does that appreciation now give you -- have you sized what your goal for fund 4 I guess is my question? I would have been tough fund raising up until recently, but it looks like it is doing pretty well now.

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

As it relates to the appreciations during the quarter E3 performed quite well, so we mentioned that in private equity the portfolio is about 4.5%, in E3 that portfolio was actually up about 8%. And when you think about it from where it is from cost to where we are caring it at right now, that fund is at 1.4 times cost. And remember it is a fund that has only been in existence for five years, so you really have not seen the maturity or the write up in that particular portfolio. As it relates to your second question on fund-raising, Scott mentioned earlier that we were just starting to market E4 and we would rather not comment on size at this time.

Chris Kotowski - *Oppenheimer & Co. - Analyst*

Okay. Fair enough. Thank you.

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

Thank you.

Operator

Our next question comes from Michael Kim of Sandler O'Neil. Michael, your line is open.

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

Good morning. First wanted to follow up on the outlook for realizations, curious if you are starting to see any evidence of a decoupling between the public opportunities versus strategic sales just given broader market trends and the strength of corporate balance sheets, so maybe entering a period of when more of our exists are coming from M&A and less from IPOs and secondary offerings. And if that does in fact to turn out to be the case, could that potentially drive a quicker step up in carry as you are not selling down stakes and portfolio companies over the course of quarters or years?

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

Michael, it is Scott. I think it is a great question. It is hard to predict, but I think you will continue to see a mix. If you look going back to 2012 through today, about 60% of the exists have been through the Public Markets and about 30% strategic and about 10% or 12% somewhere in there in dividend recaps and other, just to give you a sense of where we have been. If anything I would say that given the M&A market has pick up more recently that 60% in public side is probably a bit more than we would normally expect. So recently as we said OB, Avincis this morning with Biomet we are seeing more strategic activity. We sold Ipreo outright, it wasn't to a strategic but it was a sale of the Company. I think it is hard to be too precise but I would expect that you are going to continue to see a mix of strategics and secondaries going forward. And as we have discussed in the past, the strategic exits tends to be a bit more efficient and more of the carry shows up all at once or in a shorter period of time. I will say parenthetically that at least from what we are seeing color in the market would tell us there is more strategic dialog going on and there does seem to be strategic interest in our Companies which we have been talking about for the last couple of years and it is starting to come through.

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

Okay, that is helpful. And then maybe switching gears to fund -raising. It seems like the breadth of products you are currently marketing you mentioned E4, infrastructure, direct lending it just seems pretty diverse though. Wondering what the implications are for the pace and maybe more importantly the consistency of your capital formation going forward?

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

Sure. If you look at what is on tap, as I mention on the episodic side, fund-raising side, there is E4 (inaudible) direct lending two, private capital maybe European direct lending and don't forget we have the continuance strategies that we raise money for hedge funds both Prisma direct, credit , high yields, loans, CCT, Avoca has a number of strategies that raise capital continuously so you will see those vehicle continue to raise capital. I would say it is going to be a bit of a different year this year on the capital raising front. Last year we had some of the lumpy big funds with Asia 2 and NAXI. This year we have E4 but everything else is kind of successor funds that are not likely to be the size of those two. So we would expect to continue to see good growth in our fee paying assets subject to a couple of things.

One, I would tell you that as we have discussed in the past, AUM we think is a bit of a dangerous metric on its own and quarterly AUM I would tell you we think is a very dangerous metric. So we tend to look over trailing 12 and 24 month period, and fee paying assets were up about 35% in the last 12 months. This year I think it is more likely to be more fund 2 coming online. But also a couple of things, one, we have about $4 billion of shadow AUM that we do not talk about that much. This is AUM that is committed, that will turn on when the capital is invested which will start to show up over the coming quarters. I would also point you to if you are thinking about where we are heading obviously with KFN hopefully the transaction gets approved next week that will actually reduce our fee paying assets but as we discussed in December materially increase our cash flow and our recurring distribution. So that is something else for you to have in our thought process. But overall I think probably the most important thing to remember is our AUM ignores our balance sheet and our capital markets business, which were over half of our earnings in Q1 and in the LTM period. So it is an interesting metric, but for us it is an interesting metric that has implementation on about half of how we make money.

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

Got it. And then finally to follow up on KFN, just be curious to get your current thoughts on how you are thinking about reinvestment opportunities as the KFN CLOs wind down and what ROE expectations are you targeting both in the near term and over time as the underlying mix of the investments on the balance sheet continues to evolve.

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

I would say there is no real change on that from last quarter, Michael. Our perspective is that we view that we are going to run the balance sheet as a holistic balance sheet. And you know the ROEs we have been able to generate on the balance sheet the last couple of years which are materially higher than what KFN has been generating on its own. So we continue to see opportunities across all of our businesses and strategies and perhaps in future quarters we can dig into that a bit more.

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

Fair enough. Thanks for taking my questions.

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

Thank you.

Operator

Our next question comes from Devin Ryan of JMP Securities. Your line is open.

Devin Ryan - *JMP Securities - Analyst*

Thanks. My question has already been asked. I appreciate it.

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

Thanks, Devin.

Operator

Our next question comes from Patrick Davitt of Autonomous. Your line is open.

Patrick Davitt - *Autonomous Research LLP - Analyst*

Hello. Good morning.

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

Hi, Patrick.

Patrick Davitt - *Autonomous Research LLP - Analyst*

How are you all doing. Could you give us an update on performance at Prisma and maybe break out the organic growth and how that has been tracking?

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

Sure. It is Scott. Performance has been good. We had a strong year last year. And I would say it is inline with or ahead of our expectations frankly. AUM today is probably $10.5 billion give or take up from $7 billion or $8 billion when we closed the deal. So the performance has been strong both from the stand point of the underlying investment performance. The financial performance has been very strong. We had a good incentive year last year and AUM is on or ahead of our expectations, soso far so good. There has been a bit of choppiness in the markets as of late, which is going to bring down performance a little bit on the year-to-date but tends to create investing opportunities as well. So far continues to be ahead of our expectations overall.

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

And, Patrick, this is Bill, just to give you a little color on performance. Remember the S&P was only up 1.8%, and Prisma actually outperformed their benchmarks by a pretty nice delta. Also as it relates to first quarter when we are talking about the capital raised $700 million of the capital that was raised this quarter actually came from Prisma.

Patrick Davitt - *Autonomous Research LLP - Analyst*

Were there any meaningful redemption?

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

Less than the capital that was raised (inaudible) point. Total capital raised as I said was $700 million, the redemption were about $350 million. But net AUM grows because of performance and new net capital raise.

Patrick Davitt - *Autonomous Research LLP - Analyst*

Okay, great. And then Finally a broader question on Asia and China given your success there over a long period of time and a lot of dry powder obviously. I'm just curious as discussion has been percolating around a credit event there or more distress there if you are seeing any opportunities starting to emerge from that kind of chatter and discussion?

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

Patrick, it is Scott. Absolutely. I think the volatility creates good investment opportunity for us and good entry points. A recent example is we announced we were buying a stake in a company called Haier which is white goods manufacturer company in China. I think the EBITDA multiple is three or four times EBITDA or something like that. It is a creating market and dislocation and opportunities for us. So we are investing in that dislocation and noise. And I would say overall the emerging market pull back both Asia also Latin America is creating some opportunities for us, and the good news is as we said, we have capital at the ready. So it was good timing on the Asia fund-raise and now we are excited to put it to work.

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

A little more color on Asia just as far capital deployment. Of the $4 plus billion that Scott had mentioned that we have either invested in the first quarter or plan to invest in the second quarter about $1.3 billion or about 35% of that is being deployed in Asia, so we are quite excited about the opportunities there.

Patrick Davitt - *Autonomous Research LLP - Analyst*

Okay. Thanks a lot.

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

Thank you.

Operator

Our next question comes from Brian Bedell of Deutsche Bank. Your line is open.

Brian Bedell - *Deutsche Bank - Analyst*

Thanks. Thanks for taking my questions most of them have been asked and answered, but maybe an extension of Matt's question on Europe with Avoca closed. Maybe looking at longer term, Scott, if you could comment what your ambitions are to further leverage your credit capabilities there. I guess what I am getting at is really to scale them up and maybe if you could give some color on the European marketplace and the opportunities that you think will be presented over the next one to two maybe even three years and whether there is interest or appetite to further acquisitions to scale up that opportunity.

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

Thanks, Brian. One, I think in terms of let's talk about what the business looks like today. So in aggregate we manage about $30 billion in our credit business as I said $12 billion of that is now in Europe. I think we expect that number will continue to scale as we combine the private credit capabilities and the liquid credit capabilities that I referenced earlier. And in terms of the nature of the opportunity set I would say it is very broad based. It is everything from the liquid side where we are starting to see activity again in the European CLO markets where Avoca has been a meaningful player in the European CLO market starting to come back much like the U.S. market did coming out of our crisis here, so there is opportunities to continue to print CLOs. It is an interesting potential investment for our balance sheet and also fee generating opportunity, but there is also opportunities for the leverage loan separate account type vehicles which continue to garner quite a bit of interest from investors looking to play the European recovery.

Perhaps most exciting as we sit here today is the opportunity we see on the private credit side in Europe and that is a very broad based. It is everything from direct lending which I referenced earlier, for companies that bank with European banks are internally focused and they don't have access to funding anymore so we are able to, much like we did in the U.S., provide them with senior secured loans through the mezzanine part of the capital structure. The high yield market in Europe is not as well developed so it provides opportunities for us in our mezzanine business and most of our mezzanine fund has actually been put to work in Europe, so we expect that that will continue to be an interesting important area for us.

And then our special situations group is very active in Europe as well. And it is everything from buying loans off of bank balance sheets to doing rescue finance. It largely has been the latter of those. It largely has been frankly companies that need help where their traditional funding sources are no longer willing to help them that has created the opportunity for us. So I would say you add all that up you are talking about a market opportunity and a supply and demand imbalance that is huge compared to the capital that we manage. So that gets us pretty excited about our ability to scale that $12 billion in that European credit business meaningfully over the course of the next several years as we invest in to that dislocation. It is hard to size that but we are pretty enthused about it. The question on acquisition I think the short answer is yes, we have considered making other acquisitions in European credit. There has to be a good cultural fit and it has to add to what our team already brings. As I mentioned before, we think we have it pretty well covered now pro forma, but if there is something that fits well, we definitely take a look.

Brian Bedell - *Deutsche Bank - Analyst*

That is great. Thanks for that color. Maybe one last one on capital markets, the activity was good this quarter maybe just your outlook for the balance of the year. Certainly good year-on-year performance in cap markets and maybe comments on seasonality versus your expectations for the balance of the year.

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

This is Bill. It is really hard to predict what the rest of the year looks like, but I can certainly comment on the quarter. We had a pretty robust number, and quite interestingly 45% of the revenue came from non U.S. activity so that is either in Europe or in Asia. And about 25% came from our third party business which we only launched a couple of years ago. Activity was quite robust. We actually transacted with over 40 portfolio companies either third party or KKR existing during the quarter. So we are optimistic now that business has been online for five or six years that we continue to just build traction.

Brian Bedell - *Deutsche Bank - Analyst*

Great. Thanks so much for taking my questions.

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

Thank you.

Operator

Our next question comes from Bill Katz of Citigroup. Your line is open.

Bill Katz - *Citigroup - Analyst*

Okay. Thanks very much for taking them. First question maybe for Bill, I am just really curious -- thanks for all the updates into the second quarter. When you step beyond that and maybe pro forma the news what you have already sold, can you give us an update on percentage of the portfolio of carry that are now cash eligible if you will and what percentage of the portfolio companies are publicly traded?

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

Sure, Bill. As it relates to when you take a look at the funds we actually manage right now roughly 20% of those investments are in public security. And I'm sorry, what was the second question?

Bill Katz - *Citigroup - Analyst*

What percentage of eligible carry (inaudible).

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

I am happy to report that when you take a look at our mature funds every single mature fund is in position to pay cash carry. There are a couple of immature funds, so when you look at the total of about $38 billion two immature funds both China (inaudible) and Asia II which just came online obviously are not in a position to pay cash carry. So roughly about 95% of our funds to the extent we have a realization would be in position to pay cash carry.

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

Bill , it is Scott. One other interesting metric if you look at the unrealized value in our private equity portfolio it is about $38 billion about half of that is 2009 and prior. So as you think about a meaningful amount of the portfolio, nearly $20 billion is in the more mature stage of its lifecycle.

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

And away from the funds that we manage because I'm sure you will ask a follow up question so I will try to beat you to the punch . As it relates to our balance sheet roughly about 30% of that portfolio is in public liquid securities.

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

And the final thought on that , Bill, is when you think of whether it is Walgreen's or the U.S. Foods transaction or certainly the stock component from Biomet those would all not be included as it relates to those percentage public statistics.

Bill Katz - *Citigroup - Analyst*

That is helpful. And then coming back, I apologize this is a (inaudible) question. But in the quarter on the (inaudible) earnings side you did benefit pretty nicely from a step up of net monitoring and transaction fees, is the moral of the call here that with just a pick up in activity levels that may be a better run rate all us being equal or anyway to think through what a more normalized level might be?

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

Bill, that is going to be hard to predict. You are right the transaction activity was robust in this quarter, and you can see that the transaction fees both on the Private Market side and just as importantly on the capital market side were robust. You did see a little pick up in monitoring fees and there I can give you a little color. We actually when we took Pets public received a termination payment of roughly $8 million so that is a one time number. So what you should think about as far as monitoring fees for your modeling is roughly in the $30 million range each quarter.

Bill Katz - *Citigroup - Analyst*

Okay. That's helpful. Finally one certainly sounds like a lot of things are going well in a lot of different parts of the business. Scott, maybe for you maybe an update in terms of LP penetration in terms of what you are seeing in terms of new growth versus existing LP.

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

Yes. I would say we continue to make progress. I think we are at 735 investors now up from 275 or so when we really began our focus on investing and building out our distribution team. Cross sells at about 1.6. As we have talked about in the past, there is a little bit of tension obviously when you add a new investor you add usually one product but it stayed steady at 1.6 despite the growth in the number of investors that we have. I would say the interest has been quite broad based. One of the things we look at is if you look at the percentage of the capital we raise that comes from new investors versus those that have been with us for a long time, for example the EIGF fund that we just closed 52% by number of investors are new and it was 37% of the capital we raise. So we continue to see those types of statistics in these newer vehicles and the interest is broad based. I commented before on the individual investor market but we are also seeing expansion in terms of what we are doing with pension plans, Sovereign Wealth Funds, insurance companies and foundations. So it is global and it is across multiple different types of investors.

Bill Katz - *Citigroup - Analyst*

If I could just ask one more. Thanks for taking all my questions. I think there was an article on Bloomberg citing some unnamed sources that regulators might be looking in to some of the economics on the private equity side specifically around some of the ancillary revenues and pricing dynamics. Has there been any change in tone coming out of regulators coming in terms of looking at the business or is that story a little off base?

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

There is nothing that we are aware of that we would point you to as changing our view of the business or the outlook.

Bill Katz - *Citigroup - Analyst*

Thanks for taking my questions.

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

Thank you.

Operator

Our next question comes from Robert Lee of KBW. Your line is open.

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

Thanks. Good morning guys.

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

Good morning.

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

Just curious to know if the last couple of years and putting aside the KFN transaction whether it was in Prisma, Avoca, the investment in Nephila, certainly your willingness and ability , willingness maybe to look outside for inorganic opportunities to expand and grow the business has picked up, so as we look forward what are you thinking particularly as you bring on the assets from KFN (inaudible) more flexibility about where you see or have the opportunity or desire to deploy that in an organic with way and accelerate growth?

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

Sure. Robert, it is Scott. We do have a focused effort around identifying corporate development opportunities for the firm. It is primarily focused in a few areas. First I would say hedge funds. You mentioned Nephila where we bought a 25% stake. We now have a dedicated effort looking at stakes and potential feeding opportunities for hedge funds and we have created one unified hedge fund platform with the Prisma team to make sure you we have the diligence in place and brains behind the hedge fund business working all together. That is a specific area, those are opportunities we are not focused on raising a fund. That is something that we would do with a balance sheet. It is more of a strategic effort.

The next major effort I would say think of it as a globalizing some of the newer business we built. So as you look at real estate or energy or credit obviously we did the Avoca deal, but looking at opportunities U.S., Europe, Asia, Latin America to expand those businesses globally. That is another area we are focused on. It is not so much adding new legs to the stool as expanding the legs we started and continuing to scale the businesses that we have begun in the last few years. Very hard to predict what is going to get done if anything. But we are focused on it. And we found that although it is a bit of a needle in the hey stack effort over the last couple of years we found some very interesting opportunities and I would anticipate we would continue to do so although the precise areas is going to be a little bit hard to predict.

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

Great, thanks. This is a follow up to Bill's questions it was a few weeks ago that article talked about the FCC looking at so called hidden fees that they claim some firms are charging portfolio companies undisclosed LPs. How should we think about that in context of KKR or your thoughts on that?

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

Scott mentioned this earlier we really haven't heard much about this. Other than what I do want to comment on is I have read some of the articles and it is talking about fees charged to portfolio companies and when you think about it especially in private equity space especially as it relates to KKR we have a fee sharing agreement with are LP where they get 80% of the economics and we get 20%. At the end of the day it is for the most part very interesting but really not applicable.

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

Rob, this is Craig. The other thing on that just to bear in mind we have been registered as investment advisor now for several years, and our legal and compliance area also has probably been a growth area within the firm. So as you think about those factors I think those are other things to also bear in mind.

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

Thanks. One last question. Thinking about the hedge fund platform just curious you started the long short equity effort a couple years a ago (inaudible) curious where that is at the this point in terms of fund-raising. or ability to fund raise.

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

Sure. I would point to more broadly, we have three more direct hedge fund efforts inside the firm long. So you have the long short equity which you referenced Robert but we also have two credit vehicles. We have a credit long short vehicle that is more global and with Avoca they have nice credit long short business in Europe that is focused on investing in that part of the world. All three of those efforts continue to scale. I would say our long short equity effort as I mentioned last year we had pulled back on the fund-raising side we were up 18% gross last year in that business the performance has been good, manage a bit over $500 million of capital there and the two credit vehicles are also beginning to scale nicely. We will give other updates over time. You can see in our disclosure on our balance sheet that the money we invested from the balance sheet is up quite a bit since we invested it.

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

Great. That was it. Thanks for taking my questions.

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

Thank you.

Operator

And our next question comes from Mike Carrier of Bank of America. Your line is open.

Michael Carrier - *BofA Merrill Lynch - Analyst*

Thanks guys. Bill, on the distribution outlook I think you mentioned $0.40. I just want to make sure you are just talking about the cash carry into the balance sheet not looking at the fee earnings and I think you mentioned two exists Ipreo and U.S. Foods that you didn't include and given the timing of those any indication of whether it is in the back half of the year what that can contribute.

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

Sure. I'm glad you brought this up. Just to be clear the $0.40 that I was referencing is cash carry or realized balance sheet income with the majority of that coming from cash carry. It does not include any fee related earnings, and if you take a look at what fee related earnings are over the last five or six quarters that number has not been below $0.10 a quarter. So if you added that to the $0.40, we would be looking at for the second quarter a $0.50 number. As it relates to Ipreo that transaction which isn't in that $0.40 we expect to close in the third quarter and we are cautiously optimistic on U.S. Foods that that would close probably in the fourth quarter could be in the third quarter but more likely than not in the fourth quarter. And

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last but not least with Biomet which we just announced this morning we are not actually going to see that hit in 2014 and we expect that to come through in the first quarter 2015.

Michael Carrier - *BofA Merrill Lynch - Analyst*

That is helpful. And then last you gave a lot of color on the portfolio the percentage of funds that are in carry so you are well positioned there and also the percent that is public so it seems like from an exit stand point in distributions things are relatively well positioned. I think on the fund raising side and, Scott, you hit on this with the bigger funds that are out there, but I think lot of the smaller opportunities that can obviously add up to something significant over time. When you are thinking over the next 12 to 24 months despite a pretty good exit back drop are you still looking at whether it is organic or inorganic and still being able to on a net basis grow your assets over time? I understand the quarterly variability's and that kind of stuff.

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

I guess it is a little bit hard to predict, Mike. It is a little bit good news bad news, right. When we sell something and generate a big carry payout our AUM goes down by virtue of the invested capital behind that investment, so that is just something to keep an eye on. I mentioned KFN that is going to reduce our fee paying AUM, but meaningful increase our cash flow and our recurring distribution which we said in December that would be up 28% a unit pro forma for KFN that is good news but fee paying AUM would be down. I really do think for us AUM is a pretty dangerous metric to get too fixated on. You can't eat AUM. . You can spend cash flow, you can spend dividend per share and that is what we are focusing on generating. So we are not going to predict outcomes, but as I mentioned we have a lot of different funds in the market. We do have a (inaudible) 50% or so increase in our fees year-over-year, so we continue to see these newer businesses scale and new funds come online. But what I would focus you on more is our distributable earnings and our distribution, and AUM we may choose to strategically bring down if things like KFN come up where we can make more money for all of us as shareholders per share by doing it, but we are not going to predict there but we will keep you up dated on the individual fund-raises along the way.

Michael Carrier - *BofA Merrill Lynch - Analyst*

Okay. That is helpful color. Thanks a lot guys.

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

Thank you.

Operator

Our next question comes from Luke Montgomery of Sanford Bernstein. Your line is open.

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

Thanks. So the big picture on European credit was helpful but maybe a stab at some specifics. On the Italian non performing loan deal with Intesa and UniCredit are you able to maybe help us size a potential for that transaction? I guess it is $2 billion in loans from those two banks but could this special purpose vehicle be expanded to include loans from other banks? And then will you initially be funding that with your own balance sheet over the client AUM or will the vehicle issues CLO through Avoca and if so approximately what kind of yields, funding costs and spreads could we be talking about there?

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

That is a lot of specificity. I would say the Italian MPL deal which was briefly mentioned in the press the other day not going to be able to give you a lot of color on that, those conversations are ongoing. Whatever we do in European credit will be a combination of our balance sheet and third party capital, so it could be funds and balance sheet. And depending on how much of the assets we like it could be a very significant opportunity for the firm over time. But it is too early to be able to say. Obviously we as I mentioned we are excited about what is going on in European credit and have lot of resources focused and dedicated there and trying to bringing as much creativity to it as we can. Sorry not able to give you more specificity but that is about all we can say at this point.

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

Okay. Fair enough. Then just on the tax over haul in front of Congress right, its author David Camp announced he is going to retire. I don't think that was a surprise, but even though I think he would like to make this his swan song it sounds like he probably lacks support from his own party and he has less than nine months to get it done before he leaves. So I am just curious how you are feeling about the threat of tax changes near term, and then if you share the longer term view that momentum is slowly building toward a tax change for how the BTPs are taxed ?

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

On the former I agree with your comment so the probability of anything probably going through short term is probably not there. Long-term it is hard to predict. We have all talked about the taxation of carry interest since we have been public. It continues to come up. Down in Washington episodically and I hate to put it back to you but your guess is as good as mine.

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

All right. Thanks a lot. I appreciate it.

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

Thank you.

Operator

And our last question comes from Matt Kelley of Morgan Stanley. Matt, your line is open.

Matt Kelley - *Morgan Stanley - Analyst*

Hate to be a buzz kill, but my question was already answered when guys said the portion of the portfolio that was public was not pro forma for the recent exit. So thanks for taking another question though.

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

Thanks, Matt.

Operator

I'm showing no further questions at this time.

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

Okay, great. Thank you everybody for joining us . Look forward to chatting with you next quarter. If you have any follow ups in advance, please feel free to give either me a call or Sara.

Operator

Ladies and gentlemen, this concludes your conference. Thank you for participation and have a wonderful day.

Editor

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