

How Kravis, Roberts think

No worry about pace of deals, doyens say; doubt on derivatives

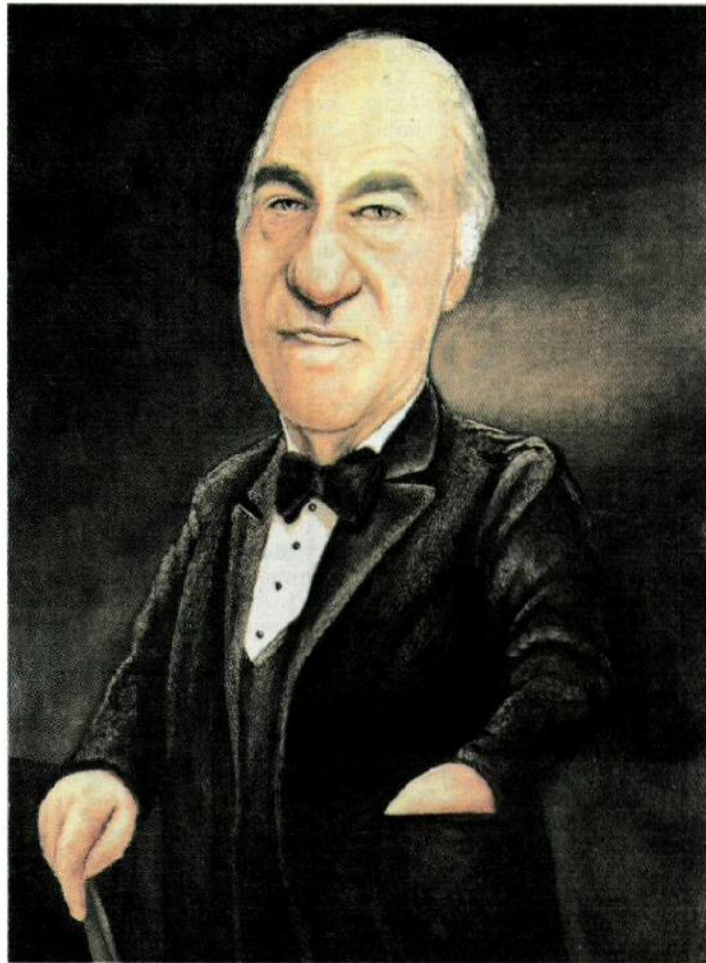
By Henny Sender

IN THE NEW YORK office of private-equity icon Henry Kravis, an eclectic collection of books competes with Lucite tombstones commemorating Kohlberg Kravis Roberts & Co. deals for shelf space. The tombstones seem to be winning.

KKR pioneered the buyout business in the late 1970s and did the first leveraged buyout of a publicly traded company when it bought Houdaille Industries in 1979 for \$355 million. Even as the private-equity business has mushroomed in the past few years, KKR still owns bragging rights for the biggest deal ever: the \$25 billion buyout of RJR Nabisco in 1988.

KKR has done 145 deals and now is among the small handful of so-called megafunds that have investment warchests of more than \$100 billion and are rapidly snapping up companies around the world. Last year, KKR invested \$6.9 billion in 12 companies and participated in about \$104 billion of deals. It is expanding outside the U.S. through a \$4 billion fund it is currently raising in Asia as well as a €4.5 billion (\$5.9 billion) fund for Europe. Adding it all up, KKR has \$30 billion to invest.

Private-equity firms have become some of the biggest employ-



ers in the U.S. Mr. Kravis and his cousin George Roberts, who are presiding over an expansion of the firm, head an investment company that has 35 portfolio companies

with \$95 billion in annual revenue and about 540,000 employees.

At a time when private-equity firms find themselves the object of
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DEALS 
DEAL MAKERS



Inside KKR's world

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growing scrutiny, Messrs. Kravis and Roberts sat down to discuss how the world has changed—and how it hasn't—since the early days of KKR. Mr. Roberts, who is based in Menlo Park, California, was on a speaker phone.

Perhaps the most surprising change? KKR is no longer the "barbarian at the gate," a term popularized when it became the title of a book that chronicled the RJR Nabisco takeover. Like their counterparts at other top private-equity firms, Messrs. Kravis and Roberts believe that management disillusionment is helping to drive the vast expansion of private-equity investing. "Managements want to take the long term view, but they know they get clobbered in the short term," says Mr. Roberts. "When we say our average hold [before selling the company or taking it public] is seven years, they sit up."

Of course, private-equity investors like KKR want—and expect—good results from their portfolio companies. Their mission: to clean up and turn around the company, making it attractive to a buyer in the public or private market. That can mean ruthless cost-cutting or the movement of jobs to cheaper markets in Asia or elsewhere, moves that fuel criticism of the buyout firms. Private-equity advocates counter that the process makes companies leaner and more competitive.

KKR, like other big firms such as **Texas Pacific Group**, **Carlyle Group** and **Blackstone Group**, are swimming in cash, raising multibillion-dollar funds with ease.

Critics believe that the private-equity buying binge is loading too much debt on target companies. Messrs. Roberts and Kravis believe the debt issue is overblown. "In 1987, the average deal was 93% debt and 7% equity," notes Mr. Roberts. "In 2006, the average deal had 33% equity and 67% debt. Given that the average company in the

Standard & Poor's 500-stock index is now eight times the size of 20 years ago, that means 32 times the amount of equity of the old days to do a comparable deal. That is why we don't believe there is a bubble."

But they concede it is possible that some companies controlled by private-equity firms may get into trouble.

Mr. Kravis also thinks the proliferation of deals hasn't reached a manic phase. "It may seem like deal frenzy today," says Mr. Kravis. He says people don't decline to do deals because there are so many deals and so many players. Instead, they do deals if the deal makes sense. "The dollars are substantially bigger, but on a per-firm basis it isn't so different since we have grown our resources and human capital so much."

The other big change in the industry is the global reach of the big U.S. private-equity firms. "Fifty percent of the money raised comes from outside the U.S. In the 1980s everything was domestic," says Mr. Kravis. "In 2006, eight of the 12 deals we did were foreign."

What could bring the boom in private-equity activity to an end? The two said they haven't spent much time focusing on the issue, but they have two concerns. The first is financial protectionism. "If there is more protectionism, if there were limitations on investment in the U.S. and capital flows were cut off, that could have an impact on liquidity," says Mr. Kravis.

He also worries about derivatives, which have become a major source of investment capital. "There are staggering amounts of derivatives," he says. "If there are difficulties and counterparties start to default, that could pose problems" for private equity.

One thing that hasn't changed in the decades of private equity? "Any fool can buy a company," says Mr. Kravis. "You should be congratulated when you sell."