Going public in perspective

Is the new KKR Euronext offering a true turning point, or another marker on a very long road? By Kelly DePonte

The launch of KKR Private Equity Investors, raising nearly $5 billion in its initial public offering, has certainly caught the attention of investors and fund managers throughout the private equity world. Already, Blackstone and Carlyle are said to be actively pursuing listings as well, and certain prognosticators are predicting that large pension plans will be disintermediated in the market. But although this new vehicle certainly has been successful in raising money for Kohlberg Kravis Roberts, the jury is still very much out on what it means for the private equity market as a whole.

Before turning to what it means, however, one must first summarize what it is. KKR Private Equity Investors, LP, is a limited partnership formed under the laws of Guernsey, with common units privately placed in Amsterdam and other markets, listed on Euronext's Amsterdam NV's Eurolist by Euronext under the ticker KPE. As part of this arrangement, restricted depositary units were also made available to qualified institutional buyers in the United States. It should be noted that these units are restricted to qualified institutional buyers, and are thus inherently much less liquid than common stock. The investment mandate of KPE is:

- To invest in KKR's funds, either on a primary or a secondary basis;
- To make direct co-investments in portfolio companies of KKR's funds; and
- To pursue opportunistic investments with KKR outside the scope of their private equity funds

The offering memorandum described the investment portfolio at the launch of KPE as being:

- A $100 million commitment to KKR European Fund II purchased on a secondary basis, with $21.9 million invested;
- A $50.6 million co-investment in Capmark, the vehicle KKR used to invest in GMAC; and
- A commitment of up to 40 percent of KPE (or roughly $2 billion) into the KKR 2006 Fund

At the original target of $1.5 billion, the percentage of fees and expenses charged against the proceeds of the offering was approximately 5.4 percent, or roughly $270 million if the same percentage was applied to the actual $5 billion fundraise. Running these numbers, it would seem that on the day of its launch roughly $72.5 million of the proceeds were invested as targeted, some $270 million were paid in fees and expenses, and over $4.6 billion were placed in temporary investments. Given the normal investment pace of KKR's private equity funds, a large portion of KPE will be residing in temporary investments from some time to come.

Though launched at $25 a share, at the end of its first full week of trading on May 12 KPE closed at $24.01, a discount of about 4 percent to the launch price.

One of many

Though KPE has been touted broadly in the general financial press, it is just one of a number of publicly traded private equity vehicles. The table below includes a selection of some of the more significant vehicles currently in the market that have investment mandates similar to private equity funds. It doesn't include those vehicles that operate as broadly diversified fund-of-funds or narrowly defined special purpose acquisition vehicles (SPACs) which are normally traded over-the-counter and are focused on making single acquisitions.

The last frenzy over private equity going public occurred in the spring of 2004. Apollo successfully launched at business development company (BDC) on NASDAQ, raising $930 million, and the IPO was quickly followed by nearly $7 billion in additional filings from both small independent firms as well as private equity stalwarts such as Blackstone, KKR and Thomas H. Lee. Almost none of these proposed vehicles were actually launched as the difficulties of managing a BDC structure, especially in its early stages, began to filter through the market. Early in its life Apollo Investments frequently traded below its offering price, and though its subsequent success - it was able to place more and more of its capital to work in permanent investments - is notable, it has still not spawned many imitators.

Apollo was not, of course, the first in this market in the US. Other BDCs such as Allied Capital, American Capital Strategies, and MVC have been publicly traded for years, but the constraints of the BDC structure have meant that those organizations willing to follow their lead have been few and far between.

Given the interest surrounding the KKR listing, one would assume such a structure was brand new. In fact, the European market has a long history of publicly traded private equity vehicles. Unlike BDCs, which by law are stand-alone entities with separate investment mandates, most of the largest European vehicles are like KPE in that they invest alongside sister private equity funds. Though these vehicles are permanent "evergreen" sources of capital, their sponsors have continued to raise private equity funds in tandem with these public vehicles.

The problem with many of these vehicles is that they are lightly traded, and that they often, except in hot markets, trade at a discount to net asset value. Only the largest vehicles seem to have the size to generate a strong float, and without that

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both liquidity and strong valuations are problematic. In addition, information on the underlying holdings of these vehicles is often rather sparse, making it more difficult for stock analysts to review and evaluate the prospects of underlying holdings - and for certain vehicles the number of underlying holdings can be quite large.

There is one other transaction of note on the table. The week after KKR launched in Amsterdam a US middle market vehicle, Compass Diversified Trust, went public on NASDAQ. Unlike KPE, at launch this vehicle received almost no fanfare and was priced in the middle of its offering range. It is structured as a trust and not a BDC (unusually for a US vehicle) and was almost fully invested in equity and debt of four underlying portfolio companies at its launch. In its first week in the market it has traded near its offering price on very thin volume.

Cracking the code

Whether KPE or even Compass is a major turning point for private equity is yet to be seen. KPE has an original investment profile somewhat similar to Apollo Investments at its launch - a large original fee load and a large portfolio of original temporary investments that create a drag on returns normally expected of private equity investments. When compared to the normal upfront fee structure of a private equity fund available to institutional investors and the normal just-in-time funding mechanism, the return profile of KPE over the next few years will be hard put to match the returns of the underlying KKR funds, though only time will tell whether the co-investments and the opportunistic investments will boost those returns significantly. Compass is a different story - at its launch it looks more like a middle market conglomerate with a small number of operating companies in different industry sectors and not a typical "blind pool" of capital available to invest in the best new opportunities that present itself to the fund manager.

In any case, success in the public markets comes not just from being able to raise money once, but to successfully continue to trade at volumes and pricing levels that can provide liquidity, enhance value, and assure easy access to additional capital when needed. By and large, the publicly traded private equity vehicles now in the market have not yet demonstrated that they have cracked the code to investors' hearts or have been able to do so in a manner that is readily replicated and applicable broadly across all areas of private equity. How KPE in particular performs in the next few months will determine whether there is a private equity rush to Amsterdam, or whether it is just another marker on the long road to the ultimate answer. ■

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Select publicly traded private equity vehicles

Vehicle	IPO	Exchange	Ticker	Notes
Allied Capital Corp	1960	NYSE	ALD	Founded in the OTC market, moved to the NYSE in 2001, structured as a BDC.
Electra Investment Trust	1976	LSE	ELTA	Headquartered in London, has a wide investment mandate - though focused on established companies.
Candover Investments plc	1984	LSE	CDI	Founded in 1980, Candover invests in buyout transactions across Western Europe; created a listed vehicle in 1984.
3i Group	1994	LSE	III	Founded in 1945, created a listed vehicle on the LSE in 1994; has a very broad investment mandate.
SVG Capital	1996	LSE	SVI	Over 75% of its investments have been in Permira sponsored funds; Currently trades at a premium to NAV.
American Capital Strategies	1997	NASDAQ	ACAS	Founded in 1986, went public as a BDC in 1997; largest vehicle in the sector.
MVC Capital	1999	NYSE	MVC	Originally founded as MeVC at the height of the Internet boom by Draper Fisher Jurvetson, now operates as a more traditional BDC.
Apollo Investment Corp	2004	NASDAQ	AINV	The most successful BDC of the group that filed for IPOs in Spring 2004.
KKR Private Equity Investors	May 2006	Amsterdam	KPE	KKR investment vehicle with a mandate to invest in KKR funds (either on a primary or secondary basis) as well as co-investments directly in selected KKR transactions.
Compass Diversified Trust	May 2006	NASDAQ	CODI	US middle market buyout effort that just launched, seeded with 4 investments; related to Compass Group Investments, founded in 1998.

Source: Probitas Partners

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