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KKR - Q1 2016 KKR & Co LP Earnings Call

EVENT DATE/TIME: APRIL 25, 2016 / 2:00PM GMT

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PRESENTATION

Operator

Ladies and gentlemen,

thank you for standing by. Welcome to KKR's first-quarter 2016 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.

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

Thank you, Bridget. Welcome to our first-quarter earnings call. Thank you for joining us. As usual, I'm joined by Bill Janetschek, our CFO; and Scott Nuttall, Global Head of Capital and Asset Management.

We'd like to remind everyone that we will refer to non-GAAP measures on the call, which are reconciled to GAAP figures in our press release, and that this call will contain forward-looking statements which do not guarantee future events or performance. Please refer to our SEC filings for cautionary factors related to these statements. And also, like previous quarters, we have posted a supplementary presentation on our website that we'll be referring to over the course of the call.

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Turning to the quarter, the first quarter was a bumpy ride across global capital markets. And, like many others, we weren't immune. This morning, we reported a first-quarter economic net loss of $507 million and an after-tax economic net loss per unit of $0.65. Total cash earnings for the quarter were $169 million.

Now in our second-quarter reporting under our fixed distribution policy, we have again announced a $0.16 per-unit distribution. And on the buyback front from February 11, the date we last provided an update through April 21 we repurchased and canceled 10.9 million units for $147 million, leaving us with about $110 million remaining under the current authorization.

And with that, I will turn it over to Bill to discuss our performance in more detail. Bill?

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

Thanks, Craig. To set the stage for our results, let me begin with our performance. Overall, our private equity portfolio was down 0.9% in the quarter and on a trailing 12-month basis was up 7.7%. This compares to a 0.2% decline for the MSCI World Index in the quarter and a 2.9% decline over the last year. So on a relative basis, our PE portfolio was in line with the MSCI over the three months, with 1,000 basis points of outperformance over the last 12.

Let's turn to page 2 of the earning supplement that Craig mentioned earlier, which frames performance in more detail. This page, as you will recall from prior quarters, reviews the performance of our benchmark funds. In the middle of the page, you can see that our flagship US and Asia PE funds were flat for the quarter, with meaningful outperformance on an LTM basis, while Europe III outperformed over both time periods.

Within real assets, our real estate and infrastructure funds continue to perform, while EIGF has seen write-downs, largely due to declines in underlying commodity prices.

Shifting to alternative credit, Q1 was a volatile period, with leveraged credit indices rebounding in March after a difficult start to the year. For the quarter, our benchmark Special Sits and Mezz funds were down modestly, though both continue to outperform their benchmarks by several hundred basis points on an LTM basis.

Focusing on total segment financials, management, monitoring and transaction fees were $280 million. While fees were higher last quarter, largely as a result of the First Data IPO and subsequent re-financings, this quarter we benefited from $25 million in net fees related to the Mills Fleet Farm transaction, which we talked about on last quarter's call.

Performance income in the quarter was minus $125 million, due to the modest declines in our carry paying funds. Realized carry was driven principally by activities from Masan and US Foods.

Shifting to investment income, investment performance was weaker this quarter, as our balance sheet investments were marked down 5.4%. Scott is going to provide some additional color around this in a few minutes, as this ultimately drove the $530 million of investment loss in the quarter.

Cash compensation and benefits came in at about $100 million, lower on both a quarter-over-quarter and a year-over-year basis, as we reduced compensation to protect margins, given the decline in revenue in the quarter. Occupancy, together with other operating expenses, came in at $78 million, also lower on a quarter-over-quarter basis.

Bringing it all together, fee-related earnings came in at $141 million, with reported pretax ENI at a loss of $557 and after-tax ENI of about the same.

Touching on AUM and fee-paying AUM, page 3 of the supplement highlights the growth in our AUM over the last 12 months. Our AUM has increased 17% to $126 billion over this period, driven primarily by $27 billion of new capital raised and the inclusion of $6 billion from the Marshall Wace transaction. Of note, the $126 billion includes over $18 billion of assets where we are not yet earning economics. So, we haven't seen that impact on our management fees. Fee-paying AUM has also grown nicely and is up about 9% over the same time period.

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In the quarter, AUM increased by $7 billion behind continued fund-raising activity in private and public markets. Net inflows in private equity, special sits, hedge funds, our strategic partnerships and a few of our liquid credit mandates were the noteworthy contributors. Fee-paying AUM increased $2 billion in the quarter, with relatively equal net contributing factors coming from private and public markets. This leaves us with approximately $35 billion of dry powder at the end of March.

Moving to deployment, we invested $2 billion of capital in private markets, a 47% increase from last quarter. The large contributors were private equity investments in Mills Fleet Farm out of NAXI, LGC and Webhelp within Europe IV and Max Financial in Asia II.

Before I hand things over to Scott, there are two additional items I'd like to touch on. The first relates to our private equity portfolio and the performance of our publics this quarter. If you turn to page 4 of the supplement, we've laid out a few key statistics. First, to reiterate, private equity performance has been quite strong within our benchmark funds: NAXI, Asia II and Europe III, all currently top-quartile-performing funds.

This quarter, at a high level, performance was negatively impacted by our public holdings and, as you can see on the top of the page, were down 7%, compared to our privates, which were up 4%. As of March 31, publics comprised over 40% of the total PE portfolio.

Taking a step back, as everyone on the call understands, public holdings can swing over any 90-day period. And while we felt that impact of that volatility this quarter, we benefit from long-term locked-up capital and aren't forced sellers. Additionally, when you look at the performance of our top five level one public holdings on the bottom left-hand side of the page, you will understand why we feel very good about these investments. Four of the five are trading at between 3.5 and 5.3 times our costs, and we continue to have a great deal of conviction around First Data.

And in looking at the health of the overall PE portfolio, as you can see in the bottom right-hand corner of the page, over 60% of our investments are marked above 1.5 times cost, with over 40% above 2 times cost. In a period where our publics were adversely impacted by market volatility, these stats highlight the strong fundamentals of our PE portfolio and its increasing maturity.

Finally, I would like to circle back on monetizations. While we had a handful of exits in Q1, Q2 has been even more active. Page 5 highlights this more clearly. Q1 saw the dividend recap at US Foods, exits in two of our Asian portfolio companies and a small realization out of our flagship Real Estate fund.

Looking forward, we have a nice pipeline of activity. Of particular note, we have seen an increase in cross-border M&A. Examples here include the announced transactions at Group SMCP, a leading French fashion company which is being sold to a large Chinese textile manufacturer; the sale of a minority stake in a UK regulated water company to Mitsubishi Corporation; and the sale of Alliance Tire, an India-based off-highway tire manufacturer to Yokohama Rubber Company. While these transactions have yet to close, as we look at them today, these three exits were done at 2.1 times cost with an IRR of gross 31%.

We've also seen cross-border M&A activity within our underlying portfolio companies. Haier, our largest investment in China, acquired GE's white-goods business; and Panasonic Healthcare completed the acquisition of Bayer's Diabetes Care business. Given our global platform and relationships, we are continuing to build a track record of helping companies accomplish their goals through cross-border strategic M&A, which should further position us as a partner of choice.

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

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

Thanks, Bill, and thanks, everyone, for joining our call today. Q1 was a volatile and strange quarter. Since 1986, no period besides 2008 to 2009 has had a larger number of three standard deviation moves across asset classes. Cutting through it all, there are two main stories this quarter from our point of view. The first and most important is our ongoing progress building our businesses. The second are the unrealized marks flowing through our financial statements as a result of how all the volatility happened to land on March 31.

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Let me discuss each of these. I'll start with business building. The success we are having is best evidenced by our AUM, which, as Bill walked through, has increased 17% on a year-over-year basis, driven by the $27 billion in new capital that has been raised organically over this period. In terms of the quarter, we have held closes on several funds and feel good about our fundraising momentum across multiple products.

Special Sits II held its final close at $3.4 billion this quarter, and the Special Sits strategy now manages over $9 billion in assets compared to $2.5 billion three years ago. On the heels of our $1.3 billion capital raise for Direct Lending II last year, we recently held an $850 million final close on Lending Partners Europe, our first direct lending fund with a Europe-focused mandate.

At a time when traditional lenders are pulling back, deleveraging and cleaning up their balance sheets, we feel well-positioned to capitalize, given our credit platform.

Other recent activity included an initial close on our Private Credit Opportunities Fund, or PCOP II, the successor to our Mezzanine fund, as well as an initial close on our Next-Generation Technology Growth fund, or NGT. Prior to forming NGT, our technology and media growth equity platform have been funded largely with balance sheet capital. Several warehoused balance sheet investments will be transferred into the fund, again illustrating the power of our balance sheet to accelerate fundraising.

Shifting over to hedge funds, our strategic partnership with Marshall Wace has developed very positively in its first six months and is well ahead of our expectations. They have a deep pool of talent around the globe, and their management team has built a robust and diversified business that combines systematic and discretionary equity strategies. We see real momentum in their business and large incremental demand for their hedge fund products, which combine long-term track records and institutional infrastructure.

With strong investment performance in 2015, a broad suite of products and new product launches, Marshall Wace is well-positioned for 2016.

And shifting to America's private equity, we are making excellent progress on NAXI's successor, and we expect to hit our hard cap of $12 billion of third-party capital. Fundraising has progressed quickly, which we believe is due to NAXI's strong performance and the continuing expansion of our client base. We'll keep you updated as we progress on this topic.

Overall, since 2010 we have seen our total client count grow from 344 to 920, about 2.5 times. And the number of fund investors in multiple products has more than doubled over this timeframe.

Our investment in distribution globally and our strong performance are paying off. We have significant opportunities to scale our client franchise from here.

Now let me move on to investment performance. We have built KKR with a focus on long-dated capital and, in turn, measure performance through a lens much longer than any 90-day period. Our model allows us to weather and capitalize on short-term dislocation, and that is exactly what we have been doing. With record dry powder to begin the year, we have been finding interesting investment opportunities. And deployment in private markets, in particular, was healthy in the quarter.

Having long-term capital with the ability to enter and exit investments at points in time and at valuations we deem attractive is, quite frankly, one of our largest strategic advantages and beneficial to all of us as investors. This advantage, however, does not exempt us from mark-to-market losses in volatile quarters like Q1.

Bill covered the performance of our funds in the quarter, so let me talk to our balance sheet performance specifically. While we believe our business is one that should not be evaluated over any 90-day period, looking at Q1, balance sheet investment performance was below our expectations, as the 5.4% mark-to-market decline drove an unrealized investment loss of $565 million in the quarter. The most significant component of this unrealized loss was the marks on our largest public holdings. You can see those on page 6 of the deck.

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The share price declines in the quarter at our three largest balance sheet positions -- First Data, Walgreens and WMI Holdings -- combined to create a $270 million unrealized loss in Q1. But March 31 is just a snapshot in time. Looking back, these three holdings contributed approximately $650 million of positive investment income over 2014 and 2015, but in a volatile Q1 2016 they took a step back.

Let me spend a moment on First Data in particular, given its significance. First Data's stock declined from approximately $16 to $13 per share over the quarter. This does not concern us. From our standpoint, fundamental performance at the company has been quite good. First Data's fourth-quarter results showed adjusted revenue growth of 4% on a constant currency basis and adjusted EBITDA growth of 7%. And this morning, First Data reported Q1 results, with top-line growth of 5% on a constant currency basis and adjusted EBITDA growth of 13%. If First Data continues to produce results like these, we're going to end up in a very good position down the road.

In addition to the declines in our large holdings, we did see further write-downs this quarter in our energy portfolio. With natural gas and crude prices declining three to four years out on the forward curve, DCF values were negatively impacted. And as a result, we saw a little over $100 million in unrealized losses from our energy portfolio.

And finally, there were a handful of positions within our credit and specialty finance portfolios which also saw write-downs in the quarter.

Overall, everything I just covered accounted for almost all of our unrealized balance sheet losses in Q1.

Given the focus on balance sheet performance and its impact on our results, I would like to shift gears a bit and discuss the evolution of our balance sheet. Going back in time, you will recall our balance sheet is the result of merging with two of our own permanent capital vehicles: KPE in 2009 and KFN in 2014. These transactions created and expanded our permanent capital base and provided for more recurring cash earnings. At the time of the transactions, we saw opportunities to redeploy capital over time into higher-returning assets.

In effect, we have been transitioning these two portfolios to a more permanent and optimal asset allocation.

Take a look at page 7, which details the evolution of our balance sheet since 2009. At the time of the merger with KPE, 97% of KPE's investments were in private equity, including the First Data and Walgreens co-investments. As we realized investments from that largely PE portfolio, we redeployed capital to seed new product offerings for the firm. As a result, immediately prior to the KFN acquisition in April 2014, that figure had declined to approximately 60% in PE.

Then we acquired KFN, which was largely a yielding credit portfolio. As a result, credit investments, including specialty finance, grew to roughly $3 billion, or 37% of fair value, immediately after the KFN acquisition approximately two years ago. You can see this in the middle pie chart on page 7.

Since then, as investments have matured or been monetized, we have redeployed capital into higher-returning investment opportunities. So today, the credit portfolio is about $2.1 billion, or 26% of FMV, and we're on our way to reducing it further.

If you dig into the detail, our acquired CLO 1.0 portfolio, which are CLOs issued pre-2012, have actually been reduced from $1.2 billion to $500 million, or nearly 60%, in the last two years.

In its place, we have been creating new CLOs, called CLO 2.0 in the chart, where we hold a small portion of the equity on our balance sheet and generate new management fees for the firm. So far, our total CLO equity portfolio has declined from 19% of our balance sheet investments to 10%.

Going forward, you should expect us to have lower overall credit exposure made up of even less exposure to CLOs relative to where we are today and larger GP commitments to our alternative credit funds. Given the illiquid nature of many of these existing investments, this transition will not happen overnight, but we are well on our way.

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In addition to changes to our credit book, we have also been reducing our exposure to other legacy assets and redeploying the proceeds into our own funds and strategic initiatives, both seeding new businesses like growth equity and real estate credit and making strategic investments like Marshall Wace.

Stepping back, the primary use of our balance sheet over the last several years has been to seed or acquire new businesses and accelerate the growth of our third-party AUM and our capital markets business. Said another way, a lot of the economics from how we have used our balance sheet do not show up in investment income, but it does show up through our AUM fees and carry.

As you can see on the chart, AUM has grown over this period from $50 billion to $126 billion, or by $76 billion, increasing our management fees and carry opportunity meaningfully as a result.

To wrap things up, as I said, Q1 was a strange and volatile quarter. But looking through the volatility, we feel very good about how we are positioned. We are pleased with our fund investment performance. Fundraising has been strong. With record dry powder, we have been deploying capital into a dislocated environment, and we successfully exited investments through strategic M&A, secondary sales and leveraged recaps. We are not immune to mark to market in a given quarter, but we don't invest, manage or build our businesses with a 90-day view. In fact, we think market volatility is great for us over the long term. We've built KKR to outperform by capitalizing on markets like these.

With that, we are happy to take your questions.

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

And Bridget, just before we open it up, just looking at the screen, we have quite a long queue. So if we could ask everyone to limit it to one question and a follow-up if necessary, we would appreciate it.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Bill Katz, Citi.

Bill Katz - *Citigroup - Analyst*

It sounds like you may have bought back another million units, round numbers, from the end of the month to now. So just stepping back, Scott, sort of your last discussion point on the migration of your balance sheet and then sort of the redeployment of that capital, could you counterbalance how you see return of capital to investors versus growth in some of these other initiatives? And then more specifically to that, how you are thinking about incremental buyback, assuming you were to finish off this current $500 million authorization?

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

Yes. Just by way of background, we do see a lot of opportunities to grow our firm and our businesses. And as I mentioned, with the next-generation technology growth fund, real estate credit, we continue to use the balance sheet to seed new businesses and drop them into fund format so that we can accelerate management fee and carry realization. So we will continue to do that, and we see a lot of opportunities to continue to use the balance sheet for that purpose.

As background, I think as you are aware, we announced a $500 million buy back in late October and we started buying stock in early November. So at the time we announced the program, we said we thought we would spend the $500 million over 12 months or so. And we also said that our

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goal was to keep our share count flat over time, control dilution from comp-related share issuances. So we said $500 million, and we thought it would take about a year to spend.

Over the last less than six months, we have bought back or canceled about 30 million shares. And so we spent $400 million, give or take, of the $500 million already in less than six months.

So we feel like we are on pace -- ahead of pace, actually -- in delivering on our objectives. And our share count actually has come down since the announcement. So we don't plan on forecasting buyback activity, Bill. But what we are happy to share is that we do see a lot of opportunities to continue to invest in the firm and grow our businesses; our fee and carry businesses, in particular. It doesn't mean we're going to buy back shares continuously, but we are committed to, at a minimum, keeping our share count flat over time. So we have a framework internally for how we compare the price of our stock to the internal opportunities. So far, the light has been green, so we have been buying. But we will keep you posted as we go forward.

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

Just as a follow-up, to help you with the math a little, as of March 31 total units outstanding were about 845.4 million shares. From March 31 through Friday of last, we actually bought back another 2.4 million shares and canceled an additional 2 million shares vis-a-vis the tax allocation. So the share count right now as we stand today is down to 841 million.

Bill Katz - *Citigroup - Analyst*

Okay. Thank you.

Operator

Glenn Schorr, Evercore ISI.

Glenn Schorr - *Evercore ISI - Analyst*

Curious -- on the seven exits so far in April that you announced, did you mention what type of distributable earnings are attributable to them?

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

Right now, as we stand today, if I did the math on the seven, the cash carry that would come to us would be approximately $0.16 in total. And then, to the extent that we have some economics by our GP interests in those assets as well, that would produce roughly about another $0.07 of cash earnings on our balance sheet.

Glenn Schorr - *Evercore ISI - Analyst*

Okay. Appreciate that. And then could you remind us the process on how investments make their way -- new investments going forward make their way onto the balance sheet? What goes in the funds? What gets co-invested on the balance sheet? Is that a corporate decision one investment at a time?

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

I think the most straightforward way to think about it is the balance sheet is a large investor in our funds and often times is either the largest or certainly one of the largest investor in all of our funds. So when you have a draw-down of capital that goes into a fund, the balance sheet capital is just drawn down pro rata alongside your limited partner investors. And that's how the vast majority of the capital is getting deployed these days off the balance sheet. So, just every time we announce a transaction across asset classes, think of it as the balance sheet making a pro rata investment alongside the third-party investors.

Periodically, we will also announce strategic activity, and that is clearly 100% balance sheet. Things like the Marshall Wace transaction as an example. And also even less periodically, we will have co-investments where the balance sheet will participate. But I'd point to the vast majority of activities just going alongside the third-party LPs.

Glenn Schorr - *Evercore ISI - Analyst*

So I guess over time we should see public -- never mind. Okay, I got it. Thank you.

Operator

Patrick Davitt, Autonomous.

Patrick Davitt - *Autonomous Research LLP - Analyst*

It looks like the energy mark was significantly higher than even the curve move in the quarter, at least the oil curve. Is there some real impairment to some of those positions? Could you now walk through why it appears to be so disconnected this quarter?

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

If you take a look at where we marked the portfolio in December and where we marked the portfolio in March, when you take a look at where the three- and four-year forward curve is, it was down roughly 14% and 16%, respectively. And so when you run that through a DCF, you should expect that our energy portfolio would be down in about that percentage. So, nothing really to talk about as far as any impairments.

Patrick Davitt - *Autonomous Research LLP - Analyst*

Okay. Great. Thank you.

Operator

Devin Ryan, JMP Securities.

Devin Ryan - *JMP Securities - Analyst*

Just on the private equity investments, a little surprised by the 4% increase in this backdrop. Just curious if that was a function of some specific situations or movement in public comps. And can you also provide any perspective around the type of discount you are applying right now relative to public comps and how that has changed maybe over the past year since the privates have outperformed quite a bit, up about 10% relative to a flattish market?

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

Just at a high level on the privates, when you think about it, where we were carrying some of our private investments in December and then where we marked them in March, we mentioned that there were a couple of strategics that we're selling. So during this quarter you actually saw a pretty nice uplift in those investments.

Typically, when we value our privates, 50% is DCF, 50% is market comps. And we usually take a liquidity discount on those values. Obviously, when someone comes in and you have a strategic for 100% of the company, and someone is willing to pay a premium, you're going to see an increase in those privates.

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

The only other thing I'd add, Devin, is that we do -- have seen good operational performance in the private equity portfolio. So if you look at the weighted average performance across the portfolio globally, last 12 months about 8% revenue growth and about 10% EBITDA growth. So it's really a combination of good underlying operational performance plus some strategic exits that Bill mentioned.

Devin Ryan - *JMP Securities - Analyst*

Great. That's helpful. And then just a quick follow-up here. On Europe last quarter, you guys were pretty constructive on the call. I'm curious how you are feeling today. It sounds like you still are. And I guess I'm just more curious with Brexit, that conversation, is the timing there impacting activity, or is stuff on hold until post-decision?

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

Great question. The private equity funds in Europe are continuing to perform really well. The underlying portfolio is performing. But it's not just private equity. We are also seeing good performance across credit, real estate, infrastructure. And really strong performance as we have seen in the last 10 years, ex-energy.

So we have been busy. We have been selling businesses in Europe. Buying is a bit more challenging with high prices, but we managed to get a couple things announced including the Airbus Defense electronics deal. And financing is available. So, yes, we remain constructive on Europe overall and see lots of opportunity.

In terms of the Brexit question, it is impacting how we think about investing in the UK in particular. But it's really much more isolated to the UK as opposed to pan-European.

Devin Ryan - *JMP Securities - Analyst*

Understood. Great. Thanks, guys.

Operator

Chris Harris, Wells Fargo.

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Chris Harris - *Wells Fargo Securities, LLC - Analyst*

A question about the marks on the balance sheet this quarter -- you highlighted here that around $350 million tied to First Data and energy. That still leaves about $240 million of other write-downs. You mentioned, I think, that this was tied to a handful of other positions. Wondering if you could maybe talk a little bit about what happened with those positions in the quarter.

And then if we step back more broadly and think about the balance sheet, it sounds like we think the First Data marks are sort of technical in nature. The energy marks -- clearly some fundamental issues going on there. But how would you guys characterize the other marks, whether you think they are broadly technical or whether there are some more fundamental problems in those underlying investments?

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

I think your math is right. So you are right; if you look at page 6 of the deck, you can see -- if I lumped together Walgreens and WMI with First Data, if you look at just what's on that page, you've got $380 million, give or take, of marks there just in those positions. And that's the first big bucket.

The other balance sheet marks are really going to be -- have a couple themes to them. One is going to be some credit positions we have that will have some indirect exposure to energy so that there's some look-through in the credit book to some energy names. And that would be the other big theme.

Everything else will be just little one-offs, for the most part, of individual comps that have traded down in the quarter, but no other big themes that I'd point you to. So it's kind of the big ones listed on page 6 plus a little bit of read-through through the energy credit portfolio.

In terms of the second question as to how we characterize those marks, I think for the vast majority of what we saw in Q1 it was moment-in-time, mark-to-market unrealized. If you really look at the face of the financial statement, you can see there's about $24 million of realized losses. Everything else was mark-to-market.

So as we look at the underlying exposures that we have, our view is the vast, vast preponderance of the marks are just related to the volatility and some of the noise that we are seeing in terms of commodity prices or otherwise. Very few of those positions are situations where our option can be truncated for us. So the vast majority of those are going to be situations where we do not have, necessarily, a gun to our head. It's more that we've seen a mark, and we anticipate that the vast majority of that will come back as markets normalize. And we have probably already seen some of that in Q2, but we will continue to watch the markets closely.

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

And then when you look at the balance sheet in particular, when you take into account interest and dividend income, even net interest expense -- Scott mentioned that $25 million realized loss. On a realized basis, we ended up booking an investment gain, cash earnings, of in excess of $35 million.

Chris Harris - *Wells Fargo Securities, LLC - Analyst*

Okay. Thank you.

Operator

Chris Kotowski, Oppenheimer.

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Chris Kotowski - *Oppenheimer & Co. - Analyst*

I'd like to ask Scott to elaborate a bit on the comments he made about credit. And just going from 37% of the balance sheet to 26% in the span of just two years seems fairly dramatic. And I'm curious to what extent does that reflect a much more cautious view on the credit cycle. And I guess also if you can elaborate a little bit on what are the relative risks of CLO 1.0 versus CLO 2.0 and of a GP investment in a fund. How do you see the risk-reward of those three categories of investments?

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

Happy to take it. You are right; we have gone from 37% credit in June 2014 to about 26% as of March 31.

But I'll point you back to when we announced the KFN acquisition. And we said that we saw an opportunity to redeploy a lot of the capital on the KFN balance sheet into higher-returning opportunities including business building. So as a reminder, the KFN portfolio when we bought it was about a 10% to 11% ROE business. And we thought that we could generate higher returns by monetizing some of those legacy investments and redeploying the cash into other opportunities that we saw as a firm.

And so that was really the articulated strategy when we did the deal. And a big portion of this, Chris, is just us following through on that commitment. So if you look at the pie chart, you can see the biggest change on the pie charts on page 7 is really what we call that 1.0 book shrinking from 15% of the balance sheet down to 6%. And that has been purposeful. Really, what we saw there was that they made a lot of CLOs that were done pre-crisis that were getting into their periods where we could call them. The return on equity was at such a level we thought it was the right thing to do was to call those CLOs.

And that's really what we have been doing. That's what is a big portion of the move in terms of the reduction in the credit exposure.

And then we have been redeploying the proceeds into several new things, as you can see at the bottom of page 7, that we do think have a higher return than the 10% to 11% that the KFN portfolio was yielding.

Chris Kotowski - *Oppenheimer & Co. - Analyst*

Okay. So, just as a follow-up, there was about $1 billion, I think, of debt that had 25- to 30-year maturities. Are those the funds you are redeploying? Is it in the KFN legal structure?

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

No. To be really clear, there's two things going on here. KFN had investments in CLOs. So we owned the equity in CLOs that we were managing. And then KFN as an entity had created a capital structure for itself and had borrowed money and issued preferred stock that were very long-dated in nature.

So, we moved the liabilities over to KKR's balance sheet, and we continue to enjoy the benefits of that long-dated financing to finance all of KKR now on a holistic basis.

And on the asset side, some of those investments that KFN were making, those are the ones that we called and have been redeploying the cash into new investment opportunities.

Chris Kotowski - *Oppenheimer & Co. - Analyst*

Finally, on the Hudson Yards, are you -- is your investment there limited to your headquarters, or does it go beyond that?

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

It's just limited to our headquarter purchase.

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

It's just our headquarter purchase. But one thing I want to come back to on the second part of your CLO question, Chris, is around the 2.0 investments that we've made. And really the distinction we are making there is that we are issuing new CLOs. Our balance sheet is taking an equity position in those. But at this point, it's just the minimum required for risk retention. And the newer CLOs that we are doing -- actually, the equity investment in those CLOs is not mark-to-market. And so you will see that as a footnote in our press release.

So the way I would think about that is that we are issuing new CLOs, we're booking a management fee on that new liability structure and we are making a modest investment in the equity of those CLOs. And we think the return on equity of the CLO 2.0 book is going to be very attractive - mid teens, 20%-plus.

Chris Kotowski - *Oppenheimer & Co. - Analyst*

Okay. Got it. Thank you.

Operator

Brian Bedell, Deutsche Bank.

Brian Bedell - *Deutsche Bank - Analyst*

You talk a little bit about the management fee development. Maybe if you can just -- a couple things. Just highlight the fundraising outlook for this year. Certainly between NAXI XII and the real estate investments and anything else that you want to highlight. And also how you view the timing of the $18 billion of shadow AUM coming onto fee-based AUM. And I guess related to that, how you think about appetite for more alternative manager acquisitions like Marshall Wace and Prisma.

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

Great. I'll take one and three, and Bill will take two. In terms of the overall fundraising, it has been busy. As I mentioned, Q1 Special Sits II, European Direct lending, growth tech initial close and then, of course, America's XII off to a great start. So there has been a lot going on.

As we look at the rest of this year, I'd say, one, continued fundraising for America's XII. We have our second opportunistic real estate fund, REPA II we call it, in the market. We will be wrapping up fundraising for our European real estate fund, REPE. We've got our PCOP II fund, the successor to Mezz, in market, and then we will continue raising capital for growth equity. And so those, call it, five or so funds will be in market for a good chunk of the rest of this year.

Coming down the pipe, we've got Global Direct Lending III, because we've seen quite a good pace of deployment in Direct Lending II. And then at some point we'll be talking to you about Asia private equity but it's a bit early.

And then on top of that, we've got the continuously raised capital across Prisma and new suite of products there, Marshall Wace, Nephila, high-yield leverage funds, CLOs, SMAs, etc. So, quite a bit going on on the fundraising front.

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In terms of the acquisition question, I would not expect us to do a lot more stakes investments. Marshall Wace, we think, is a great platform from which to build. So I'd expect the vast preponderance of our activity on a go-forward basis in the hedge fund space will be with our partners at Marshall Wace, if not the entirety of our activity going forward. And beyond that, we will be opportunistic, but there's nothing that's in our sights at this point.

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

And Brian, as it relates to the $18.1 billion coming online, 99% of that is going to be fee paying. And the good news is a lot of that is in the public markets side, alternative credit, direct lending. Scott mentioned PCOP II. All of those are higher fee-paying AUM, as well as on the private market side like North America XII, etc. And so the blended rate on that $18 billion is going to be north of 1.1%. So that's the good news.

As far as deployment is concerned, a lot of that fee coming online is going to be based upon when those assets are actually invested. And remember, the typical investment period on the public market side is roughly around three years. On the private market side, it could be anywhere between four and six. And so that $18 billion you'll see come online, certainly, over the next two, three, four years.

Brian Bedell - *Deutsche Bank - Analyst*

Okay. I'm sorry; did the $18 billion -- you said that included NAXI XII? Or is NAXI XII outside that?

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

Right now, NAXI XII -- it would only be in AUM. It wouldn't be in fee-paying AUM.

Brian Bedell - *Deutsche Bank - Analyst*

Right, right. Okay, so it's part of that $18 billion?

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

Correct.

Brian Bedell - *Deutsche Bank - Analyst*

Right, right. Got it. Okay. Thanks very much.

Operator

Alex Blostein, Goldman Sachs.

Alex Blostein - *Goldman Sachs - Analyst*

The question for you guys, again, back to the balance sheet for a second. I wanted to touch on the preferred shares that you did earlier this quarter, $345 million. I guess, taking a step back, the change in distribution policy was either to do a buyback or grow the balance sheet with distributable earnings coming in still kind of ahead of the $0.16 a quarter. It feels like there's room to still do both of those things. So just trying to understand the rationale for the pref and your expected use of proceeds.

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

I would just -- nothing particular to call out there. We think it's an attractive cost, long-term it's perpetual capital. And so we view it as general corporate purposes, to give us an ability to do the two things you mentioned -- invest further in building the business or buybacks or both. So nothing to call out particular use of proceeds, it's just normal corporate financing.

Alex Blostein - *Goldman Sachs - Analyst*

Got you. And then just a quick follow-up for Bill, I guess. Among the dry powder that you guys have currently raised and funded and that are in the market today, if we think about the commitment for KKR to co-invest in some of those deals, what is that amount right now?

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

It all depends on the mandate, but the GP commitment for private equity fund is going to be anywhere in between 3% and 5%. And the same will hold true on the public market side in the more established funds. But to the extent that we are raising capital in a new mandate where we really want to jumpstart it, either, A, we will season it with capital on the balance sheet and drop some of those assets into that particular fund, or we will make a stronger commitment as the GP in that particular mandate.

Alex Blostein - *Goldman Sachs - Analyst*

Okay. Great. Thanks.

Operator

Gerald O'Hara, Jefferies.

Gerald O'Hara - *Jefferies LLC - Analyst*

Thanks for the update on the Marshall Wace integration. Just a quick question -- could you potentially remind us or maybe elaborate on some of the new product launches that you touched on? And I guess as it relates to management fees, that might be associated with those strategies?

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

Sure. In terms of the way to think about it, perhaps, most of what we are in market with right now will be more traditional private equity style economics, call it 1.25% to 1.5% management fees for most of the products. It will be 20% carry. And that's certainly the case across America's XII, REPA II, which is the real estate fund I mentioned, REPE, which is our European real estate and growth equity.

PCOP II, which is the successor to our mezzanine fund, also has similar economics. The distinction, though, in the credit funds -- in the private credit funds in particular -- is that instead of getting paid on committed and invested capital, in those funds we tend to get paid just on invested. So you won't see the fees come online until the capital starts to be invested in the ground. And so it will show up in AUM but may take a little bit longer to show up in the fee-paying side in terms of impacting the management fee line. And direct lending is similar to POCP II in that regard.

So, most of those products are going to be fee and carry based. Think long-term capital, three to six years to invest and then 7 to 12-plus to harvest. So, really long-term capital in nature.

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The more continuously raised capital that I mentioned -- high-yield, leveraged loans, hedge funds -- are going to be shorter-dated. And they typically will have either management fee only or management fee plus some incentives.

Gerald O'Hara - *Jefferies LLC - Analyst*

Understood. Thank you. That's it for me.

Operator

Robert Lee, KBW.

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

I apologize if maybe you went through some of this before. But could we maybe drill down a little bit more into the new capital raised in AUM? Of the six -- in private markets, of the 6.6, how much of that was maybe the new North American fund? And then how much was the other strategies?

And as a follow-up to that, you did mention what the targeted hard cap is on the new North American fund. But can you maybe, if possible, update us on some of your target fundraising for some of the other strategies that are you out there with?

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

Just real quickly, I'll go through the particulars on the $11 billion that we raised this quarter. And Scott can elaborate more just on the particular strategies like what the hard cap might be on North America XII. But if you turn to page 11 on the private market side, most of that new capital raise is attributed to North America XII, with some attributed to the growth technology fund that we raised.

On the private market side, that gets you to that $6.6 billion. On the public market side, we are talking about $4 billion, and that came across several mandates. We raised over $1 billion in some credit SMAs. We had the final close of Special Sits at roughly $700 million. We had a final close on European Direct Lending. We actually had $600 million come in from Prisma, which was a very good number in a particular quarter.

And, remember, we report 25%, roughly, of the strategic partnerships that we own. Roughly, we own 25% in each. And when you drill down, our pro rata of that was roughly about $800 million. So that makes up the $10 billion-plus that we've raised this quarter alone.

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

Yes. Just to the second part of your question, I think the way to think about the Americas XII is we do have a $12 billion cap which we expect to hit, as I mentioned. That excludes the GP and employee commitment, to be clear. So we think it will probably be something more in the $12.5 billion to $13 billion range by the time we're done.

I also want to point out as a reminder we raise money for private equity in three geographic funds. So, we are a bit different in that regard. So you've got U.S. -- I'm sorry -- Americas, Europe and Asia. And if you add those numbers up, if you say $12 billion, give or take, for Americas, $6 billion for Asia, $4 billion or so for Europe, we are at about $22 billion in terms of expected capital for this fund cycle for private equity globally.

If you go to the other part of your question, which is around how to think about these other funds, we haven't put out a cap on any of those other funds at this point. Maybe just in terms of a framework, though, in terms of how to think about it, remember most of our first-time funds are in the range of $500 million to $1 billion. So as you think about Next-Gen Tech growth, as an example, or our European real estate fund, those new strategies will tend to be in that ZIP Code. And I think that is a fair way to think about it.

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Then we have successor funds in real estate and mezzanine or private credit. The first real estate fund was about $1 billion of outside capital. And the first mezzanine fund was about $1 billion, give or take, of total capital as well. And so, like our other successor funds, we'd hope to see growth over those numbers. But we will keep you updated through the course of the year.

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

Great. Thanks for taking my questions.

Operator

Michael Kim, Sandler O'Neill.

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

I understand the losses related to the balance sheet were largely unrealized. And, as you pointed out, the balance sheet is much more diversified today relative to prior periods. But with First Data skewing the quarter as much as it did, and I understand that position is a bit of a unique situation -- but just wondering how you might be thinking about addressing concentration risk related to the balance sheet going forward, if at all.

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

If you look at the balance sheet chart on page 7 and look at the far-right, you will see that we actually called out First Data and Walgreens in the pie chart. And First Data is about 12.5% of our balance sheet and Walgreens is about 9%. And so if you look in the grand scheme of the firm, obviously the balance sheet ignores the $126 billion now of third-party AUM that we manage.

So if you think about an individual position, even First Data at 12.5% of the balance sheet, and then the balance sheet is obviously just part of the overall organization, we feel good about the trajectory of that company. And we think that we'll be able to generate good returns on that investment going forward. Same thing with Walgreens.

But we will continue to look at trade-offs as to the trajectory from here for those individual names and other things we have on the balance sheet relative to other uses of capital.

So, we don't have a particular goal in terms of we want to get the exposure down to X. What we would really like to do is have the value creation thesis from here in both those names continue to play out. And then over time you will probably see us lighten up. But it's very early on First Data to expect that in the near-term. We think there's a lot of upside from here.

Walgreens, as we mentioned in a prior slide, has performed very nicely for us so far and is already 3.5 times our cost. So it may be a slightly different story there.

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

Okay. Fair enough. Thanks.

Operator

Michael Cyprys, Morgan Stanley.

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Michael Cyprys - *Morgan Stanley - Analyst*

Just on real estate, just to follow up there, could you just update us on the build-out of your real estate platform, which -- I know you started off your balance sheet a couple of years ago. Recently, you have been investing on the real estate credit side. Just how that has been progressing, the strategy around that and any thoughts on timing for raising a third-party fund.

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

Great question. So, look, I'd say the real estate business has been developing really well and certainly at least in line with our expectations, if not ahead of.

So as a reminder, we did seed our opportunistic real estate strategy off the balance sheet and dropped those investments down into our first-time real estate fund that we call REPA. That fund right now has a gross IRR of about 26%.

So, so far, so good on that. We are in the market now with REPA II, marketing off that track record. So the opportunistic strategy is going quite well.

I also mentioned that we are in the market and have had the first closing on our first European real estate fund, and that's because we saw so much opportunity to invest in real estate in Europe. We filled up the basket on our global fund and needed more capital. So that fund is progressing quite nicely. We've already raised $600 million of capital for Real Estate Europe.

You are right. In credit, we saw an opportunity, brought a team over from Rialto not long ago. Same story again -- we seeded investments in a real estate credit portfolio off the balance sheet. We are dropping that portfolio into a vehicle where we will have third-party investors alongside us, and we will seek more third-party capital fee and carry paying to invest with us in real estate credit, both whole loans and a variety of other opportunistic situations we see in the credit space, given how the markets have evolved there. We're looking at the CMBS market closely as well. So we see opportunities in credit to expand, and that's a very large marketplace.

And then if you go to places like Asia and India, we've actually created some vehicles and are investing on the ground in India in real estate as well.

So, relatively early days, but the development of the business has gone quite well to date.

Michael Cyprys - *Morgan Stanley - Analyst*

Great. And just quickly to follow up, I saw in your press release a reference to real estate investment trust holdings of about $300 million or so that are not held for investment on the balance sheet. Are you creating a REIT of some sort? Just any color you can share around that.

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

Just to be clear, the assets right now are in a structure where it is a REIT. And we anticipate raising third-party capital through that vehicle. And we are holding those assets to maturity, and that's why we had that footnote.

Michael Cyprys - *Morgan Stanley - Analyst*

Great. Thank you.

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Operator

Michael Carrier, Bank of America Merrill Lynch.

Mike Carrier - *BofA Merrill Lynch - Analyst*

Scott, maybe just on the mark-to-market in the quarter, you mentioned some of the portfolio trend in terms of revenues and EBITDA. And it seems like things are progressing still relatively well, given the backdrop. So I just wanted to get your take on either what are you guys looking for to turn that around? And maybe, if you have an update -- I don't know -- quarter to date on where things stand, but just wanted to get a sense on what are you guys looking at in terms of the drivers to shift that.

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

Happy to take a shot at that. So, look, I think for us, we are focused on what we can control. And the biggest driver in our view over time of performance of our portfolio is how the companies are performing from an operating standpoint. That's why I called out the 8% revenue growth, the 10% EBITDA growth. Even in names like First Data, that's why we called out the 5% revenue growth, the 13% EBITDA growth for Q1. And our view is if our companies continue to perform like that, then over time we will perform quite nicely. And you can see, bottom left-hand side of page 4, how the biggest names have performed in terms of multiple of invested capital.

So the operating performance continues to be strong in the first quarter; no big change in trends that I'd point you to. And I think the important thing is for us all to remember we can't get too hung up on the recency effect. The market was quite volatile in Q1. We find ourselves in a bit of an emotional market with a bias to negativity. And our job as investors is to monetize the emotion. And so when we have got volatility and things get cheaper, we are investing into that. And that's why you saw the deployment that you saw in the quarter. And when the market gets happier again, we are selling into it. And that's why you have seen the exits in the quarter, both to strategics and secondaries into the market. And the re-financings that we have been doing when the market gets more upbeat as well.

So we'll continue to monetize the emotion. The portfolio is performing quite nicely with a couple of areas like energy, which we talked about. Industrials are in a bit of a recession in the US. But our global portfolio continues to perform well. And our job is just to continue to monetize the environment over time. And that's why we encourage you not to look over any 90-day period. We will continue to show you the LTM results, the since-inception results. The balance sheet IRR since the beginning of 2010 is about 14.5%. And so we would encourage you to think that longer-term mindset. We got 600 basis points of outperformance over the MSCI over that time frame, and we think we can continue to generate outperformance even as the balance sheet has been in transition.

Mike Carrier - *BofA Merrill Lynch - Analyst*

All right. Thanks a lot.

Operator

I'm not showing any further questions, so I'll now turn call back over to Mr. Larson for closing remarks.

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

Thank you, Bridget. I'd like to take a moment to thank all of you for joining the call. Hopefully, we will see many of you in the coming weeks. In the interim, if you have any questions or follow-ups, please feel free to reach out to Danny or to me directly. Thanks, everybody.

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Operator

Ladies and gentlemen, this does conclude the program and you may all disconnect. Everyone have a great day.

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