Lay of the land: KKR in Europe

The firm's co-heads of Europe, Philipp Freise and Mattia Caprioli, discuss investing during wartime, and doubling down on their partnership playbook for the region, writes Carmela Mendoza

When *Private Equity International* met KKR's co-heads of Europe, Mattia Caprioli and Philipp Freise, in late-March, the war in Ukraine had been raging for more than a month and the world had changed in ways that were hard to fathom. These circumstances made the notion of preparedness more important than ever.

"People are looking for orientation," Freise tells *PEI*. "The common thread to all this… is that Europe is experiencing a period of radical and accelerating change at the same time as the very fabric of our business community or political community undergoes a very significant generational change."

From investing through the dotcom boom, the financial crisis and the European debt crisis to navigating a pandemic, and now contending with the Ukraine-Russia war, KKR's co-heads of Europe private equity have seen it all.

"Our job as investors is to drive the car through the fog and to keep our eyes on what we can control," Freise says. "Risks… are known unknowns. What can we calculate? How do we navigate? We all know Europe is behind in digitisation, and we have to push all of our businesses in that direction. Uncertainty is unknown unknowns. What are the radical changes that are coming?"

Caprioli notes an interesting parallel between covid and the current geopolitical environment: "Essentially, we've entered both dislocations with a conservative capital structure in our portfolio companies. That was critical in both scenarios – at the time of the war and covid – to be able to lean in."

KKR's average leverage at the portfolio level is less than 4x, while the market is close to 6x, he notes.

"When you enter uncertainty with a conservative capital structure relatively speaking across the portfolio, you can [better protect] your portfolio companies and think about how you lean into the dislocation," Caprioli says.

He adds that the firm's investment philosophy is about imagining the future. "We don't get distracted too much by the implications of energy prices or oil prices at $120. We think five years from now, 10 years from now, what is

the world going to look like and what is this business going to look like based on our capabilities?"

By design, KKR was already focused on macro trends – such as digitisation, cybersecurity, healthcare and sustainability – before covid. All of these have accelerated since the pandemic.

For context, technology has become the single largest destination of capital in the last three years among the firm's large-scale businesses. In the Americas, it represents 38 percent of every dollar that KKR has invested in private equity, the firm noted during its investor day in April last year. In Europe, tech constitutes an even greater proportion of KKR's portfolio, at 46 percent, while Asia amounts to 34 percent, and about a quarter in its core private equity business globally.

Freise says: "Change is accelerating quicker than most anticipated. Europe is leading in sustainability at a time when it's most needed. And covid and the humanitarian catastrophe that is the war have accelerated digital change across many industries."

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MATTIA CAPRIOLI

He recalls that the firm received a lot of criticism when it invested in rail booking company Trainline in 2014, because people were saying that the company was a partnership between 14 train operating companies and not "a real tech company".

"The conviction we had at the time was to think about the consumer. The consumer in 10, 20 years will simply not use paper tickets, but will want a digital transformation," Freise says. "The same is true with the energy crisis in Europe. Fossil fuels in 30 years will be less attractive than today. There's no doubt about it."

Acquisition spree

Between them, Caprioli and Freise have more than 40 years of investment experience at KKR. They were promoted to co-lead the private equity business in October 2019. Before their appointments, Caprioli built out KKR's European services industry team, while Freise led its technology, media and telecoms industry vertical.

The firm is in the market with its sixth European flagship, the first under the pair's watch. The vehicle has raised $7.1 billion as of Q1 2022, already surpassing the $6 billion prior European PE vintage, according to head of investor relations Craig Larson, speaking on the firm's first quarter results call in early May.

Caprioli and Freise declined to comment on fundraising.

Caprioli says there's a massive difference between investing in 2020 and in 2022: "What happened when covid hit is that everybody thought the world was upside down, that it was coming to an end, and so everybody was pricing massive risk into the equation.

"We saw an opportunity to invest with the perspective where the returns would exceed the risk we were taking, and we had a playbook for it. We looked at businesses over a five-year period. We planned for a post-covid recovery at some point over a five-year, or even a 10-year horizon. And we thought we could actually invest a very attractive valuation at a very attractive risk return. We were managing the downside risk with conservative capital structures by playing all the optionality and post-recovery for the business that we invested behind."

The situation now is very different, Caprioli says, noting that people are to some extent discounting the effects that the war can have on the economy. The bottom line: there's a lot of capital chasing transactions, and the risk return these days is probably not as attractive as it was in 2020.

Capital raised for KKR's Europe funds focus on upper mid-market deals in the range of €500 million to €2 billion in equity value, with the ability to go higher selectively in some assets. Target sectors include business and financial services, healthcare, industrials, TMT, and consumer and retail.

Caprioli and Freise's team invested $6.4 billion across 10 private equity deals in 2020, including the carveout of Wella and Clairol beauty brands from Coty in a $4.3 billion transaction.

Across strategies, KKR was the most acquisitive private equity firm globally, with nearly $36 billion's worth of deals, according to a report from Bloomberg. Its biggest transactions include Spanish telecom operator MasMovil, which was acquired for €5.3 billion with Cinven and Providence Equity Partners, and Pennon Group's waste management arm Viridor, which was acquired for £4.2 billion ($5.2 billion; €4.9 billion).

"[KKR] don't shy away to invest during a dislocation, and are among the bravest during this period," Joana Rocha Scaff, head of Europe private equity at Neuberger Berman, an investor in KKR's Europe funds, tells *PEI*. "KKR are a bit more willing to get a good deal at a time when everyone is in risk-off mode."

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PHILIPP FREISE

Caprioli admits that the heightened pace of dealmaking in 2020 is unlikely to be repeated this year. He reassures, however, that the firm has been acquisitive. "We see the current environment as investable, and if we find the right opportunity that fits our macro trends and themes we want to invest behind, we lean into them."

For example, the firm picked up a significant minority stake in Hamburg-based Körber's supply chain software business early this year. From January to April, KKR has worked on five deals – with some yet to be closed – worth around $5.4 billion.

Secret to success

KKR's Europe team is known for its partnership deals. Neuberger Berman's Rocha Scaff describes this as "something they do well", in which they give the owner – typically a corporate or family – the option to remain invested and to benefit from the value creation going forward.

"A lot of their track record is comprised of such deals," she says. "KKR, earlier than most other groups, decided to create a team of operating consultants. They are by far one of the most advanced firms in having these operating resources, which they bring to their portfolio companies, from the diligence phase to ownership in driving the value creation plan. That's very credible for corporate owners and family owners in Europe, effectively demonstrating to them that KKR is not just a financial investor."

Neuberger Berman has backed KKR's three latest European vehicles, and has also co-invested in certain assets and transacted in secondaries deals with its older European funds, *PEI* understands.

Freise says that between 70 percent and 80 percent of the firm's European deals have been partnership deals in the last decade, and half of all transactions have been completely proprietary. That compares to the market average of roughly 20 percent, he adds.

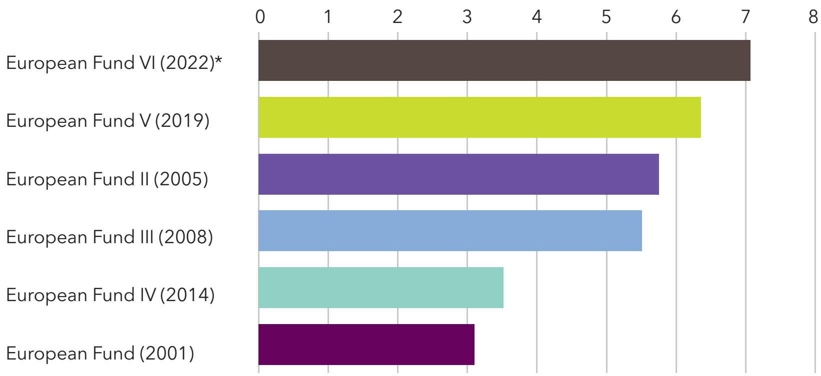
For Clare Gilmartin, former chief executive of Trainline, this meant support from KKR's Capstone team in crafting its three-to-five-year plan, which involved a significant tech transformation. "They have the same growth DNA that we had," Gilmartin tells *PEI*. "They're smart, future facing. And I felt like we always got constructive debate and challenging questions. I felt that with KKR, we weren't going to have a blind spot."

KKR bought Trainline in 2015 for £450 million via its €3.4 billion Fund IV. Freise, head of KKR's European TMT team at the time, led the investment. Under the firm's ownership, Trainline bought French online ticketing business Captain Train in 2016 for $189 million, significantly expanding its geographic footprint. With KKR, Trainline transitioned from being a purely web-based business to largely a mobile one, and has expanded from one to 40-plus markets.

Shares in Trainline were listed on the London Stock Exchange in June 2019, in an initial public offering that valued the company at about four times what KKR paid to acquire it.

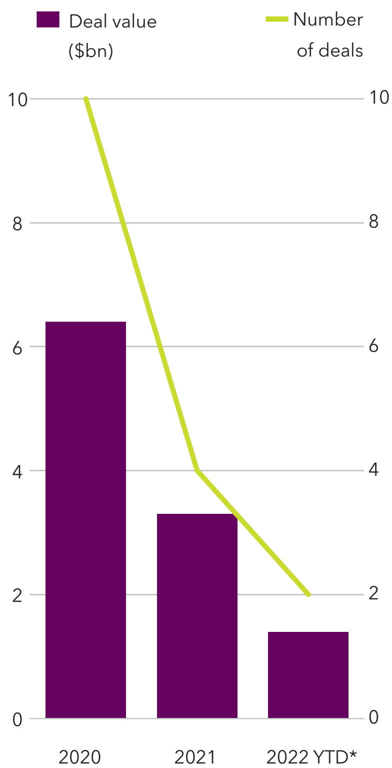
Freise says: "That shows you that what we are trying to build and invest behind is in fact at the height of what European partners need. They partner with us because we add more than capital – we can go to Asia and America and have the ability to bring resources around sustainability and digitisation, for example."

Capital raised ($bn)



*KKR is in the market with Fund VI
Source: KKR Q1 2022 results

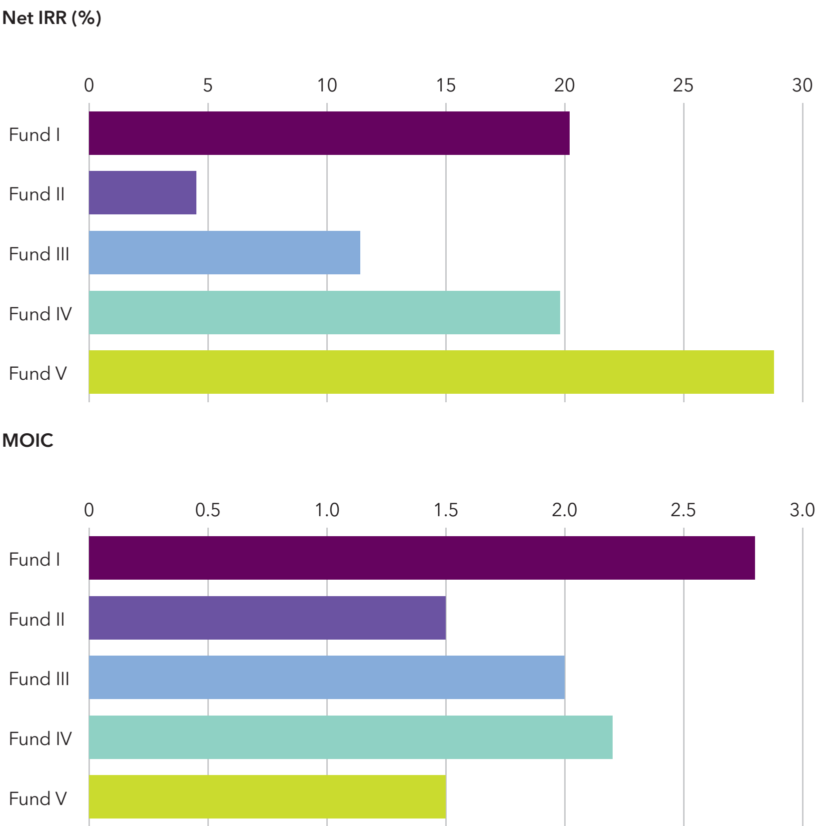
Total deal equity in Europe (2020 to April 2022)



*KKR has three additional deals in progress, bringing the total year-to-date value in 2022 to $5.4bn
Source: KKR

> *"There are pockets of growth for alternatives that have not been penetrated yet, like insurance and high-net-worth individuals. That's another area of growth that is going to come"*
>
> **MATTIA CAPRIOLI**

KKR fund performance as of 31 March 2022



Source: KKR Form 10-Q

He adds that these kinds of transactions have allowed the firm to create better entry multiples, to focus on growth and on the value and resources they bring to the company. "As result, we do not put too much leverage on our investments," he says.

That Europe has three times more family-owned companies than the US is also a critical element of its playbook in the region. "It's a very conservative continent, " says Freise. "So, if you have done a BMG-Bertelsmann transaction, that allows you to do the Axel Springer transaction. Because the first thing that the owning family of one does is to pick up the phone and ask the other one, 'How did KKR behave?'"

Capitalising on change

High-net-worth investors are an essential component of KKR's capital-raising plans. The firm is aiming for between 30 percent and 50 percent of fundraising to come from the channel over the next several years, and has been investing both resources and staff in this space.

"There are pockets of growth for alternatives that have not been penetrated yet, like insurance and high-net-worth individuals. That's another area of growth that is going to come," Caprioli says. "When Philipp and I joined the industry over 20 years ago, the most sophisticated investors were at less than 5 percent penetration in alternatives. Some of them now are between 30 and 50 percent."

He adds that this is where high-net-worth individuals and insurance companies are today. "That's going to grow for the next 20 years, to levels probably more similar to where the most sophisticated pension funds have allocated. And if that happens, you see our industry doubling several times over the next 20 years."

Meanwhile, the last three years have put diversity, equity and inclusion centre stage. KKR Europe's co-heads have worked "extremely hard" to bring that change into the business, the pair say. Half of the team hires have been diverse. "We are now 40 percent-plus diverse. That is industry-leading in Europe," Freise says.

"We know that we will have the best investment returns and long-term sustainable performance if we create a team of top talent who want to work here and who reflect the world outside. The world outside is younger, it's more diverse, and it's more international."

Freise admits, however, that there's more work to be done in the firm's senior bench, which is about 20 percent diverse. On a positive note, that figure is slightly higher than the average for senior management in global PE firms – 18 percent for females and 16 percent for minorities – according to Meketa Investment Group's latest DE&I questionnaire.

In the almost three years since Freise and Caprioli assumed their posts, employee headcount in EMEA has grown from 277 in October 2019 to 436 as of end-April. "Mattia and I love this job. We have been here for more than 20 years because we've been able to redefine ourselves from doing Italy and Germany, to spearheading the tech or the sustainability franchises, to thinking broadly about the whole European team. And our job is to intensify that experience for our team," says Freise.

Freise recalls an interview Elon Musk gave to German publisher Axel Springer: "[He said] if you are 10 – maybe maximum 20 – years older than the median of your talented team, the daily concern and worry has to be that you're additive to the innovation and the leadership. Otherwise, you're no longer the right leader for that place. That is our daily challenge." ■