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Q2 2019 KKR & Co Inc Earnings Call

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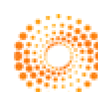

CORPORATE PARTICIPANTS

Craig Larson *KKR & Co. Inc. - MD of IR*
Scott C. Nuttall *KKR & Co. Inc. - Co-President, Co-COO & Director*
William J. Janetschek *KKR & Co. Inc. - CFO*

CONFERENCE CALL PARTICIPANTS

Alexander Blostein *Goldman Sachs Group Inc., Research Division - Lead Capital Markets Analyst*
Christoph M. Kotowski *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*
Christopher Meo Harris *Wells Fargo Securities, LLC, Research Division - Director and Senior Equity Research Analyst*
Craig William Siegenthaler *Crédit Suisse AG, Research Division - MD*
Devin Patrick Ryan *JMP Securities LLC, Research Division - MD and Senior Research Analyst*
Gerald Edward O'Hara *Jefferies LLC, Research Division - Equity Analyst*
Glenn Paul Schorr *Evercore ISI Institutional Equities, Research Division - Senior MD & Senior Research Analyst*
Michael J. Cyprys *Morgan Stanley, Research Division - Executive Director and Senior Research Analyst*
Michael Roger Carrier *BofA Merrill Lynch, Research Division - Director*
Patrick Davitt *Autonomous Research LLP - Partner, United States Asset Managers*
Robert Andrew Lee *Keefe, Bruyette, & Woods, Inc., Research Division - MD and Analyst*
William R. Katz *Citigroup Inc, Research Division - MD*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to KKR's Second Quarter 2019 Earnings Conference Call. (Operator Instructions) This call is being recorded. I would now hand the call over to Craig Larson, Head of Investor Relations for KKR. Craig, please go ahead.

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

Thanks, Michelle. Welcome to our second quarter 2019 earnings call. Thanks for joining us. As usual, I'm joined by Bill Janetschek, our 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. This call will 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. And I'm going to begin by referencing Pages 2 and 3 of the deck.

So Page 2 shows a summary of our 4Q metrics. The strength of our underlying fundamentals are evident in the trends that you see on the page. Perhaps most importantly, the earnings power of the firm continues to grow nicely as can be seen by the charts on the left-hand side. Our AUM is now at $206 billion and book value per share is $17.81.

Spending a minute on book value, we've seen attractive returns really across asset classes in this performance, combined with the power of compounding has driven the 14% year-over-year increase in our book value per share. This 14% figure compares favorably to broad market indices like the MSCI World, which is up 7% over this timeframe. As well as fixed income indices like the LSTA, that's up about 4% over the last 12 months.

Highlighting the strong performance we've seen, unrealized carried interest, one of the key components of our book, is up 21% since last quarter and has increased 45% since the beginning of the year.

Looking at the right-hand side of the page, alongside of this, management fees have grown steadily and distributable earnings on an LTM basis have increased 12%

Turning to Page 3, you'll see some additional details. We reported after tax distributable earnings of $327 million for the quarter or $0.39 on a per adjusted share basis. And as a reminder, as you look at these figures, we do report our distributable earnings after taking into

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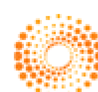

account equity based charges.

Management fees for the quarter came in at $303 million, up 16% compared to Q2 2018, and 17% comparing the year-over-year LTM periods.

Fee related earnings for the quarter are $287 million and on an LTM basis are $1.1 billion. This is a record fee related earnings figure for us on a trailing 12 month basis, up 28% compared to the LTM figure as of a year ago.

Now as we've reviewed historically, there are 5 things we need to do well as we evaluate our performance. We need to generate investment performance, we need to raise capital, find attractive new investments, monetize existing investments and use our model to capture more economics from everything that we do. I'm going to update you on the progress on the first two, and Bill is going to cover the remaining three.

In terms of our investment performance, please take a look at Page 4 of the deck, which shows the trailing 12 month performance across our flagship funds. In private equity, our 3 flagship funds appreciated 12% on a blended basis and the private equity portfolio, as a whole, appreciated 15%. Both of these figures compare favorably to the 7% total return of the MSCI World mentioned a minute ago.

Our real asset strategies are performing as well with our more mature real estate and infrastructure flagship funds, up 7% and 13%. While our flagship energy fund is flat over the last 12 months compared to a 36% decline in S&P's Oil & Gas E&P Select Index.

And in credit, our composite performance compares favorably relative to the LSTA and the HFRX Special Sits Indices which are plus 4% and minus 8.7% respectively over the last 12 months.

In terms of fundraising, we raised $6.5 billion of new capital in the quarter. We held an initial close in our new Asia real estate strategy. We priced new CLOs in the U.S. and Europe and had inflows into leveraged credit SMAs, as well as various alternative credit products.

Additionally, we progressed in our goal of raising long duration capital. As of quarter end, we now have $43 billion in permanent and strategic capital that has either recycling or a very long expected life of 15 plus years or more at inception.

In total, inflows in the quarter contributed to $56 billion of dry powder at quarter end and included in this is $18 billion of capital commitments that become fee paying on an as invested basis at a weighted average rate of just over 100 basis points.

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

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

Thanks, Craig. I'll start with the third thing we need to do well, which is find new investment opportunities. We invested $5.8 billion across businesses and geographies in the second quarter. Public Markets deployment was $1.8 billion, coming primarily from our Private Credit and Direct Lending strategies.

On the private market side, we invested $4 billion. The largest contributors were our newest core investment coming out of Europe and a Middle Eastern midstream investment from our infrastructure fund. Other notable investments were a handful of Asia private equity investments and a European private equity investment.

Shifting to monetization activity, we completed a number of secondaries, including our final exit from Haier. We also completed multiple strategic sales that positively impacted both our funds and the balance sheet.

On a blended basis, the PE exits were done at 4x our cost. For the quarter, it was $358 million of gross total realized carried interest and total realized investment income. This compares to $600 million that, as we stand here today, has closed or has been signed and is expected to close in 2019 or 2020. Of which, at this point, we expect $250 million to close in Q3 and it's only the end of July.

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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 the firm from all of our activities.

Focusing first on Capital Markets. KCM had a strong quarter with $158 million of transaction fees. The market environment in Q2 certainly improved compared to Q1 of this year. Performance in this quarter highlighted the geographic breadth of the business, as Capital Markets revenues out of Asia and Europe both outpaced revenues in North America.

And if you turn to Page 5 of the supplement, I'm going to spend a minute on our core investing strategy, as we've seen core begin to impact our balance sheet investment performance and our book value compounding.

We introduced the core strategy on this call two years ago with a focus on investments that have a lower targeted return profile than private equity, but are solid businesses, and we want to own for 10 plus years.

We chose to commit significant balance sheet capital alongside a handful of partners. We currently have $10.5 billion of AUM focused on this strategy, including $3.5 billion we've committed of our own capital.

Now, two years in, looking at LP capital together with balance sheet capital, we've invested a total of $4 billion through transactions across the U.S., Europe and Asia, with a gross IRR of 21%.

And in terms of the investment line on the segment balance sheet, core has a fair value of $1.9 billion as of quarter end. Keep in mind, the 21% IRR has not run through our total distributable earnings yet and is all unrealized gain.

However, core has contributed approximately $425 million of balance sheet value since we began investing in this strategy. We feel we're off to a good start and we'll keep you posted along the way.

There are 2 other points I'd like to make in relation to the balance sheet. The first thing I want to point out is you'll see BridgeBio, a biopharma investment, is now our third largest balance sheet holding. Following its Q2 IPO and strong trading post IPO, fair value as of June 30 was $395 million and is marked at 5x our cost. Given its significance, we wanted to provide that additional color.

The second thing, I'd like to call out relates to our debt obligations. We recently priced 2 bond offerings, a euro denominated offering and a U.S. dollar denominated refinancing of a 2020 maturity, both at attractive rates.

Putting aside any premium associated with taking out the 2020 notes, we will have added approximately $725 million in liquidity to the balance sheet with effectively no increase in interest expense.

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

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

Thanks Bill, and thanks everybody for joining our call. I want to focus today on how we've been scaling, and how we think about the trajectory for our business from here.

I mentioned on our last call, that despite our 43-year history, we're a young firm. 18 of our 22 strategies were launched in the last decade. And in our business it takes about a decade to start to achieve scale. So we have a lot of growth ahead of us as we go from Fund I or II to Fund III, IV and V across the majority of the firm's investing activities. We think that upside is dramatic.

But for us, this growth opportunity is compounded by the fact that while we've been launching new investing businesses, we've also been making large investments in distribution. We were late to building out our distribution efforts. Remember, 10 years ago, we had about a dozen people on our fundraising team and 275 investors. We now have 90 people on the team and nearly 1,000 investors. But we still have a long way to go.

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Our investor count has been growing and our cross-sell stats have been improving, but we still see an opportunity to meaningfully expand both of those numbers.

As a result, going forward, we expect to see our AUM compound significantly from the powerful combination of more mature track records and a growing investor base.

Page 6 of the deck gives you a good sense of what's been happening on this front over the last 7 years. We report in our press release, the gross new capital raised every quarter. That number can be lumpy, given the timing of closings and when our funds come to market, especially the larger funds.

To give a better sense for what we're experiencing, this chart looks at the new capital raised and acquired on a trailing 3-year basis. You can see from the chart that despite the youth of many of our strategies and relationships, the trailing 3-year number has grown from $18 billion in 2012 to $95 billion today. And with acquisitions, the number is over $100 billion.

As you can see from the chart, PE has grown from about $8 billion to $20 billion to $30 billion as our 3 regional PE funds have scaled. What's more dramatic, however, is our non-PE funds, which on this trailing 3-year basis have gone from $9 billion of capital raised to $73 billion. As you look at this chart and think about these numbers, please keep in mind what I said. This has all happened with a lot of Fund Is and a lot of new relationships.

So while we're pleased with the progress we've made, we feel like the last 10 years of building track records and relationships position us to really scale from here. We see growth from creating new investment platforms, scaling our existing platforms with existing relationships and doing more with those existing investors. And we see even more upside from creating new relationships across channels and around the world.

And on top of these points, it's important to recognize that in the next 6 to 18 months, we'll be in the market for our largest 3 funds; Asia PE, Americas PE, and infrastructure. So the long term opportunity is large and the near term visibility is high.

Thank you for joining our call. We're happy to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

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

And Michelle, we would like to ask everyone if they wouldn't mind to please ask one question and then one follow-up, if necessary, to just allow us to work our way through the queue. Thank you.

Operator

And our first question comes from Michael Carrier of Bank of America.

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

Maybe the first question, Scott you mentioned sort of the fundraising outlook, focus on distribution, some of the opportunities there. I guess, just given the pace of deployment, given the performance relative to whether it's the peers or the benchmarks. How should we be thinking about it? I think we have a pretty good view maybe over the -- in the second half in terms of what's out there. But as you're thinking about '20 and '21, both on the distribution with the flagships, like how meaningful can it be over that timeframe?

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

Craig, why don't you kick us off and talk about what we see coming to market over the next couple of years, and then I'll give some color.

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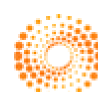

Craig Larson ***KKR & Co. Inc. - MD of IR***

Yes, sure. So, Mike, in terms of where we're fundraising currently, why don't we start there. That would include fundraising for number of European strategies, so that's private equity, opportunistic real estate and direct lending. In Asia, we're fundraising for strategies outside of private equity, within -- including infrastructure and real estate. And we're also fundraising across our impact, real estate credit, special situations, and our next generation technology growth strategy. And at the same time, we have areas where we look to raise capital on a more continuous basis. That includes the CLO business, leverage credit platforms in the U.S. and Europe as well as our BDC and hedge fund partnerships.

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

So I'd say -- just as an overlay, Michael. I'd say the opportunity to scale from here we think is dramatic. We mentioned the 3 large funds coming to market in next 6 to 18 months, because those do tend to be a little bit more sizable when they do come. But as you can tell from the chart on Page 6 of the deck, it's much more than just the larger episodic funds coming to market that's showing up in the numbers. And so the way we look at it is, we have these 18 other businesses of the 22 that we're in, that are starting to work their way through kind of the Fund I, Fund II dynamic.

And as we talked about in the past, we think successor funds can be multiples of the prior. And we just happen to have that in a lot of different places across the firm. And so, it's -- the opportunity to scale is something that we're quite optimistic about. And at the same time, the reason we mentioned that we have been building out distribution is we see opportunity everywhere, more institutional relationships, insurance, retail, high net worth, structured products. We begin -- we believe we're just scratching the surface and there's a lot of incremental relationships we can create and a lot of relationships we can build from a good start.

So long way of saying we see a lot of upside, and this chart has been created during a period of time where we're just creating a lot of things.

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

You guys talk about ROE as a metric, just given the balance sheet. But you mentioned core on this call and the growth in that area. When you think about like how that impacts the balance sheet, meaning the mark-to-market more immediately versus a -- the benefits on the realizations flowing through DE, but that can take years for that to play out. Like, how do you think about that and especially relative to ROE in that being a metric?

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

Mike, thanks for asking about it. And it's actually a very good question precisely for the reason you mentioned and core is a great example of this dynamic. So as we look at our ROE and we evaluate our performance, we do look at ROE on a marked basis in order to really focus on total value creation. And I think to us that aspect is critical.

So for the numerator, we look at the change in book value over the last 12 months. Again, as you know, we mark-to-market investment in our book, and we'll add the dividend to that to really look at the total value that's been created, whether that's paid out in the dividend or retained on the balance sheet. And we'll look at that versus the average book over that period. So if you do that over the last 12 months, you'd get 16.5%. And I think as we think about an after tax ROE, 16.5%, with really low net leverage as a firm, is very attractive versus broad financials.

So that's how we focus on ROE. And, again, I think most importantly, reflecting mark-to-market in the numerator and denominator is a critical piece of that.

Operator

Our next question comes from Craig Siegenthaler of Credit Suisse.

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Craig William Siegenthaler ***Crédit Suisse AG, Research Division - MD***

Last quarter, you had a slide that provided us an update on the KKR shareholder base following the C-corp conversion, and I didn't see it this quarter. But I'm wondering if you had any fresh data points that you can share with us in terms of how your investor base has evolved over the last 3 months?

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

Craig, thanks for asking about it. The answer is actually a good one. So thinking back to what we had last quarter, if I could have you jot down 3 numbers, and then let me walk through what they represent. So the 3 numbers are 177, 291 and then 332. So as you pointed out last quarter within the supplement, we had a slide that highlighted the evolution in our shareholder base since conversion. And what it showed most significantly was an increase in the mutual fund, the index fund and the other institutional components.

So if you were to go back and look at that slide, as of year-end 2017, so pre-conversion, that group combined owned 177 million units -- that first number. And as of year-end '18, so post-conversion, that group combined owned 291 million. So over 2018, we saw an increase of 114 million shares looking at that part of our shareholder base. So to help put some numbers around that update, as of March 31, that group owned 332 million shares. So in that 3-month period, we saw an increase of 41 million or about 14% with increases across all 3 categories.

And the other statistic that we look at is the number of institutions that file 13Fs gives a sense of breadth. So we saw a double digit percentage increase in the institutions that file 13Fs, it was a 12% increase and when you look at, again, just over that time period. So we've seen a continued improvement across all these statistics, as you probably get a sense. We follow them pretty closely to help gauge their progress.

And I think 2 other final thoughts. One, when we look at these stats as best as we can against other large financials and C-corps, both those that are inside the S&P 500 and outside, it looks like we still have a lot of room to grow. So I think we're seeing continued progress, which is great, but importantly, still feels like there's a lot to do.

Operator

Our next question comes from Patrick Davitt of Autonomous Research.

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

On the Capital Markets revenue, I think you came in a lot better than anyone was expecting given the lack of kind of large visible deals. Could you walk through maybe any of the key drivers of the increase in syndicated capital and the surge in revenue there?

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

Sure Patrick, this is Bill. Remember, when we mentioned the number in the first quarter was only about $60 million, we said that Capital Markets was "Shut" for probably half of the quarter. Capital Markets has rebounded and we saw a nice activity in the second quarter. The interesting thing this quarter, and that's why I highlighted in the prepared remarks is, we've always talked about the geographic breadth. And this quarter the fees generated from Europe and from Asia were actually in excess of the fee generation from the U.S. And so that is positive as far as the geographic expansion that we talked about.

But more importantly, from a revenue point of view, we have KKR portfolio companies plus we also have our third party business. And when you look at the activity during the quarter, about 70% of the revenue was generated from debt issuances and about 30% from equity issuances. And the mandates were in excess of 35. So that means this came from over 35 separate and distinct clients that actually used KKR and Capital Markets in their business. And lastly, when you think about those 35 mandates, there were only 2 mandates that were in excess of $20 million. And so, again, this is again, the broad breadth of the activity in Capital Markets this quarter.

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

And did you give the percent that was third party?

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

I did not, but this quarter it was roughly about 15%.

Operator

Our next question comes from Gerald O'Hara of Jeffries.

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

Bill, maybe staying with you for a minute, just kind of looking at the income taxes in the quarter and thinking about how to kind of model that going forward. Is this a reasonable run rate to sort of to begin that sort of linear increase over the next several years? I know you've kind of given some guidance previously on a steady increase to sort of the low 20s in 2023? Any kind of change in how that progression might play out or should we still kind of think about it as somewhat linear in nature?

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

Gerald, as you know, we talk about this every single quarter since we actually did convert to C-corp and trying to give you better guidance as to how to model this. But what we did say was that, when we did go C-corp, about half of the step-up was towards goodwill, and would be amortized over 15 years. And so that's pretty linear and that could be modelled.

The other 50% was actually tied to specific assets or specific funds and carry. And as we sold those investments, we would get the benefit of that shelter of tax. What's happened in this quarter in -- so we're talking about second quarter 2019, is there were a couple of investments, which weren't written up much as of June 30, 2018 when we did go C-corp. A lot of the appreciation occurred after that time. And so when those investments were monetized, we didn't have any shelter as far as against that income.

That being said, we still have a halfway decent amount of shelter to provide to investments that when we went C-corp had a lower cost than value and so we were able to allocate to those investments. As those investments are sold, we'll get the benefit of that tax reduction. But as I mentioned, a year ago, it is very hard to predict. We, to try to keep things simple, said that it was going to roughly go up a few percentage points every single year on a walk from roughly 9% up to the 22%. And so longwinded way of telling you that it's pretty hard to model. I wouldn't hardwire a 15% rate, which is the rate this quarter. Next quarter, it could be -- depending on the mix of assets -- could be 11%. Or it could very well be that if all the assets that are sold in the third quarter weren't written up at all, when we went C-corp, the tax rate on that will be 22%.

Operator

Our next question comes from Bill Katz from Citi.

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

So big picture question, as you continue to scale your business and diversify, can you talk a little about maybe the dividend policy and how important does the book value strategy remain?

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

I'd say that the book value compounding remains a critical priority and focus for us, Bill. As we talked about in the past, in particular, got into -- in good detail when we changed our distribution policies several years ago, we're big believers in the power of long term compounding.

And if you flip back to Page 2 of the deck, and look at the bottom left-hand side, you can see over the last few years since the distribution policy was changed, we've started to see meaningful compounding in our book from $12 or so to the better part of $18 in a relatively short period of time. So book value compounding continues to be a big part of our story as does AUM compounding and fee related earnings compounding. So we're focused on all of the above.

Dividend policy is something that we'll revisit on an annual basis. But we are going to continue to invest in our own growth and bet on

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ourselves and that will show up in our book value per share. So I think you should expect all else equal to have the dividend policy move up the dividend over time. So we do expect it to grow. But we'll largely be focused on compounding book as we compound the rest of our metrics.

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

And a bit more tactical question, just coming back to the FRE drivers sequentially. Just given the very strong activity on the transaction line, is there a way to think about the incremental impact of that activity on FRE?

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

Well, Bill, when you focus on the transaction fees, you have to break it down between KCM and KKR proper. As you know, in private markets, you see transaction fees and they were quite robust, but there also was a big increase in fee credits. Because remember, on the private market side, we have been sharing arrangement with our LPs and roughly speaking, that's 80% to the LPs and 20% to us. So if you see a transaction fee go up on the private market side that's good news. But the fee credit is going to be adjusted in the economics to us or roughly be about that 20%.

Again, to belabor the point, if you go back to Capital Markets, any sort of transaction fee we report there, it's going to be 100%. Interestingly, though, you saw a pretty robust activity in the second quarter compared to the first and if you take the transaction, monitoring fees and net it against fee credit, you actually saw an increase of roughly about $23 million. And keep in mind if you look at the capital investment line, we went from investing $3.3 billion to almost $4 billion. And so you should expect that that transaction fee would be higher this quarter.

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

I was trying to get toward the incremental FRE contribution, but we can follow-up offline.

Operator

Our next question comes from Alex Blostein of Goldman Sachs.

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

Scott, to follow up to your discussion around scaling the business and the fact that maybe you guys were late at some of the distribution initiatives, but maybe have been sort of been catching up over the last couple of years. As you look out -- and especially as we look at the flagship funds that are on horizon here, how should we think about the comp rate being in that 40-ish percent range for now? How much flexibility you guys have to bring that down over the next couple of years?

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

I think the guidance we've given you that we expect the comp ratio to be in the low 40s, Alex, I think that's what we'd suggest is still the right assumption to use. As we scale our businesses, and in particular, as we seeing carried interest be generated from a number of these Fund Is and IIs that have been invested, but not yet realized, and as our AUM and fees continue to scale from all the good works that teams have been doing in terms of creating a very attractive track records, we would have more flexibility overtime to potentially bring that down. But in the next couple of years, I wouldn't guide you any differently than the low 40s.

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

And then just a quick follow up, Bill, to your kind of state of the union sort of update on where realize incentive income investment stand for the next couple of quarters, so that $600 million number. I just want to make sure, does that contemplate any disposition of First Data, FIS now kind of in the related transaction there or any of your other public holdings?

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

Good question. To be clear, it does not contemplate any secondaries. So these are transactions that have closed or strategic sales that have been signed and have yet to close. And the reference was that the $250 million, which we expect in that in the third quarter and headline number was $600 million, that's because there were a couple of strategic sales that have taken place. We have signed documentation and we expect those to close in the early part of 2020.

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Operator

Our next question comes from Glenn Schorr of Evercore.

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

We hear all the growth, the scaling, the distribution we get it and it's working great. If you look at the proposal out of Elizabeth Warren recently, it would suggest something other than we all believe is taking place. So, I guess, I'd love to give you a shot to either A: respond and/or B: talk about how the business would adapt if some of those proposals are put in place.

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

Thank you, Glenn for the question. I always appreciate being given an opportunity. Just not going to take you up on it today. We're not going to comment. I think we're, obviously, at the beginning of probably a season of a number of different things that will be in the media and we'll watch it as will you and we'll let you know as these things develop, if and how it impacts our business. I would tell you that we have, been focused for the last decade plus on making sure that we have a robust effort around all things ESG and making sure that we're being thoughtful about all the stakeholders to whom we're responsible. And so we'll continue to focus on that endeavor and then adjust as the environment adjusts.

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

Maybe a business-related one. There seems to be a rising public to private trend. Curious if you're seeing that to the same degree I am? If it's just a function of differential in valuations and think of it as a seasonal thing?

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

We're seeing it too and I think it is providing opportunities to us. I think the market, Glenn -- it's become a bit of a have, have-nots market. And I think if a company has real growth or is in certain sectors and has a really simple story, they tend to get a high multiple and a lot of capital goes that direction. If there's some complexity, if it's lower growth, if there is more explaining needs to be done, there's a lot of companies that get left behind. And so we are seeing this bifurcated market develop and I do think that is leading to more interest on the part of management teams to consider going private transactions. So, that's clearly creating opportunities for us.

I'd say the market is focused on simple stories, is also creating opportunities, and so far as a number of companies are selling non-core subsidiaries. And we've been particularly active around corporate carve-outs all around the world. And I think that's a derivative of this public to private trend. It's more of a simplify trend that we're benefiting from, but we're seeing the same thing you are.

Operator

Our next comes from Chris Kotowski of Oppenheimer & Co.

Christoph M. Kotowski ***Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst***

I noticed the carried interest receivable is up 21% linked quarter and that just seemed like a big number in kind of a ho-hum market. Is there any particular story behind that?

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

Hey, Chris this is Bill. No, particular story other than, we manage a lot of capital and the appreciation was quite robust during the quarter. For example, private equity, our private equity portfolio was up 6.4%. So if you manage a lot capital and you see that appreciation, you'll see that come through in the accrued carry number.

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

The only thing I'd add Chris is, it's also coming from non-PE and we mentioned a number of these younger funds are now getting invested. The dollars in the ground are growing and the accrued carry is starting to tick up for non-PE as well. And we've shared that we think there's significant upside to our carried interest line overtime as that continues to play out and those investments are exited. So, all else equal, we hope to see that accrued carry from non-PE continue to grow.

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

And to that point, we actually had a slide in the supplemental deck last quarter and of the $123 billion of carry eligible funds that we manage, that number was $88 billion. So, again, to Scott's point, as we continue to grow the business not only in PE, but continue to add different mandates and they walk their way through the preferred returns and then are carry eligible, you're going to see that number go up.

Christoph M. Kotowski ***Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst***

And then as a follow up, is BridgeBio also in the health care growth fund or is it just a balance sheet investment?

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

Good question and it's not a straightforward answer. The answer is that, it was originally on our balance sheet. Again, the beauty of our balance sheet is we have the ability to use some of that balance sheet capital to prove concept and then we go raise capital with a third party mandate attached.

BridgeBio, we invested over 4 separate tranches. The first 2 were made specifically just on the balance sheet. And then as we raised a fund and that fund was eligible to participate in that investment, the fund participated. So that $395 million is balance sheet capital plus a sliver of the GP interest in the health care growth fund. But more importantly, you've got $395 million of value, but it's only $75 million of cost. And we made that that investment over the last 2.5 years.

Christoph M. Kotowski ***Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst***

I guess what I was also wondering about is, obviously it's nice -- it would be nice to have a 5 banger in your first time biotech fund. I mean, did that -- did it help boost the performance of the fund by a similar amount as to what we see on your balance sheet?

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

And it certainly has. And that's a very -- very good point. And when you take into account, we're just talking about the $395 million, which is our investment on our balance sheet. Embedded in there is also some accrued carry, because the healthcare growth fund, because of the IRR that it has right now. Health care growth fund is right now -- remember it's an early fund and that we had some big write-ups, so the gross IRR is I think over 100%. And so you're going to see that big bang that you talk about.

Operator

Our next question comes from Devin Ryan of JMP Securities.

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

Maybe just one here for Scott. You had mentioned a lot of visibility into the business near term, and you had given some longer term perspective on fee-related earnings and the trajectory at the Investor Day. But since then we've gotten some pretty specific FRE guidance for the next few years from some of your peers just -- given this transparency, which I think has been helpful to the market. And so if possible -- is it possible to give us anything more granular on where you see fee-related earnings, maybe over the next 2 to 3 years or a range of growth rates from here just based on that level of visibility you have into the business and some of the moving parts like fundraising or deployment?

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

Great question Devin and appreciate this opportunity as well, but also not going to take you up on it. I think we're not -- we're not as comfortable giving FRE guidance per se. I think what we're comfortable doing is just sharing with you the trends that we're seeing in the business. And as you can tell from the narrative and the significant growth we've had in management fees, 16% give or take, plus the opportunities we see to continue to scale our Capital Markets businesses, we will share with you what we're seeing. But we do see meaningful upside and the opportunity to create operating leverage as well, but no specific guidance. But I'll tell you the overall sentiment here as we put in a lot of hard work in the last decade, getting ourselves to this point in terms of creating track records and new relationships. And if we can create Page 6 with Fund Is, and new relationships, we're kind of in a mode of being very optimistic around what we can do as we scale from this point forward, so upbeat, but no specifics for you.

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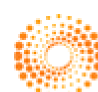

William J. Janetschek ***KKR & Co. Inc. - CFO***

And just to give you a little bit of color, very short term. Remember, when you take a look at fee-paying AUM, year-over-year it's up 9% and we have talked about shadow fee-paying AUM, that number is roughly $18 billion and at over 100 basis points of fee income attached to that so as that capital is invested over the next couple of years you're certainly going to be able to see management fees increase because of that.

Operator

Our next question comes from Chris Harris of Wells Fargo.

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

There is a lot of negative yielding debt in Europe as you guys know. How is this impacting your business or your approach to investing in that region if at all?

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

It's a great question. And what we are finding in Europe is that the opportunity in the private markets and the opportunity to generate returns from capturing the illiquidity premium, Chris, it's significant. And so it's not impacting our investment approach per se, but we are finding that when we talk to investors around the world, especially those in Europe or with big European components of their portfolio, they are looking to do more with us, because they are focused on figuring out how to capture that illiquidity premium for them. So it hasn't really changed how we are investing per se, but what it has done is allowed us to create a series of discussions with investors that are trying to figure out how to position their portfolio in a negative yielding environment. So we're seeing more flows into things like private credit, infrastructure, real estate, anything that has a yield coming from the illiquid or private markets, we're finding a lot of interest.

Operator

Our next question comes from Michael Cyprys of Morgan Stanley.

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

Just hoping you would talk a little bit about some of the newer product initiatives that you're introducing, targeted toward insurance companies. And in particular, I saw you recently had a return-enhanced structured note that I think invests across a number of your strategies, but pays a fixed distribution. So I guess what sort of market opportunity do you see for these sort of innovative solutions and how are you able to structure such a high coupon that pays out on the sort of structured note. Are you evolving the return streams and payouts on your private equity funds to match, if you could just help us understand that?

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

Thank you, Michael. Yes. This question brings together a few different themes we've covered in the past. One is that we are focused on how we can continue to raise capital that is longer duration. As you know, we are focused on kind of generating more permanent capital and recycling long term, 15 plus year lock up type capital, so that's one thing we've been very focused on. Another thing we've been very focused on is building our relationships out in the insurance space.

And over the course of the last four or so years, we've seen our AUM from the insurance company to go from $8 billion to north of $25 billion. As we've been spending time on across those 2 themes, we have found an opportunity in a number of different respects to innovate, to create products that achieve both objectives, raise longer term capital for us to invest and compound for our partners and do it in a format that is attractive for insurers and easier for them to invest in. And so the product that you're talking about is just one example of many that we have been working on and a number of them have actually been completed.

The answer to your higher level question around how can you generate yield on a private markets portfolio is relatively straightforward. If you think about what we do, private equity and growth equity, it's true, traditionally do not generate much current return. But if you think about it basically everything else we're doing does, private credit, infrastructure, real estate equity, real estate credit, energy as just some

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examples. And so we're finding that you can create a more diversified portfolio of alternatives that does have recurring yield. And I think it's a combination of that recurring yield plus upside of private and growth equity and other asset classes that we think is an opportunity to create hybrid products that are attractive, both on the run and then also in terms of long term upside.

Operator

Our next question comes from Robert Lee of KBW.

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

And I apologize if you maybe went over this as I got on the call a little bit late. Just going back to kind of capital management and the dividend, I mean, about a year anniversary since you converted, reset the dividend. So how should we think about your view about dividend growth from here since we're kind of a year in at this point?

And second question is, it really relates kind of more to comp ratio and the carry pool, I guess -- I think you guys are somewhat unique in that you pay everyone pretty much out of one big carry pool, I believe, as opposed to points from a specific fund. But as you get bigger, as you have many more strategies, is that a model that either it becomes easier to execute on or is there pressure to change it as kind of the firm becomes more diverse?

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

Hey, Rob, this is Bill. We did cover both of these points earlier on. But -- so the punch line is. As it relates to the change in dividend policy, it's something that we'll address annually and it's probably something that would be discussed on the fourth quarter call.

As it relates to that one comp pool, what we mentioned earlier is that we're targeting that comp pool to be in the low 40s. And remember we pay everyone off of one P&L and we don't breakdown specifically how that income is generated, whether or not it's fee income or whether or it's carry or balance sheet earnings. We look at everything more holistically. But you've got to believe that as we continue to scale our business and grow our business, you should see over time margin improvement. But that's not going to happen next quarter per se. And so when we went to the C-corp conversion and we only reported one comp number, we said that we were going to target that number in the low 40s to make sure that the operating margins would be roughly about 50% and so there is not going to be any change any time soon.

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

And I think on the last part of your question, Rob, the pressure to change it, we -- no -- we don't see any pressure to change that. This is been part of how KKR has operated from inception. That everybody has always participated in the global carry pool. It's a critical part of our culture and allows us make sure we connect the dots across the firm and everybody works together. And so we expect that to continue to be the case.

Operator

Our next question is a follow up from Michael Cyprys, Morgan Stanley.

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

On lending, just how you're seeing that used across the industry today and in terms of order of magnitude in size and to what extent does KKR use capital call lending when you are making deployments delaying capital calls using leverage and then drawing down on that.

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

You know Michael you actually just cut in halfway through your question, would you mind just repeating it, we didn't catch, you were silent for the first part.

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

Sure. I was just asking about capital call line lending, so when you're buying an asset in a fund using leverage initially to buy and then drawing down on a line to and repaying it off in the future, just curious what you're seeing across the industry in terms of usage of this form of leverage, what sort of magnitude in size do you see for this that part of the industry and to what extent is KKR using this form of leverage.

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

When you think about the administrative ease by having a subscription facility in each one of the funds, we've been doing that for the past few years, so that line is not kept open much at all, it again more for administrative ease as opposed to anything. As it relates maybe to a question that you might be asking as far as to the extent that you use a facility, do you actually increase the return profile in that particular fund because of the delay draw, but I just want to let you know that as we report to our LPs, we report the IRR because of us having the ability you use that subscription line, but we also report a return as if we didn't use the subscription line, so we actually have these transparency reports where again we report both for those numbers.

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

What would be typical duration of a draw on that?

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

Typically on average, we have a facility, we draw on a facility and it usually gets paid down every 6 months.

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

Got it, okay so 6 months.

Operator

There are no further questions. I would like to turn the call back over to Craig Larson for any closure remarks.

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

Michele, thanks for your help and thank you everybody for joining our call. Please of course follow up directly with anything else and we look forward to chatting next quarter.

Operator

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

Editor

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