



KKR & Co. (KKR)–Balance sheet leverages investing acumen, but adds risk

Founded in 1976 by Co-CEOs Henry Kravis & George Roberts, along with Jerome Kohlberg, KKR is a pioneer of the modern private equity firm, starting out as a leveraged buyout shop that grew into core private equity. From an investing perspective, we see KKR's core philosophy as a more traditional fundamental equity investor, with a focus on deep industry knowledge, but willing to make very concentrated bets with an attempt to leverage high conviction ideas to a greater extent than peers. This has permeated the firm's culture from the start and continues today, most recently exemplified by its balance sheet growth strategy, which is differentiated from peers.

A valuation battleground stock, but we see greater risk profile restraining PE:

With more concentrated positions and its balance sheet strategy, we view KKR risk profile as the highest among these five Alts. Although we see the merits of the strategy – investing to a greater extent alongside its LPs, enabling flexibility to deploy capital more nimbly, and leveraging its investment acumen into stronger potential earnings (while also improving consistency of a recurring distribution), the greater balance sheet size is likely to drive considerably more earnings volatility and restrain KKR's P/E to levels below peers. That said, we view the valuation debate as the most controversial in this stock within the group, with good arguments on both sides. Also, like peers, KKR is diversifying into more fee-based business that may enable a steadier DE profile over the longer-term, albeit with a more volatile ENI profile. Overall, we do not see a significant positive valuation catalyst currently, especially with the recent market sell-off, and the higher risk profile drives our Hold rating for now.

Oaktree Capital Group (OAK)–Conservative credit investment manager

Founded in 1995 by Chairman Howard Marks and President & CIO Bruce Karsh, Oaktree's investment foundation is in credit, and the firm is widely regarded as among the most astute credit investors. We view the company as more akin to a traditional asset manager, with an alternative "twist", given a more pure focus on investing and less on business line development vs. these five peers. Still, we would place OAK squarely in the alternatives camp given its private control investing ability and willingness to participate in financing and complex capital structures to a degree most traditional asset managers can't.

A lower risk profile emanating from a better fee mix and purer business focus:

We especially like OAK's financial profile, with a greater mix of recurring fee-based revenue, and incentive income that is more weighted toward performance fees vs. higher carried interest at peers. We also like OAK's conservative value-oriented and distressed investing strategy, and while seeming risky at times, the performance track record has been outstanding with few misses, and the income stream from its investments drives a steadier AuM profile. We also see substantial growth opportunities for OAK by launching more tangential products (as opposed to new businesses) and benefiting from the slower supply of credit from banks, especially in Europe. This more reliable DE stream helps drive our Buy thesis, along with further P/E expansion toward traditional asset managers.