KKR Real Estate Finance Trust Inc.

First Quarter 2017 Earnings Conference Call

Wednesday, June 14, 2017, 10:00 A.M. Eastern

CORPORATE PARTICIPANTS

Sasha Barenbaum – *Investor Relations*

Chris Lee – *Co-Chief Executive Officer*

Matt Salem – *Co-Chief Executive Officer*

Patrick Mattson – *Chief Operating Officer*

Will Miller – *Chief Financial Officer*

CONFERENCE CALL PARTICIPANTS

Ryan Tomasello – *Keefe, Bruyette, & Woods, Inc., Research Division*

Rick Shane – *J.P. Morgan Securities, LLC, Research Division*

Charles Nabhan – *Wells Fargo Securities, LLC, Research Division*

PRESENTATION

Operator
Good morning and welcome to the KKR Real Estate Finance Trust Incorporated first quarter 2017 financial results conference call All participants will be in listen only mode. Should you need assistance, please signal a conference specialist by pressing the star (*) key followed by zero (0). After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star (*) then one (1) on your telephone keypad; to withdraw your question, please press star (*) then two (2). Please note this event is being recorded. I would now like to turn the conference over to Sasha Barenbaum. Please go ahead.

Sasha Barenbaum
Thank you and good morning. Welcome to the KKR Real Estate Finance Trust first earnings call for the first quarter of 2017. I'm joined today by Chris Lee and Matt Salem, our co-CEOs, Patrick Mattson, our COO, and Will Miller, our CFO.

Before we begin, I would like to remind everyone that remarks and responses to your questions today may contain forward-looking statements that are based on current expectations of management and involve inherent risks and uncertainties that could cause actual results to differ materially from those indicated, including those identified in the Risk Factor section of our prospectus dated May 4, 2017, filed with the SEC on May 8. Such factors may be updated from time to time in our filings with the SEC, which are available on our website at kkrreit.com. We assume no obligation to update any forward-looking statements except as required by law.

In today's remarks, we will refer to certain non-GAAP financial measures. Reconciliations of these non-GAAP financial measures to the most comparable measures calculated and presented in accordance with GAAP are available in our earnings release and in the supplementary information, both of which are available on the Investor Relations portion of our website.

With that, I would now like to turn the call over to Chris Lee.

Chris Lee
Thank you, Sasha. Good morning and thank you for joining us for our first earnings call for KKR Real Estate Finance Trust. So far, 2017 has been a very active year for the Company. As of today, we've originated $515 million in loans, we've increased our borrowing capacity to $1.8 billion, and in May, we successfully completed an IPO, raising approximately $226 million in net proceeds. We are excited about our entry into the public market and are appreciative of the support our investors have shown us as a private company, and now a public company.

Since our inception in 2014, we have been scaling our equity capital base and borrowing capacity and investing in our target assets. As a public company, we will continue to execute on the same primary investment strategy we have had since the end of 2015, originating floating rate senior transitional loans.

The market environment continues to offer us attractive investment opportunities. Despite operating in a competitive environment and dealing with some recent spread compression, we are seeing opportunities to deploy capital consistent with the same risk return parameters we have had over the last two quarters. We feel confident in our ability to deploy the recently raised capital from our IPO to further grow and diversify our portfolio and, in turn, grow the earnings capacity of the Company.

We have extensive longstanding relationships with owners and operators of real estate, with whom we have had active direct dialogs. Our integration with KKR real estate platform, and KKR more broadly, gives us a competitive advantage in originating, underwriting, and financing loans. We believe these competitive advantages translate into differentiated deal flow and opportunities to lend. We, in turn, try to convert as many of those opportunities into attractive investments and risk adjusted returns to shareholders.

Last but not least, our primary objective is capital preservation. We are value oriented investors with a focus on downside protection. KKR is the largest shareholder of the Company and, therefore, fully aligned with our shareholders in our focus on preserving capital and prudent risk management.

In summary, we are pleased with the progress we've made thus far and are optimistic about the remainder of 2017. With that, I'll turn the call over to Matt.

Matt Salem
Thank you, Chris, and thanks to everyone for joining us on the call.

I'll start with capital deployment. In the first quarter, we originated $291 million of floating rate senior loans. These loans are secured by one office and two multi-family properties. They are located in dense infill markets consistent with our investment strategy. All three loans were directly originated, which speaks to the quality of our team and origination platform.

The weighted average LTV for these loans is 71% and the weighted average coupon is LIBOR +4.1%. These metrics are consistent with our existing senior loan portfolio, which has a weighted average LTV and coupon of 67% and LIBOR +4.4%, respectively. On a levered basis, the three loans have a weighted average underwritten IRR of 13.8%, in line with our targeted returns.

Our origination pace has continued into the second quarter. Subsequent to quarter end, we have closed two new senior loans totaling $224 million, one of which is to a repeat borrower for KREF. Looking forward, we have a robust pipeline as we continue to benefit from our connectivity with the broader KKR platform and from our improving brand awareness in the market.

Now, let's discuss the portfolio. As of March 31, the portfolio totaled $1.1 billion and is diversified both geographically and across property types. 100% of our loans are performing, and our securities portfolio is performing as expected. 80% of the portfolio is invested in senior loans, up from 75% at year-end, and we expect that percentage to increase as we continue to scale.

Turning to the right-hand side of the balance sheet, post quarter end, we successfully upsized one of our repurchase facilities and put in place a new corporate revolver. Patrick will give you more detail around this. As we've expanded our borrowing capacity, we have improved terms and extended maturities.

In summary, we are pleased with our origination activity, our portfolio, and pipeline. I'd like to thank our shareholders for your support. We look forward to creating value for you as we grow. With that, I'll turn the call over to Patrick.

Patrick Mattson
Thank you, Matt, and good morning, everyone. For the first quarter of 2017, our net core earnings, which is core earnings less incentive fees, were $8.9 million, or $0.33 per share. GAAP net income for the same period was $10.4 million, or $0.39 per share. Book value per share was $20.51.

Our portfolio, which totaled $1.1 billion at the end of the quarter, has a weighted average risk rating of 3 on a 5 point scale. The portfolio experienced no repayments in the quarter and as of 1Q, 88% of the portfolio was invested in LIBOR-based floating rate loans, which positions us well to benefit from increases in short term interest rates.

Looking at leverage, we closed the first quarter with a debt-to-equity ratio of 0.7 times. As we ramp the portfolio and target a 3 times leverage ratio on new senior loan originations, we expect the debt-to-equity ratio to increase but remain at a prudent level. Additionally, we'll continue to diversify our financing channels to further optimize our overall financing strategy.

As Matt mentioned, post quarter end, we successfully increased our borrowing capacity to $1.8 billion. Specifically, we increased the size of our Wells Fargo term credit facility from $500 million to $750 million and extended the final maturity to 2022. We also entered into a new $75 million secured corporate revolving facility, which will be available to us for general corporate purposes. This financing activity will help fund our active pipeline and enhance the liquidity profile of the Company.

Finally, I want to discuss our dividend. For the first quarter, we declared a dividend of $8.8 million, or $0.28 per share, which was paid April 18. Today, we announced a dividend of $13.4 million, or $0.25 per share for the second quarter, payable on July 14 to shareholders of record on June 30. We view this as a stub dividend, given the substantial capital markets activity on our balance sheet during the second quarter, including the May IPO.

Thank you again for joining us on our first earnings call. We are pleased with the initial results and feel well positioned for the quarters ahead. And now we're happy to take your questions.

QUESTIONS AND ANSWERS

Operator
We will now begin the question and answer session. To ask a question, you may press star (*) then one (1) on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star (*) then two (2). At this time, we will pause momentarily to assemble our roster. The first question comes from Jade Rahmani with KBW. Please go ahead.

Ryan Tomasello
Good morning, this is actually Ryan Tomasello on for Jade. Thanks for taking my questions. Can you discuss the pipeline in terms of the number and dollar amount of deals and perhaps the amount of signed term sheets you've seen post 1Q, including what you disclosed in the release and perhaps any color on the types of transactions in that pipeline in terms of property type, geography or sponsor types?

Chris Lee
Yeah, hey, this is Chris. Thanks for the question. With respect to number of signed term sheets, we can't really comment on the level of activity. What we can say, though, is we are

very pleased with the amount of activity that we have in the pipeline today and feel like there is…we are on pace to meet our deployment targets that we've articulated to the market. With respect to what the current pipeline looks like, we're still very much focused on what we call the "light transition bucket," which we define as any collateral with moderate or near term cash flow with a path to stabilization in 18 to 24 months from closing. The other thing is we're focused generally on the major population centers in the U.S. That's where most of our pipeline opportunities are today, and then I'd say the last thing is we are selectively focused on some development opportunities where we can provide lower leverage subordinate debt to complete a capital structure. We currently don't have any development exposure in our pipeline, so we do think there is some room for selective opportunities where it's the right sponsor and the right product and the right market.

Ryan Tomasello
And in terms of the overall competitive environment, can you say how that compares to maybe 6 or 12 months ago and, specifically, regarding spreads and the comments you made in your prepared remarks? Can you quantify the amount of compression you've seen over the past few months and if that compression is more pronounced in certain assets or markets?

Matt Salem
Yeah, hi Ryan, it's Matt Salem. I'll take that one. I would characterize the market as competitive but disciplined. I'd say, post-election, we have seen a tightening in spreads. We haven't seen a lot of new competition in the larger loan segment of the market, but it's certainly a competitive area. Spreads on the higher quality opportunities have decreased by 50 to 75 basis points, partially offset by increases in LIBOR. So what we haven't seen is any material change in leverage or structure, terms of structure.

Ryan Tomasello
And regarding structure and leverage, would you say you're more likely to accept a lower yield or perhaps compromise on origination reqs and fees versus compromising on leverage and structure and what are you seeing among peers in the market?

Matt Salem
I would say we continue to focus on the higher quality opportunities and if that means tightening yield or spread a little bit to participate in that segment of the market, that's what we'll do, and I would also just, as a backdrop, we don't see, at least the borrowers we're financing opting for higher leverage options. Usually, they are capping themselves in leverage and so I think that's been a positive dynamic in the lending markets this time versus the last cycle.

Ryan Tomasello
Great and then, just lastly, in terms of the CMBS market, can you give us some color on what you're seeing in terms of new B-Piece acquisitions and the competitive landscape there?

Matt Salem
Absolutely. If you'll recall, it's a small component of what we do in KREF. We do have an active business away from KREF that participates more broadly in that sector, and I would say that we do see a pretty high quality opportunity in that market. We think risk retention has had a real impact on the underlying credits there and is effectively driving better collateral within the CMBS pools, and also the opportunity lends itself to larger, more institutional players like ourselves that can be good providers of long term capital and partners with the banks that are looking to share or really share some of the risk retention or place all the risk retention with a third party purchaser, which is really what we're targeting in that segment of the market.

Ryan Tomasello
Great, thanks guys.

Operator
The next question comes from Rick Shane with JP Morgan. Please go ahead.

Rick Shane
Hey guys. Thanks for taking my questions this morning. I just want to talk a little bit about retail. Obviously, right now, you're concentration's a little bit greater than the peer group. Want to talk about how that's going to evolve over time. But, also, the potential for sort of contrarian investments there given concerns about retailers. Are you seeing any interesting opportunities?

Chris Lee
Hey, Rick, this is Chris. I'll take that one. I think, when you think about our exposure today, we really have three retail loans and it represents 23% of our current portfolio with subsequent closings. Our view, when we look at the pipeline, we think that'll probably trend down into the kind of the mid-teens, which we think is kind of consistent with where we've seen kind of historical activity. I'd say, in terms of new retail opportunities, the bar is very high, and I think to describe our thesis, the best way to describe it is we're only really focusing on opportunities in dense urban locations where we like the fundamentals. The other thing is I'd say weighted average LTV on the retail loans in our portfolio is 62%, which is about 500 basis points inside of the weighted average portfolio on the broader portfolio, and we like where our existing retail loans are tracking today. And then to answer the last part of your question on new opportunities, we think that we will see them. We think that we have a competitive advantage in underwriting, given that we own retail, we own retailers in our corporate private equity portfolio and, of course, invest in their corporate credit, as well, through our credit business, corporate credit business. So we do think there will be opportunities as the retail landscape changes, but, in the short term, we continue to have a high bar for incremental retail exposure.

Rick Shane
Got it. Hey, Chris, thank you very much.

Operator
Again, if you have a question, please press star (*) then one (1). The next question comes from Charles Nabhan with Wells Fargo. Please go ahead.

Charles Nabhan
Hi, good morning and thanks for taking my question. I was just wondering, I appreciate your comments on the spread compression on the loan side. But I was wondering if you could comment on the degree to which you've been able to offset that on the financing side, and maybe if you could give us some insight into the conversations you've had with your lenders and if you've been able to improve your financing terms over the past quarter or so.

Matt Salem
Hi, it's Matt, I'll take that one. I would say that we have seen the senior sector of the market tighten up, as well. Each transaction is a little bit different, but I would probably quantify that somewhere in the neighborhood of 15 to 25 basis points of tightening in the senior segment of the market.

Charles Nabhan
Okay, great, thank you guys, I appreciate the color.

Operator
The next question is a follow up from Jade Rahmani with KBW. Please go ahead.

Ryan Tomasello
Thanks for taking the follow up. Just in your prepared remarks, you mentioned an increasing opportunity in development financing. I was wondering if you could provide a bit more context around that in terms of the incremental spreads on those types of assets, the competitive landscape as it relates to banks, LTVs and if there is a specific target allocation you're looking at for the overall portfolio.

Chris Lee
Hey, Jade, this is Chris, I'll take that. So with respect to development, it is, it's going to be a very narrow focus for us. Right now, as you know, we don't have any current exposure. We have historically done some development – that one loan that we had is now stabilizing so that does not currently count as development. I'd say a lot of it is sponsorship and market driven. We do think that we can earn incremental spreads in the development sector, probably on the mortgage side, in the 100 to 150 basis points, wider spreads but also at a lower LTV level, as well. I think, secondly, we're able to get very attractive loan structure, so we think when you look at the entire risk return spectrum, it's quite interesting. But it really does focus on, we really are focused on certain markets that we find have compelling risk return supply demand dynamics, but also it is a very narrow focus in terms of which sponsors we are willing to lend development capital to because of the expertise needed to execute on those strategies.

Ryan Tomasello
Great, thanks for taking the follow up.

Operator
This concludes our question and answer session. I would like to turn the conference back over to Sasha Barenbaum for any closing remarks.

CONCLUSION

Sasha Barenbaum
Great. Thank you, again, for joining our first quarter earnings call. If you have any follow up questions, feel free to give me a call. Thank you again.

Operator
The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.