

Handelsblatt

Mr. Stavros, Mr. Ollig, the mood in the private equity industry seems to be poor. Investors are holding back, lucrative takeover targets are rare – and sales of portfolio companies are also difficult. How are you dealing with these challenges?

Pete Stavros: Christian and I are thinking of quitting – (laughs) – but seriously, our industry has weathered several cycles where too much capital was deployed when interest rates were low and valuations high. This is always followed by a period where valuations fall and investors want capital back at the same time. We last went through this in 2008 and 2009 during the financial crisis – and just as it did back then, the industry will once again find a way through.

How could it succeed at the moment?

Stavros: It simply takes time. Valuations were really high in 2020, 2021 and the first half of 2022. Some in the industry spent too much money at too high prices during this period. Thankfully, we avoided that.

How did you achieve that?

Stavros: Our approach is to spread a fund's capital evenly and invest it over four to five years. In this way, we avoid performance being too dependent on individual years. We don't do this because we are smarter than everyone else, but because we've been around for almost 50 years and we've made all those mistakes before.

The industry has grown tremendously since the last downturn. Assets under management have risen from \$700



Christian Ollig and Pete Stavros:

“Europe remains very attractive”

The two KKR top managers talk about the difficult situation in the private equity industry—and explain what they currently find exciting about Europe and Germany.

billion to \$6 trillion worldwide over the past 20 years. Competition for the best investments is getting tougher. Do investors, known as limited partners (LPs), have to prepare themselves for lower returns?

Christian Ollig: As the industry has grown, so have the opportunities. The market in Europe was still in its infancy 20 years ago, and the market in Asia was practically non-existent. In addition to private equity, other alternative asset classes such as infrastructure, credit, and real estate have emerged. If you put the capital available for investment, the so-called dry powder, in relation to the potential targets, little has changed in relative terms.

Stavros: We still target the same returns that we set ourselves 20 years ago. But, to be clear, any fund in our industry that overspent in 2021 and 2022 is likely to underperform.

Have company valuations fallen enough to make new portfolio investments attractive again?

Stavros: We are always open about the fact that we don't know exactly where the world is headed – which is why we focus on linear deployment. But if I had to place a wager, I'd bet these upcoming vintages will be attractive.

How do you determine that?

Stavros: We pay close attention to the ratio of dry powder to the value of private equity assets that haven't yet been sold. The ratio is as low as it has ever been, meaning there is little available capital compared to the assets coming to market in the years ahead. This dynamic should put downward pressure on prices and make the next five years a good time

to invest.

KKR co-founder Henry Kravis recently said in an interview with Handelsblatt that your firm wants to invest more in Europe, and specifically in Germany. Does that still hold true now that the markets in the US are back at record highs?

Ollig: Europe remains very attractive. KKR has invested more than 20 billion U.S. dollars in equity across various asset classes in Europe this year. That is the highest amount KKR has ever deployed in Europe in a single year. The same applies to Germany: given the strategic goals of the federal government, there seems to be a good opportunity to invest here – just as KKR has done here for over 25 years.

Does the erratic US customs policy play a role in your decision to focus your investments on Europe?

Ollig: They are not connected. It's more to do with the high investment requirements in Europe, which the Draghi Report puts at up to 800 billion euros a year. Germany alone plans to invest 500 billion euros in infrastructure in the coming years, in addition to spending on defense. The mood towards Europe and Germany has changed and this presents real opportunities.

Is this change in sentiment real? In political Berlin, the question is whether the autumn of reforms is already over before it has even begun.

Ollig: There are good strategic signals from Brussels and Berlin - and clearly good opportunities to deploy capital. The implementation of the reforms is important, but this does not influence our opinion on individual investments.

What kind of investments are you looking for in this country?

Ollig: Over two thirds of KKR's investments are made in partnership with founders, family-owned businesses and corporates.

What can KKR offer German SMEs?

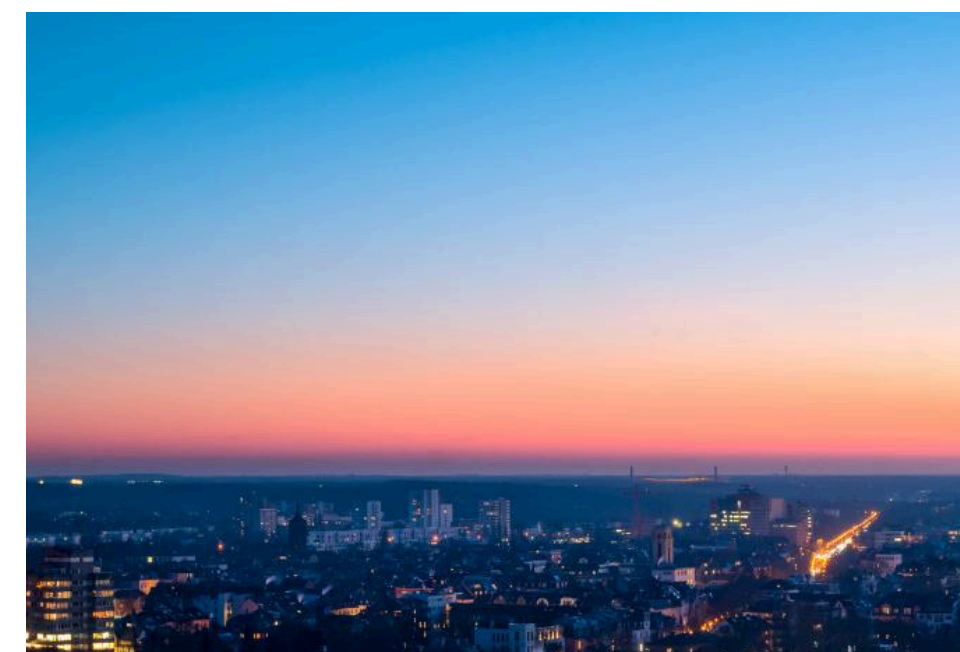
Stavros: KKR has a global network and knowledge of all sectors and markets. The firm can help companies that want to expand in Asia or North America, or prepare for the capital markets. KKR's long-term, entrepreneurial approach fits well with German family businesses seeking a trusted growth partner.

Many of KKR's competitors take the opposite approach and only acquire majority stakes in order to retain control. Is control less important to you?

Ollig: In the last almost 30 years of activity in Germany, KKR has simply had very good experience with this approach. For example, KKR's first minority investment in Germany was Wild Flavors, 15 years ago...

... Hans-Peter Wild's company, which also owns the beverage manufacturer Capri-Sun.

Ollig: KKR acquired a 35% stake in that company and developed a concept for



how the firm could offer added value for our partners in the face of challenges such as internationalization and takeovers. We build up trust with the entrepreneurs over the years. This is not something that happens overnight.

In addition to the family entrepreneur, you also have to build trust with the workforce of an investment. How can that be achieved?

Stavros: At KKR, we have an equity ownership program for employees of our portfolio companies. They become shareholders in the company from day one. They have a say in decisions and access to all relevant financial information. They are treated like business partners.

How much money can employees expect to receive?

Stavros: That depends on the performance, length of service, and position of each individual employee. Our goal is to give employees, for example in production, the opportunity to receive their annual salary in the form of free shares within five years. The upside potential is unlimited. There is no guarantee, but if we perform particularly well, they can earn significantly more. In the US, I have seen truck drivers in our

portfolio companies earn almost a million dollars through these participation programs.

Is the employee participation program already being used in German portfolio companies?

Ollig: KKR has indeed launched such an initial participation program this year at Coriolis Pharma (near Munich). Employees at German locations of KKR's international portfolio companies are also already benefiting. In total, around 3,000 employees in Germany in 23 portfolio companies are involved in such programs. But KKR has only just started to introduce them here in Germany.

In order for employees, entrepreneurs, and KKR to benefit, you are dependent on successful sales. These have become increasingly difficult recently. When do you expect a recovery?

Stavros: It's hard to predict, but it appears that the global IPO market is in an early phase of a recovery. The pipeline of companies that want to go public is well filled. Recent IPOs have been oversubscribed and have performed well.

How heavily does KKR still rely on IPOs as an exit strategy?

Stavros: Our dependence on IPOs has decreased significantly. Some large firms only focus on very big deals, because there's less competition at the top end. The problem is there aren't many of those assets, so you can't be very selective. Also, these businesses can often only be exited through the public markets, which are unpredictable and costly to access. Because IPO exits also take years to complete, they can weigh on returns.

What is the alternative?

Stavros: For the past 15 years, KKR has been more focused on the upper end of the middle market. Yes, this part of the market is more competitive, but there are far more targets to choose from. And it doesn't leave us beholden to the public markets for exits. If you look at the history of our industry, investors have had much more success with transactions of between one and four billion dollars than with deals of ten billion dollars or more.

Why is that?

Stavros: Mid-sized companies are easier to move operationally -- it's like steering a speedboat rather than a tanker. And you have a lot more exit options. You can still go public if that makes the most



sense, but there's also typically a number of potential acquirers, whether a strategic buyer or another financial investor.

The \$55 billion acquisition of US game developer Electronic Arts shows that big deals are booming.

Stavros: There are always investors who focus on very large deals.

But not KKR?

Stavros: We feel very comfortable in the upper mid-market segment and are very satisfied with our returns.

Will fewer companies be listed on the stock exchange in the future – partly because more and more companies are moving from public to private ownership?

Stavros: I'm convinced private markets will continue to gain share from the public markets. Companies are making a conscious decision to remain in private hands for longer, or to leave the public markets for private ownership. In my opinion, this will not change any time soon.

Is it sustainable to keep a company in the hands of a private equity firm for decades?

Stavros: That depends on the fund structure. In our Core Strategy in Private Equity, our investors deliberately have a very long investment horizon - decades. They want long-term returns. This suits investors such as life insurance companies, who have long-term liabilities.

Biographies

Pete Stavros has been with KKR for 20 years and, as a partner and co-head of private equity, is responsible for the company's global corporate investments.

Christian Ollig has been with KKR since 2008 and heads the Germany, Austria, and Switzerland (DACH) region. He advised on many high-profile investments, such as Axel Springer and the household goods manufacturer WMF.

The company

The US investment company KKR is one of the pioneers of the private equity industry. Current investments in Germany include the space company OHB and the travel platform Getyourguide. KKR also made headlines with its temporary investment in the Axel Springer publishing house.

More and more investments are moving from one fund to another within a private equity firm. Are such continuation funds becoming their own asset class?

Stavros: In the history of our firm, we have only used a continuation vehicle once. We've simply been less active than others in this space.

Are there no plans for further continuation funds?

Stavros: Not at present.

Is KKR currently experiencing difficulties in raising fresh capital from investors, similar to some of its competitors?

Stavros: Our returns have been strong and, as I've noted, we avoided some recent mistakes others have made. Because we've steadily deployed our capital, we've been able to return it to our investors at a measured pace. We haven't suffered from some of the liquidity bottlenecks common in our industry right now.

Won't companies that are having difficulty financing their new funds slowly disappear from the market?

Stavros: Some companies will have problems raising capital and may disappear from the market.

Mr. Stavros, Mr. Ollig, thank you very much for the interview.

The questions were asked by Jakob Blume and Hannah Krolle.

