



Daily comment

KKR's capital markets move: Stroke of genius? Or not?

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When it filed for an initial public offering more than a year ago, [Kohlberg Kravis Roberts](#) outlined a path that would put it into direct confrontation with Wall Street's investment banks.

Now, with the investment banking model thrown into chaos, that path looks either very intelligent or extremely foolhardy, depending on whom you ask.

In its IPO filing last July, [KKR](#) spoke extensively of a nascent capital-markets business that would come up with new methods for syndicating out the debt and equity used as part of its buyouts. Doing so, the firm said, would help it capture some of the fees it formerly had to pay others for syndications, while "[reducing] the need to partner with large consortiums of private-equity firms on large leveraged buyouts."

That unit has since done several deals, all of which appear to be supporting companies owned in whole or in part by KKR's private equity funds. It served as joint book-runner in late 2007 on a \$350m sale of shares by chemicals company [Rockwood Holdings](#) Inc. In August, it was listed as an underwriter for [Avago Technologies](#)' planned public offering. Also in August, it stepped up alongside several banks to provide some of the debt for its portfolio company [SunGard Data Systems](#) to acquire [GL Trade](#), a French software company.

In the wake of the demise of the independent investment banking model, KKR in some ways looks wise for making this capital markets move. It now has an in-house unit that can help with funding just as outside sources of capital become scarce. That may well make its private equity funds more attractive than some of its competitors to potential targets.

"I think certainly there is an opportunity for the big private equity funds to step in," said Seth Goldblum, managing director at [CMF Associates LLC](#), a private equity consultancy. "Most of them probably came out of the bulge bracket anyway, so it probably relates to their skill sets. I see it as a means to an end for liquidity and access to capital for their existing portfolio companies, which could be good for their limited partners."

On the other hand, the disappearance of every large stand-alone broker-dealer on Wall Street raises some questions about whether the capital markets business is a good place to play right now. In the current environment, that business is seen as risky, and given the sweeping changes, some are nervous about a new crop of underwriters operating without regulatory oversight.

"It's a good idea if the combination of regulation and access to debt is there, but if that's not the case it's not a good idea," said Professor David Brophy, an associate professor of finance at The University of Michigan's Ross School of Business.

[Stephen Schwarzman](#), chairman and chief executive of [Blackstone Group](#), one of KKR's biggest rivals, said at the *Private Equity Analyst* Conference last week that he doesn't find the capital markets business a particularly appealing place to play, due to the large amounts of capital it requires every day, its cyclicality, and the typically high cost of breaking even.

"I've never liked the large capital markets business," Schwarzman said. He added that it is too early to say if the current turmoil on Wall Street presents opportunities to move into that business. Blackstone has to date chosen to expand in a different way, bulking up its advisory business and raising a diverse array of funds.


A spokesman said KKR has no intention of altering its efforts in the wake of the recent turmoil on Wall Street.

Of course, the capital markets business isn't the only area where KKR is expanding. It is also looking to source more deals itself and expand into asset classes other than private equity, like infrastructure. And it has been widely rumored to be among the bidders for [Neuberger Berman](#), [Lehman Brothers](#)' wealth management unit.

But many limited partners remain skeptical of attempts like these on the part of any of the big buyout firms.

"The firms that generate the best long-term returns are the ones who are focused and are in one business, not multiple businesses," said one investor who co-manages a portfolio of private equity funds. "Why would they want to get into that business, unless they weren't confident in their ability to generate returns in their principal business?"

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