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KKR to 'Scale Up' Real Estate, Private Credit Units

By Tom Stabile July 27, 2016

KKR is refocusing its growth strategy to bulk up the real estate, infrastructure, private credit, and hedge fund business units it created in recent years, but will do so through smaller moves, instead of splashy merger and acquisition plays.

The shift may reflect a general slowdown in M&A moves by the largest private equity firms in the market, notably KKR and Carlyle Group, which in recent years had been on a rabid buying spree, but of late have been less active. The possible exception is Ares Management, which just announced another transaction this year.

KKR simply doesn't see new asset classes in which to grow, said **Scott Nuttall**, head of the global capital and asset management group at the private equity fund manager, during its second quarter earnings call yesterday.

"We don't feel like we need to create new legs to the stool," he said. "We created the real estate business… four or five years ago. We don't see another 'real estate' – another big asset class that we want to build a business in. So really now it's about scaling what we've started."

The business areas the fund manager has built up in recent years through acquisitions, lift-outs, and investments from its "balance sheet" – a corporate cash hoard it uses for strategic moves – all present ample growth prospects because KKR's presence in them is modest, Nuttall said.

"When you think about the size of the end markets in the infrastructure space, real estate, credit, hedge funds – these are massive spaces where our market share is still pretty low," he said.

Private equity managers also may have a logical limit to the asset classes they can expand into before "losing their edge" in the eyes of investors, says **Hank Hakewill**, managing partner at **Hakewill & Associates**, marketing and communications consulting firm.

"You don't want to be perceived as all things to all people – that usually doesn't end well," he says. "It makes sense for them to concentrate their resources in areas where they have some foothold already and to build scale."

Some institutional investors may prefer to tap specialists in different asset classes, such as a "pure play" real estate or infrastructure manager, Hakewill says. But KKR may also benefit from existing clients seeking to trim their manager relationships and get fee concessions by concentrating assets with particular firms, he adds.

“That’s a goal for big firms like KKR – the more product and services you sell to a particular client, the higher the retention rate,” he says.

Instead of big forays into new areas, KKR may instead go after smaller deals to add to the units it has bought or created, along the lines of its 2013 acquisition of **Avoca Capital**, a European credit manager with $8 billion in assets that it fused into an existing leveraged credit platform, Nuttall said.

“So I think you could see us do more tuck-in types of strategic M&A,” he said. “I think you could see more things like that across our different asset classes that allows us to accelerate growth or gives us more of a presence in a specific market where we see opportunity, like we see in European credit.”

KKR had already signaled it would step back from adding on new “strategic partnerships” along the lines of last year’s deal to acquire just less than a quarter of **Marshall Wace**, a hedge fund manager, and Nuttall repeated that assertion during yesterday’s call.

“[W]e want to scale through our partnership with Marshall Wace as opposed to doing more of those,” he said. “So I would say on strategic M&A, it’s probably going to be more tuck-in, and then over time see if we… find things we like for the balance sheet in bigger scale. [But they are] less likely to be big outright acquisitions.”

A main concern for KKR is the difficulty of melding acquisitions into the larger company, Nuttall said.

“We are burdened by the integration risk,” he said. “This is a hard space to make acquisitions in and integrate them well, and so they’ll probably be few and far between.”

KKR’s M&A trajectory is similar to that of other asset managers that have grown quickly through big deals but then turned toward narrower purchases, says **Steven Levitt**, managing director and co-founder of Park Sutton Advisors. That stems in part from the low-yield environment, he says.

“Most of these large asset managers really are interested in tuck-in acquisitions today,” he says. “We don’t see so many groups looking to write checks of $500 million plus... In general, buyers are very interested in specific product gaps that they can fill in what seem to be growing areas.”

Real estate is one of the few areas attracting that kind of interest today, Levitt says, citing Legg Mason’s January deal to acquire **Clarion Partners**, a $40 billion fund manager. And hedge funds are under considerable pressure because of their low returns and high fee structure, possibly putting firms in that market into play, he says.

“Everyone is trying to find the hot areas where assets will be flowing,” he says.

KKR still sees ample room for growth because of the widespread concern among big investors about where to put capital today in a “very tricky environment for investing,” Nuttall said.

“[W]e’re spending a lot of time with our limited partners – both longstanding and newer ones, and prospects – talking about this investing environment,” he said. “And I think they’re having a hard time figuring out where to put their capital to generate attractive returns.”

The shift from acquisitions doesn’t mean KKR is abandoning another strategy it has used in recent years to move cash from its balance sheet into seeding new products. It is currently raising $500 million to $750 million for a technology, media, and telecommunications fund that will have $150 million more plugged in from the cash balance, said CFO **Bill Janetschek** during yesterday’s call.

KKR is also investing money from its cash pot for a healthcare growth strategy, but in that case it has not yet created a fund, he said. It expects to seed a new fund from the effort, likely starting out with a managed account partner early on, he added.

KKR is still raising capital for its 12th flagship North American buyout fund, which is targeting $12 billion in external capital and may have another $1 billion from the cash balance ledger. That fund is set to close later this year.

The fund manager’s assets under management hit $131 billion last quarter after it raised $8.9 billion in new capital. KKR should see inflows from its buyout fund, its second opportunistic fund, its second mezzanine debt vehicle, the technology fund, a real estate credit strategy, CLOs, and separate accounts in the second half of the year, Nuttall said. It also plans to launch fundraising soon for its third global direct lending and third Asia buyout strategies, he said.