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# EDITED TRANSCRIPT

KKR - Q3 2017 KKR & Co LP Earnings Call

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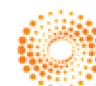

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## PRESENTATION

**Operator**

Ladies and gentlemen, thank you for standing by. Welcome to the KKR's Third Quarter 2017 Earnings Conference Call. (Operator Instructions) As a reminder this conference call is being recorded. I will now hand the call over to Craig Larson, Head of Investor Relations for KKR. Craig, please go ahead.

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

Thank you, Daniel. Welcome to our Third Quarter 2017 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 and the supplementary presentation which are available on the Investor Center section at KKR.com.

The call will also contain forward-looking statements which do not guarantee future events or performance. And please refer to our SEC filings for cautionary factors related to these statements.

In terms of our progress this quarter most significantly we continue to increase the earnings power of the firm evidenced by the $7 billion of new strategic investor partnerships closed on in Q3. While the headline amount alone from these partnerships is meaningful, the opportunity for us is even greater because of 2 things. The first is recycling where costs together with a percentage of gains will go back into the partnerships to be invested again.

And the second is the longer expected life of these partnerships. We expect them to be over 20 years in duration. As a result there's the opportunity to see that $7 billion compound over a long period of time and with performance for our total economics to be more than 3x that relative to capital committed to a traditional drawdown fund. It's very positive for us. And Scott is going to spend a few more minutes at the end of our prepared remarks to give some additional color.



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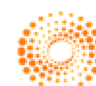

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Let's now go to Page 2 of the supplement with an overview of our performance. We reported after-tax economic net income of $308 million for the quarter which translates into $0.36 of after-tax ENI per adjusted unit. And over the trailing 12 months we've generated $1.9 billion of after-tax ENI.

After-tax distributable earnings were $464 million for the quarter or $0.57 on a per adjusted unit basis. And we've generated over $1.5 billion of after-tax DE over the trailing 12 months. Also of note we've had -- we've had meaningful AUM and fee-paying AUM growth over the last 12 months. And you're seeing this growth flow through to our financials. Management fees for the quarter were up 16% on a year-over-year basis and fee-related earnings were up 35% year-over-year driven both by the growth in management fees as well as continued strong performance within Capital Markets.

Cutting through it there are 5 things that we need to do well: one, generate investment performance; two, raise capital; three, find attractive new investments; four, monetize existing investments; and finally, we need to use our model of AUM, Capital Markets and balance sheet. I'll update you on our progress on the first 2 and Bill's going to cover the remaining 3.

Starting (inaudible) please look at Page 3 of the supplement. We've had strong performance across our asset classes in the last 12 months. In private equity our 3 flagship funds have appreciated 20% on a blended basis and our real asset strategies are performing with our more mature real estate, infrastructure and energy flagship funds up 13%, 21% and 29% respectively. And in credit we continue to see strong performance in our opportunistic credit and direct lending platforms in particular.

The second thing we need to do well is raise capital. And you can see our progress here on Page 4 of the supplement. We've had strong organically driven fundraising momentum with AUM and fee-paying AUM up 17% and 22% respectively in the last 12 months. And looking over a longer period of time, as you can see on the bottom half of the slide, our growth since 2010 has been significant with AUM and fee-paying AUM more than doubling. Turning to Page 5 you can see that not only have we become larger but we've become meaningfully more diversified across strategies and geographies with a vast majority of our capital in funds that are not subject to redemption and with a growing percentage of capital coming from longer-term strategic investor partnerships with recycling.

In terms of the quarter more specifically, our growth in AUM was driven by $8 billion of new capital raised that included the impact of these strategic partnerships with recycling, the final close of our first real estate credit opportunity partners fund and inflows in CLOs and alternative credit. And with that I'll turn it over to Bill.

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**William J. Janetschek** - *KKR & Co. L.P. - Member and CFO*

Thanks, Craig. I'll pick up on the third thing we need to do well, find new compelling investment opportunity. This was an active deployment quarter for us across the firm with a total of $4.6 billion deployed across businesses and geographies. Public markets deployment was $1.6 billion, coming from investments made across our alternative credit vehicles primarily within direct lending. Deployment need strategies contributed to the increase in public market's fee-paying AUM. On the private market side we invested $3 billion, driven by investments in private equity across all 3 geographies as well as infrastructure.

The largest investment related to Internet Brands acquisition of WebMD. Internet Brands has been an existing portfolio company of ours since 2014. So we're effectively investing like a strategic in a transaction with meaningful synergies. In total, the $4.6 billion in deployment across private and public markets still leaves us with over $47 billion of dry powder across the firm as of September 30th. And over $14 billion of that will begin to pay management fees as it's invested at a blended rate of approximately 100 basis points.

The fourth thing we need to do well is monetize our existing investments. We are continuing to see significant monetization activity across our PE business. In total, realization events at several portfolio companies drove a 58% increase in cash carry compared to last quarter. The PE exits were diversified between strategic and secondary activity and on a blended basis the PE exits were done at 2.7x our cost.





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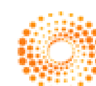

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The last thing we need to do well is use our model of AUM, Capital Markets and balance sheet to capture greater economics for our investors and the firm from all of our activities. The power of our model is evident in our results. Over the last 12 months our book value per unit is up 15%. And we generated a 19% ROE on an after-tax ENI basis.

Please turn to Page 6 of the supplement which summarizes our core fundamentals across the 5 categories. We are pleased with our progress and the momentum we're seeing across the firm. Now let me go into segment financials in more detail. Management, monitoring and transaction fees with $356 million in total, up 29% year-over-year with a 16% year-over-year increase in management fees as Craig touched on earlier.

In terms of transaction fees we reported $179 million of fees this quarter driven by equity investments in 2 large North America private equity deals and our continued momentum within our Capital Markets segment.

Page 7 of the supplement profiles the growth of the KCM segment. Year-to-date we've executed over 140 transactions generating revenues at $300 million, more than double the same period last year. On the bottom half of the page you can see that KCM continues to be active in all geographies, in debt and equity and in financing and syndication for KKR-led and third party investments. And as we said here today KCM's momentum and overall level activity is continuing into the fourth quarter.

Turning to performance income we reported $364 million which was anchored by a robust level of realization activity with over $400 million of realized carried interest in the quarter. Investment income came in at $50 million, with $76 million of realized gains, including our first secondary at First Data. Bringing it all together, on a total segment basis fee-related earnings came in at $192 million. Our after-tax distributable earnings were $464 million and after-tax ENI of $308 million.

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

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

Thanks, Bill. Hi everybody. I just want to hit on two topics today. The first is some background and an update on our work with a handful of LPs to create long term recycling strategic investor partnerships. The second is some detail on how we're using our balance sheet to grow our firm, in particular our AUM and fee-related profits.

Let's start with the strategic partnerships with our LPs. By way of background a lot of the capital we manage is in long-term fund or separate account format not subject to redemption. Most of these vehicles have a contractual 3- to 6-year investment period and an expected life of 6 to 12 years. As such we have long-term visibility in our management fees and AUM from the vast majority of the capital that we manage.

As we've grown we've evolved our thinking strategically with a view of supplementing our traditional long-term fund capital to the development of even longer-term partnerships plus permanent capital. On the permanent capital front today we have our REIT which went public earlier this year and our BDC which has begun its listing process. Combined they account for more than $5 billion of permanent capital from which we derive management fees and incentive fees. We're focused on growing that $5 billion figure.

We've also been focused on creating strategic partnerships with a small group of limited partners. These partnerships are all customized but have some common characteristics. They have longer lives than traditional fund structures, most have an expected life of 20 to 30 years. They invest across multiple asset classes. Many encompass private equity, credit and real assets. They have recycling provisions that allow us to recycle cost plus a percentage of the profits that we generate. As a result, the better we perform the more capital we have to redeploy for a very long period of time.

They're large scale. So far we generally target these partnerships for $3 billion or more each. And they have discounted pricing for the partner in return for them committing large-scale capital for a long time. From KKR's standpoint these partnerships are accretive given the aggregate economics we generate from the sizeable commitments and the visibility of funding we have across multiple asset classes and fundraising cycles. Overall these partnerships give us the opportunity to more than triple the economics relative to a traditional fund.





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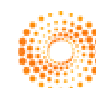

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In Q3 we signed two new strategic partnerships with these attributes and upsized an existing partnership for a combined $7.5 billion. $2.4 billion of this was already in our AUM last quarter and $1.7 billion was in our fee-paying AUM. The rest is additional capital that's new AUM this quarter. The entire $7.5 billion is subject to recycling provisions which will grow with performance and will be invested in our strategies over time. So this brings us to over $12 billion of recycling strategic investor partnership capital. And we're focused on growing that figure over time as well.

Given this progress we have more visibility on our revenues and capital base now than ever before and we have more a line of sight to capital not just for the next 10 years which is typical for us but for the next 20 to 30 years. We'll keep you posted as we continue to raise more permanent and long-term recycling capital but we wanted to make sure you know that this is a strategic priority for us and that we're making progress.

The second topic I want to discuss is how we're using our balance sheet to scale our AUM and fees. I'm going to walk through 3 examples of how we've used the balance sheet to accelerate growth and diversify our business. Take a look at Page 8 of the deck for the first example. We've been using our balance sheet aggressively to create and scale new businesses. You can see on the left-hand side of the slide all the businesses the balance sheet has helped create, including strategies across real assets like real estate equity and credit and infrastructure. The balance sheet has also been part of creating businesses across our credit and growth platforms and as a driver of our Capital Markets business.

In short we've used the balance sheet to scale our business and diversify the revenue of the firm. The aggregate impact of this repositioning is shown on the right-hand side of the slide. You can see how the split of our AUM has evolved since we've had the balance sheet. In 2010 we were 72% private equity and 28% non-private equity. Today the majority of our AUM is outside of private equity.

The bottom-right of the slide shows the picture on a fee basis. Not only have we seen significant aggregate growth since 2010 but also significant diversification of our fees across asset classes and activities in both AUM-related management fees and fees from our Capital Markets business. The balance sheet has allowed us to create and begin to scale virtually all of the businesses we've shown here, driving meaningful AUM and fee growth, diversifying our business and positioning us for further growth.

Now please take a look at Page 9. We've also used the balance sheet to create a strategic partnership with another asset manager. Two years ago we acquired 24.9% of Marshall Wace and we expect to increase our ownership to 29.9% this year. The results of Marshall Wace and our other strategic investments show up in our AUM and fee results. As you can see on the left-hand side of the slide Marshall Wace has significantly grown its assets: 57% growth over the last 2 years from $22 billion to $34 billion. This growth results from capitalizing on its competitive advantages in systems, process and controls to generate strong investment performance. Marshal Wace is already a meaningful contributor to our AUM and fee-related earnings and has made us a real player in the direct hedge fund space.

As important, the team at Marshall Wace have been fantastic partners and are making us better investors and more thoughtful business builders. We mention this for a couple of reasons. First, we haven't talked in detail about Marshall Wace. And given its importance to us we wanted everyone to know that it's going well. And second, it's a great example of us using the balance sheet to scale our AUM and fee earnings. Marshall Wace does not show up on our balance sheet investments or investment income, but it does show up in our AUM and fee-related earnings, driving our fee growth and diversity.

Finally, in addition to creating and scaling businesses and creating AUM and fee-enhancing partnerships, we've also used our balance sheet to facilitate new investments and capture more economics from those investments. For an illustration of this please turn to Page 10 of the deck. Earlier this month we closed an infrastructure investment in Europe in a company called Q-Park, which is one of the largest parking operators in Europe.

As you can see on the slide, this was a EUR 3 billion transaction requiring EUR 1.8 billion of equity and EUR 1.2 billion of debt. The process was competitive and being able to move quickly was a critical component of our success. The only challenge was that while the deal needed EUR 1.8 billion of equity, our Infrastructure II Fund is only $3 billion in total size. To keep the fund properly diversified our team was comfortable with about a EUR 300 million fund position, meaning we were EUR 1.5 billion in equity short of what was required.

With our balance sheet plus capital markets model we were able to syndicate most of the excess equity to co-investors before signing. And we underwrote a portion of the debt as well, ultimately submitting a fully financed offer that allowed us to prevail in the process. By using our model we were able to lock down the entire deal quickly and win the asset for our Infrastructure II Fund. We were able to have a pro forma board which



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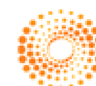

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is largely governed by us without other firms or third parties involved- in effect we control the company. And we were able to deliver significant co-invest opportunity to our infrastructure investors allowing us to highlight our strong sourcing capabilities and demonstrate that our infrastructure platform can support even larger fund sizes in the future.

The model is powerful, it allowed us to move quickly and win the asset on behalf of our limited partners while allowing the firm to create more economics for facilitating the transaction. None of the syndicated equity or debt shows up in our AUM but the fee economics are meaningful and the carry opportunity from owning the asset and the fund is significant. Part of the reason for our growth the last several years is that we're using this model of AUM capital markets and balance sheet with greater effectiveness and frequency in multiple asset classes on a global basis.

In effect we're giving ourselves a competitive advantage by using our model more which allows us to make more money from ideas we're pursuing and scale our businesses faster.

In summary, our model is not just about investing more in what we do, that's part of our strategy, but the more significant part is that the model allows us to have a competitive advantage in the market by using our culture, capital and syndication capabilities to aggressively pursue investments we like which allows us to generate better returns and more profit from every investment we make.

In short, and as shown on Page 11, we're growing rapidly and have real momentum. With that we're happy to take your questions.

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## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) And our first question comes from Michael Carrier with Bank of America.

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

Maybe first question just on the investment income or the balance sheet results, you guys, you noted during the quarter I think some weak investments on the credit side, just any color on that. I know the long term like the last 12 months it's still strong performance overall for the balance sheet but just any color in terms of what weight on it and then maybe the outlook meaning anything that's longer term or just some short-term quarter issues?

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**William J. Janetschek** - *KKR & Co. L.P. - Member and CFO*

Mike, this is Bill. There's no issue with regard to the credit on the balance sheet results certainly over the year-to-date numbers. When you look at the balance results just this particular quarter a lot of the large positions that we've had, and if you take a look on page 12 we listed out the top five, most of those investments were either flat or down modestly which drove just roughly 1% return on a balance sheet but more importantly if you look over the year to date numbers to the balance sheet, balance sheet is up 12% which is in line with our expectations.

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

Okay. And then maybe Scott maybe just on the strategic accounts, obviously big quarter, just from a deployment when -- is it similar to how you guys run the carry funds meaning you're going to be deploying that over a period of 3 to 4 years or do you have more flexibility? Just given that it's across assets and it's much broader.

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

I'd say it varies a bit, a significant amount of the capital, you're right, it will get committed to underlying funds over the next 2, 3 years most likely and then will be drawn down from there generally the economics flow in a similar way to the underlying funds. But we do have some elements of the strategic partnerships which are more opportunistic, we have some that are going to be invested more immediately and so it really does vary. But I'd say the majority of it's going to be committed and drawn over time. And a portion of it, a minority portion of it will get to work much more rapidly.

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**William J. Janetschek** - *KKR & Co. L.P. - Member and CFO*

And Michael just one little detail, we talked about the $7 billion, we've been working on these strategic partnerships the better part of the year, $2 billion of that $7 billion is already in AUM and it's already being deployed. So when you look at the AUM table you could see that we raised more than $7 billion this particular quarter in AUM only $5 billion of the $7 billion is showing up in AUM because we've already recognized $2 billion, and more importantly we've already got to work on deploying that capital.

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**Operator**

Thank you. And our next question comes from Bill Katz with Citi.

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

Scott, sort of curious or Bill perhaps, you spent some time talking about the leveraging the platform to KCM. Just wonder if you could give us sort of a sense of to strengthen the third quarter how much of that reflects just sort of the backdrop of very robust markets and a pickup of activity versus a more systemic yield concept just sort of coming off the business. I'm trying to get a sense of how sustainable the transaction revenues are at this level?

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

I'd say there is a couple of things going on. One, I'd say we're using the overall model with much more frequency just generally speaking. So when we're looking at a new transaction across asset classes our basic approach now is to work with our capital markets business and our balance sheet to make sure that if there is an equity syndication opportunity we're capturing it early and if there's a debt underwriting opportunity we're doing the same. So I think part of what you're seeing in terms of the uplift and I'd broaden it from just Q3 to this year-to-date period is we're just using the model better and with increasing frequency across the firm. Second thing I would say is we're utilizing it across more asset classes. And if you look at the growth this year, some reasonable portion of it has been by our capital markets business partnering with our infrastructure business which has seen a significant amount of deployment. Q-Park is just one example, there are others. We've had a lot of activity in Japanese buyouts but both of those areas are new in this year-to-date period. But every year, in terms of your question about the recurring aspects of it, we find that we're able to capture more and more of the economics from our own content by having better penetration of all of our global investment activity across asset classes. So I think there is, if you go back that Slide 7 of the deck and you look on the right, bottom-right, how much is KKR and our portfolio companies versus third party, it's about two-thirds-one-third. We have seen a lot of activity with our own companies on that two-thirds piece, and it's the existing portfolio companies plus new deals. And so it really is not necessarily tied to overall market activity, that piece of it is more tied to our investing activity and what we're doing with the portfolio. The other piece of it is frankly we're having a significant amount of growth and success in our third party business where we finance third party in a lot of cases sponsors and also corporates and are providing them with advice and capital markets support. And we built out the origination team there and we're having much better penetration in that market as well. So it's not -- I wouldn't call it yield per se because it's not a contractual yield. Having said that, if you look at the level of activity we tend to have in a year in our underlying companies, our global investment activities plus all the activity from the third-party clients we work with, we find that there is a significant recurring base of fee activity that's been accelerating as we've been using the model more effectively and have our whole firm working together better help scale our own businesses and others.



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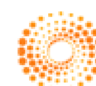

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**William R Katz** - *Citigroup Inc, Research Division - MD*

Okay, that's very helpful. And just to follow up, couple of your peers have been spending more time talking about the opportunity in U.S. retail particularly high net worth, just sort of citing a lot of under-allocated type of ratios versus the institutional bucket, just give us an update sort of appreciate the depth and breadth of your model using your balance sheet to leverage both your investments as well as new businesses, where you sort of stand in terms of the global retail opportunity set to further enhance the flow of opportunity?

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

Hey, Bill its Craig. So I'd point to few things. First, we've built a direct effort within the firm and have a team that calls directly on ultra-high-net-worth individuals as well as family offices. The second piece of that would be the work we do with platforms to leverage really the distribution of others, so whether that's marketing our funds through platforms or also creating unique products again to offer through those platforms, that would be the second piece. The third piece would be what we do through the independent broker dealer network, so we have, Scott mentioned our BDC corporate capital trust, that's an asset that's over $4 billion in size and again was really created through this channel. And the final part of that we'd almost think of as being kind of R&D. So as I know you have an appreciation we like white boards and we like to think creatively about ways to market our products and ideas through to the mass affluent and we'll keep you updated as that R&D is something that we think is worth talking about on a broader basis. Over time, if you look at the capital that we've raised in that which comes through individuals it's tended to be somewhere between that 10% to 15% of new capital raised. This quarter was at the higher end of that, it was 14%. So again it's something that we continue to see and longer term it's certainly an area that I think you look for us to find ways to expand.

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

Yes, the only additional color I'd give you is a lot of those activities are new in the last 5 to 7 years, so it feels like we're just getting started.

**Operator**

And our next question comes from Craig Siegenthaler with Credit Suisse.

**Craig William Siegenthaler** - *Crédit Suisse AG, Research Division - Global Research Product Head for the Asset Management Industry*

I just want to come back to the strategic partnerships and get your perspective on how many more of these could we actually see form in the immediate term. And also can you remind us how the performance fees are calculated and what type of hurdle metric is used? And I assume that's probably different across the different asset classes.

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

Thanks Craig, it's Scott. In terms of how many more that's really hard to predict. These tend to take 1 to 2 years to form and negotiate. And so it's not a long list of partners globally that can do this because if you think about this the requirement to commit scale capital across multiple asset classes for a long period of time, it is not going to be an extraordinarily long list but obviously when they happen they can be quite impactful. We just happened to have 2 get done this quarter but as Bill mentioned those two have been in process for quite a while. So it's more that we wanted to give you the longer term objective we have to grow this effort and find more of these. I'd say also from a servicing standpoint and the amount of time that they take to get done we will not have 20 or 30 of these would be my guess. We're going to -- we will continue to scale the number but it will take time and it's going to be a bit lumpy. But we have today more or less 3 of these 3 to 4 in place today and they do take a long time to get done. In terms of the specific metrics they do vary by partnership. We're not going to give you a detail on how the economics work, but suffice it to say the way we think about it is by doing these especially at $3 billion or more each. The aggregate economics that we're able to generate for the firm just in the first 5- to 7-year period is significantly more than what we think we would generate and the status quo partnership





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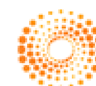

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basis with that partner. And then when you think about the ability to then compound recycled capital portion of the profits then we really have line of sight for a much longer period of time than we normally do with a traditional fund approach. So in a way we're using this fund raising environment and cycle to raise funds for the next several fund cycles. And that's how we think about it, and it's all quite accretive. And it's a win-win for the partner because they're able to actually have some discounted economics. And from our standpoint we can show some creativity in terms of structuring.

**Operator**

Our next question comes from Patrick Davitt of Autonomous.

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

Another one on the strategic partnerships with the understanding that you only have 3 or 4 now, but have you done any work around maybe trying to size how much or what percentage of these would have been AUM that would have come into your pipeline of funds anyway? I mean what's the incremental AUM you think you're winning on top of what you probably would have already gotten through the normal fund raising cycle?

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

That's a great question that I don't know the answer to. It's very hard to be precise. I will say some of these relationships I would say on average they're probably 3 or 4 times the size that I would have expected just normal course without having this kind of broader wrapper strategic partnership approach, that's one way to think about it. So maybe if you have $1 billion to $2 billion partner you end up over time with a partner that's much bigger than that especially when you think about the recycling. Some of the capital would go into product areas where we might have been able to raise the capital elsewhere but I tell you, Patrick, not a huge amount. I'd say a lot of the capital is going to be incremental to what we would have otherwise been able to raise elsewhere. And the real power is, as I just mentioned, not just the next 5 years it's the subsequent 25. And the ability to actually make an investment, generate a profit and then have more capital to invest that's precommitted to us is a big deal and a lot different than how we've traditionally raised funds where we have to go back and start over. That piece of it is incredibly powerful. And so if you look out beyond kind of years 5 to 7 I'd say what would have started as a majority of the capital I would say would be new to the firm, I'd be confident saying that. Beyond that first fund raising cycle it's going to go up from there.

**William J. Janetschek** - *KKR & Co. L.P. - Member and CFO*

And Patrick, just to give a little color, and you are right you asked a question that is really hard to answer. One of the strategic partnerships that we just closed on this quarter with a relatively new partner they had only invested a small amount of capital in one particular fund, they were interested in a long relationship with a GP and so over the past year plus we worked on that with that LP, and I think that would be all incremental as opposed to a couple of the other strategics who had been with KKR for very long time and that would be harder to try to figure out what that number would be.

**Operator**

And our next question comes from Gerald O'Hara, Jefferies.



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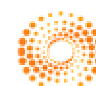

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**Gerald Edward O'Hara** - *Jefferies LLC, Research Division - Equity Analyst*

Maybe 1, just touching on infrastructure, looks like per page 12 of the release, that was a segment that was up quarter-over-quarter. Can you perhaps give us an update as to where the latest fund, vintage fund stands with respect to commitment or percent committed and when a potential successor fund might enter the discussion?

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

Sure. Hey, Jerry, it's Craig. Thanks for the question. I'll answer the first part and I'll let Bill give you an update on the commitment piece. Look, I think the part that you're totally, you're exactly correct about is the momentum we feel, and I think that's true in terms of both the global need for infrastructure, it's enormous, it's growing. The infra team as you have a sense from Scott talking about Q-Park as well as Calvin Capital a couple of quarters ago, the infra team for us remains one of the most active teams from a deployment standpoint. And I think there are a few things that make us unique in this. One, we're looking for infrastructure with a focus on downside protection. So we have a pretty disciplined focus on it. We're pleased with the returns we've been delivering for the last decade. And I think we've proven we can navigate complexity. I think there are elements of that you see in terms of the Q-Park transaction and when we're able to look at that opportunity and put that together with the balance sheet and the capital markets business it's pretty compelling. From a performance standpoint you have a sense of overall performance, you're correct, on Page 3 with the infrastructure fund itself up over 20%, the Infra II fund, similar performance for Infra I, and it's really been strong and it's been broad-based. And in terms of the platform, when you look at the 2 funds we have and the SMAs, we're at almost $6 billion of AUM and we are fund raising for an infrastructure strategy.

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**William J. Janetschek** - *KKR & Co. L.P. - Member and CFO*

And then as it relates to the remaining commitment, if you turn to Page 15 of the press release you could see that we've got roughly $1.8 billion remaining on-call commitment. However, that being said, and we mentioned this earlier, we've been pretty active in infrastructure and so Q-Park actually did close in the fourth quarter. And so we're probably going to put anywhere between $600 million and $700 million to work in the fourth quarter or the first quarter depending on the closing of the signed transactions that have not yet closed. And so we're obviously with having that much pace of deployment premarketing the next infrastructure fund.

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**Operator**

Our next question comes from Glenn Schorr with Evercore.

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**Glenn Paul Schorr** - *Evercore ISI, Research Division - Senior MD, Senior Research Analyst and Fundamental Research Analyst*

There has been some talk in the press as to some -- only the largest funds is thinking about in-sourcing and going direct on PE which I'm not a huge fan of if anyone asked. But how does that play into the whole, the client demand that you're seeing like the New York City deal in these partnerships. And I know we've asked, all asked a few different ways on how many are there, but how pervasive is that conversation on in-sourcing versus going longer term for preferred terms?

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

Hey Glenn, it's Scott. I'd say it is -- not many institutions are able to truly go direct themselves. The staffing requirements, the ability to staff across multiple asset classes and build a global investment team, there are very few institutions in the world that are able to do that. So while I read the same press that you have, in our experience that is a small, small minority of institutional investors that are pursuing that strategy. What we're finding to be much more pervasive is that institutions are beginning to act out some of the themes that we've been hearing from them the last few years which is they feel that in the last cycle they over-diversified their portfolio and they're trying to figure out how to do more with fewer partners. And I think the strategic partnership theme we've been discussing fits right into that. They're just basically acting on that view that they



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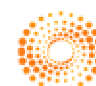

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have a lot of capital, a small amount of staff and a desire to partner closely with firms like ours to basically be an extension of their team on a global basis in a long-term structure. We're finding that to be a much more frequent conversation than those that are trying to go direct.

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**Glenn Paul Schorr** - *Evercore ISI, Research Division - Senior MD, Senior Research Analyst and Fundamental Research Analyst*

That makes a lot of sense to me. And I know you said you don't have lots of these and you don't expect 20 or 30 of these, but do you have any limitations in your mind in terms of what you'd be willing to take on? I heard you on the triple the economics, so I think more is better. And then just a follow on is, how do you set the size limitation? In other words you talked about $3 billion and above, $1 billion, $2 billion, seem like pretty big numbers too, like how do you draw that line?

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

So I'd say, look, there's no contractual limitation per se. There is a limitation vis-a-vis just our own ability to do service and operationalize in the period of time. But I want to be very clear what we're talking about, we're using this term strategic partnerships in a very specific sense. It is basically partnerships that are quite long-term, the ones we're talking about today have long-term recycling provisions that are contractual across multiple asset classes at $3 billion plus. We have a large number of investors with whom we work that are invested with us across multiple asset classes that have virtually all of those characteristics except for the long duration recycling that's recommitted. But we have a lot of partners that work with us in the $1 billion and $2 billion size range across multiple asset classes. It just hasn't been put into this kind of strategic partnership wrapper and so if you look at us as a firm across our client base our average cross-sell is 1.9 products per client. And if you look at our top 50, it's over 4 products per client. And so I'd say we have synthetically a number of these strategic partnerships already in-house and we're going to continue to grow those, but those just don't happen to have this kind of 20- to 30-year contractual element although several of them we find have very, very long lives just by virtue of the underlying partner recommitting to us across multiple strategies. So we'll look at it broadly. But it's really the specific long-term recycling element that's contractual is what we're calling out today.

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**Operator**

And our next question comes from Alexander Blostein with Goldman Sachs.

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

So shifting gears a little bit, I wanted to touch on the balance sheet. So the cash balances are up nicely I think $3.6 billion versus $3 billion last quarter. Can you guys talk a little bit about how you're thinking about deployment of that cash over the next couple years? Should we think of that at all in terms of co-invest or is there some M&A opportunities that we might be thinking about as well? And then I guess bigger picture just the evolution of the balance sheet period, how should we think about that over the next 2 to 3 years obviously with so much of the legacy investments coming down and First Data doing quite well since the offering so looks like that might be something to think about as well the next 12 to 18 months or something like that?

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**William J. Janetschek** - *KKR & Co. L.P. - Member and CFO*

Hey, Alex this is Bill. When you look at where the balance sheet is today and remember our strategy is a little different than others in that we retain a lot of the economics on the earnings and put that back onto our balance sheet to compound that. And so what you'll end up doing hopefully is actually see the balance sheet just continue to grow. From an allocation point of view, we spend a lot of time just trying to figure out where we need to deploy capital and so that might be platform specific or geography specific. And we give a lot of thought around to trying to make sure we size out what that right number is. And so when you mention co-invest, as you probably recall certainly over the last couple years we've been making significant commitments to our funds and deploying capital that way. But in addition we have the ability, and the way our model works is first we have to make sure that we satisfy the flagship funds investment mandate and then we have the ability to syndicate or to co-invest. And so we opportunistically have the ability to co-invest alongside capital that's being invested by other third-party investors.



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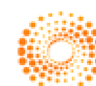

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**Scott C. Nuttall** - *KKR & Co. L.P. - Co-President, Co-COO & Director*

I'd say, look, the second part of your question, the balance sheet make up, we have an asset allocation model for the balance sheet which we work our way toward and we've made good progress over the last couple years. We've got, if you look at Page 19 of the press release, you can see the contractual fund GP commitments we have which are nearly $3 billion, so that will get drawn down as those underlying funds get drawn down. We do have some new business ideas that we're working on and that we'll continue to use the balance sheet to seed those new businesses on a go-forward basis and we'll keep you updated. Co-invest will be part of it but we also do have opportunities on the strategic side with respect to what we've already done. So I mentioned the incremental 5% that we're buying of Marshall Wace which will show up in our AUM and our fee-related earnings. And we've got other things that can happen from time to time on the strategic front. We've largely grown ourselves organically the last several years but there may be some things on the opportunistic side that could be interesting in time. But I think you'll continue to see us commit capital across all of our asset classes. And one of the things we're focused on is getting to that asset allocation number. And frankly kind of 40% to 50% is our target around private equity on the balance sheet. As we'd had lot of monetizations we've been working to make sure that we kind of keep in that range.

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

Got it. That's helpful. And then just a quick follow up around strategic partnerships. As these type of relationships scale for you guys anything you need to invest into operationally to help service these type of mandates that could kind of augment the FRE margin profile of the business as a whole or the business is generally kind of scaled enough so that's not a really needle-mover in terms of the FRE margins?

**William J. Janetschek** - *KKR & Co. L.P. - Member and CFO*

Hey, Alex, this is Bill. That's a very good question. And Scott mentioned this and this deals with operational complexity and so these strategic partnerships are very customized and so you have to deal with fee calculations and carry, et cetera. But when you think about having the ability to raise large sums of capital, like a $3 billion mandate, if we have to add a few people to deal with the compliance, regulatory environment, finance and tax, the economics far outweigh the minor expense in order to service that particular strategic partnership.

**Operator**

And our next question comes from Devin Ryan with JMP Securities.

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

I guess my question, first question here just the trajectory of FRE obviously is significantly higher year-to-date, some of that's tied to the higher capital markets transaction fees which obviously could be lumpy, but it sounds like the outlook commentary there is pretty good. So I'm just trying to think about as you guys are going into 2018 budgeting and kind of reexamining the dividend with the dividend contemplated off of kind of the trajectory of FRE how should we think about maybe the capacity for dividend increases relative to the FRE growth when you kind of factor in how strong the capital markets piece has been this year?

**William J. Janetschek** - *KKR & Co. L.P. - Member and CFO*

Devin this is Bill. When you take a look at fee-related earnings you are right. And so if you take a look year-to-date '17 compared to '16, we're up 49%. And when you think about what drove that, we raised significant pools of capital for Asia III and Americas XI -- sorry, America XII which has now come online. And so you saw a significant increase. And what we try to do is when we try to size the dividend itself it's a component of both the fee income, net of expenses as well as the yield. And when you look at the balance sheet, and Scott just talked about this a little bit earlier from an asset allocation point of view, we're trying to grow our allocation really in private equity which would impact yield. And so at the end of the



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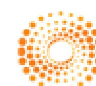

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year when we're deciding what the distribution for '18 would be on a quarterly basis and we haven't done that math yet, those two things are taken into consideration when we're talking about a distribution for 2018.

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

Got it. Okay. Thank you. And follow-up here, just I think last quarter you highlighted a second energy incoming growth fund to be coming down the pike and I am just curious about kind of aspirations for size there, would that be multiples of the First Fund of $2 billion dollars or just trying to think about kind of the outlook for that area and maybe kind of appetite for exposure there.

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

Hey, Devin, it's Craig. So you're correct, we are fund raising for a follow-on fund in the energy strategy. As you see on Page 3, the performance has been strong. As I know you have a sense, we're not big on providing target sizes et cetera, so no specific comments in terms your question of whether it could be large and if so how much, but we'll look to raise a pool of capital that we think is appropriate on behalf of our LPs to earned attractive risk-adjusted returns.

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

Yes. The only thing I would say is energy fits obviously into our real assets area. We just would tell you that over time with significant amount of growth opportunity broadly across real assets and energy is part of that, it could be multiple ways to get there but energy is a young business for us that we think has growth opportunity.

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**Operator**

And our next question comes from Michael Cyprys with Morgan Stanley.

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

Just wanted to ask about data and technology and if you can talk about your investment process today, basically how you see that evolving over the next 5 years given a lot of changes in technology, growing amounts of data and how you're integrating that today relative to where you'd like to be.

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

Michael, it's Scott. Yes, timely question, so we've been spending a lot of time working on this and thinking about it. As a reminder, several years ago, 5, 6 years ago now we had a team join us our Global Macro and Asset Allocation team led by Henry McVey and part of the logic for that team joining the firm is we felt that there was a lot of information that we have inside KKR that we could use more effectively to make us better investors. So a good portion where that team spends their time is making sure that we're looking at the information we have in-house and then they work across all of our different investment committees to make sure that our discussions are informed by the data that we have in the firm as best we can. Having said that, and I think that's had a big impact on how we think about investing and how we're deploying capital. But having said that, we think there is a long way to go and a lot more that we can do. And so we are spending time looking at how do we bring more technology to bear in terms of analyzing the data that we see coming out of our portfolio companies and that we otherwise have access to and figuring out if there are ways to get a read through from that data that will further enhance our ability to see trends and make good investments. And so it's an area that we're spending time on. I think it's something that given our globality and the breadth that we have across asset classes it should provide us with an incremental competitive advantage and so we're spending more time there. Bit early to give you a specific update as how we're going





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to use technology to get even more out of the data, but I would say we're -- we've started, but it's kind of second inning relative to where we, I think, we'll end up.

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

Okay. Thank you. And just on the balance sheet. I know in the past you gave some figures around that. I'm just hoping to get better understanding on how much capital was deployed off the balance sheet during the quarter and also how much was monetized off the balance sheet.

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**William J. Janetschek** - *KKR & Co. L.P. - Member and CFO*

Hey, Michael, this is Bill. Nothing terribly exciting in this quarter. We did mention that there was good monetizations which drove the performance income from the funds but we had some minor activity off the balance sheet. So for example, I mentioned in prepared remarks that we sold a small portion of our First Data position, that was roughly 7% of our position and that generated roughly $100 million. But overall you could see that the balance sheet hasn't gone up or down meaningfully quarter-over-quarter.

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**Operator**

And I'm not showing any further questions at this time. I would now like to turn the call back over to Craig Larson for any further remarks.

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

Daniel, thank you. And thank you, everyone, for joining the call. If you have any questions please feel free to follow up with us directly. Thanks again.

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**Operator**

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

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**Editor**

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