From left to right: Vincent Policard, Brandon Freiman, Tara Davies, Raj Agrawal

Keynote

PHOTOGRAPHY: ALEJANDRA CADENAS

Raj Agrawal, Brandon Freiman, Tara Davies, Vincent Policard
KKR

The capital-protection brigade

After closing the year's largest fund on $7.4bn, KKR's infrastructure team gathered in Miami to discuss its future strategy. **Jordan Stutts** catches up with head of infrastructure **Raj Agrawal** and key team members to find out what's changing

On the back patio of a hotel in South Beach, Miami, the captains of KKR's infrastructure team pose for pictures.

In between the photographer's demands, Raj Agrawal, who leads the team, and Brandon Freiman, head of North American infrastructure, chat among the 25 or so investment professionals who also made the trip. Vincent Policard, who is responsible for energy and infrastructure investments in Europe, chows down on buffet food, while Tara Davies, head of European infrastructure, pats her hair down, as an autumn breeze mixes with warm ocean air and sweeps through palm trees overhanging the veranda.

KKR's infrastructure team met here in October to recap the past 12 months of running a global fund-management business. They also sought to grow as a unit, performing exercises to better understand the needs of their institutional clients.

But it would be impossible to miss another likely reason for their trip; two months prior, the firm had just closed the largest infrastructure fund of 2018. In August, KKR wrapped-up Global Infrastructure Investors III, collecting $7.4 billion in commitments from a range of pension funds, insurance companies and sovereign wealth funds.

"The diligence our LPs conduct is a pretty detailed, rigorous exercise," Freiman tells Infrastructure Investor about the process of raising a fund.

Policard agrees, as he sits with the other senior members at a conference table inside the hotel. Just preparing to market the fund, he recalls, took three to five months and included the team asking themselves why they're different from their competitors and how they've been successful.

There is no doubt KKR has been successful investing in infrastructure, launching its programme a decade ago, raising $11.5 billion across three funds and managing a total $13 billion in assets. The firm's first infrastructure fund, which closed on $1.04 billion in 2012, is generating a 13 percent net annual return and 1.7 times multiple on invested capital. It raised $3.1 billion for its second fund, which closed in 2015, and is returning 12.5 percent with a 1.2 times multiple.

Demand for infrastructure is at an all-time high, with institutional investors pouring capital into an asset class perceived as a safe-bet investment. Fund managers are having a heyday, raising $68.21 billion through the first three quarters of this year, according to Infrastructure Investor data, which already tops the total amount collected in 2017, making 2018 the largest fundraising year on record. Just a month before KKR's final close, Stonepeak Infrastructure Partners announced it had raised $7.2 billion, and last year Global Infrastructure Partners closed the asset class's largest fund on $15.8 billion.

So, in a crowded field, letting investors know how you stand out can be hard to do, and sticking to that strategy can be even harder.

"The primary reason why the last fundraising was so successful is because of the story we've been telling for 10 years," Policard says. Agrawal adds: "In 2008, we looked at how infrastructure was being invested in the market. We thought we could do it differently."

EYEING THE DOWNSIDE

Two cousins, Henry Kravis and George Roberts, founded KKR in 1976 and fashioned an identity for the firm during the 1980s as a master of leveraged buyouts. A decade ago, KKR, by then an investment powerhouse headquartered at the southern edge of Central Park, in New York City, saw an opening in the market.

Managers were pitching infrastructure to clients as a good place to park capital during the turbulence wrought by the Global Financial Crisis. However, in the asset class's early days, not every manager was getting it right. Investments thought to be low risk were going belly up as GDP growth, which underpins cashflows for assets such as toll roads and ports, stalled around the world.

"Everyone thought they were buying low-risk investments. Some firms were able to survive that. Other firms weren't able to because they actually had high-risk investments," Agrawal explains. Freiman adds that private infrastructure management was new to many investors, and its risks "weren't properly defined".

"We thought that was a real opening for us to go in and be very purposeful about defining infrastructure from a risk-based approach," he says.

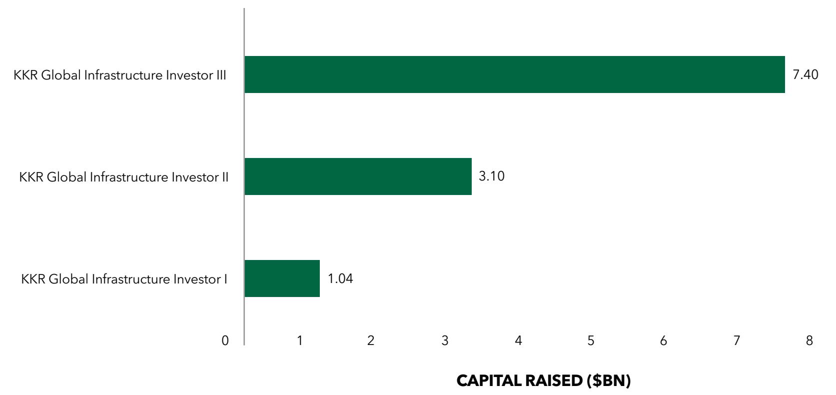
From the start, KKR's strategy has been to analyse a potential investment by risk, not sector. Agrawal says the team isn't "wedded to a limited definition" of the asset class but rather to one specific question: "Is it providing protection of capital?"

Davies adds: "If things go differently from what we had planned, we still have a high conviction that we will get our money back and be able to [provide] a small return."

In fact, through three fundraisings, KKR's defining message has been that even in a worst-case scenario, an investor will make its money back.

QUANTUM LEAP

KKR's third infra fund is its largest ever, more than double the size of its predecessor when it closed on $7.4bn



Source: Infrastructure Investor

"The idea of investing in a strategy which has protection of capital regardless of what happens in the macro-market is very appealing to investors," Agrawal explains. Even in today's growing economy, he says, "[infrastructure] is still very relevant, but for slightly different reasons."

Failing to deliver on the promise to protect capital is what caused some firms to close during the Global Financial Crisis, but keeping it is what successful ones are doing today, amid new volatility and rising interest rates, to keep their investors wanting more.

'PE DNA'

KKR's infrastructure team formed in 2008 as part of a larger energy and infrastructure group led by Marc Lipschultz, who joined the firm in 1995.

Agrawal joined in 2006 as a Stanford University graduate who had launched his career at consulting firm McKinsey & Company, worked a stint at Thayer Capital Partners and was vice president at Warburg Pincus, executing energy infrastructure deals. Jesus Olmos, an industry veteran who previously held senior roles at Spanish utility Iberdrola and Spanish power company Endesa, came onboard in 2008. Lipschultz left KKR in 2016 and Agrawal and Olmos were named co-heads of the infrastructure group. In April this year, Olmos left as well, leaving Agrawal as the sole head of the firm's infrastructure business.

Freiman had been working in private equity at KKR since 2007, having previously sourced energy deals at the investment bank Credit Suisse Securities.

At this point, KKR was a private equity firm capable of investing in and fixing infrastructure. "The PE DNA that runs through the firm is strong and creates an edge for the infrastructure business," Davies says. "We have a lot of tools that are private equity-oriented which we're applying to the infrastructure space."

However, it did not have the right capital for the asset class, which requires investors to make long-term commitments and accept the trade-off between reliability and more modest mid-teen returns. What the original infrastructure team did have setting up the business was an advantage smaller firms lacked – deep pockets and a long list of existing partnerships.

In the beginning, KKR's deep pockets paid off by allowing the infrastructure team to market their first and second funds at below-market rates, as recognised by KKR co-president Joseph Bae during the firm's

July Investor Day. The infrastructure team pitched Fund I with a 1 percent management fee and 10 percent carried interest; Fund II was sold with the same management fee but a slightly higher carry of 11 percent.

However, as the firm's success in infrastructure has grown, so have its prices, with the team marketing Fund III with a 1.2 percent management fee and 16 percent carry.

Before raising its first fund, the firm made one of its first large-scale infrastructure investments, in partnership with South Korea's National Pension Service, to acquire a 23.44 percent stake in Colonial Pipeline Company from oil giant Chevron. For more recent investments, KKR has deployed a syndication strategy, allowing investors that are not part of their infrastructure fund to access some of their deals. If the investor likes what they get, they sign up for the dedicated fund.

This proved to be an advantage when the firm was raising its latest fund. In the 2017 acquisition of Dutch car park operator Q-Park, €1.5 billion of the €1.8 billion of equity used to fund the deal was syndicated to co-investors, Davies said during KKR's Investor Day presentation. She added that 11 of the 18 investors that participated in the Q-Park syndication went on to become LPs in KKR's third infrastructure fund.

The strategy has become such a staple of the infrastructure team's repertoire that head of investor relations Craig Larson told analysts on this year's second-quarter earnings call that in 2017, "we syndicated more capital than we invested in our [infrastructure] funds".

Policard explains: "After we have secured a deal, we decide how much of the equity exposure we want to keep and put in our funds and which part we want to sell down to co-investors. That makes the whole transaction process much easier."

'YOU HAVE TO BE IN ASIA'

Policard joined in 2012 as KKR wrapped up raising Fund I, which closed in 2012 on $1.04 billion. With its first dedicated pool of capital, the firm began building its portfolio.

The infrastructure team maintains its strategy revolves around an asset's risk, but nonetheless its portfolio leans heavily towards three sectors: transportation, energy infrastructure – including renewables – and telecommunications. According to Agrawal, the one rule – protection of capital – is achieved using conservative leverage, long-term contracts or investing in regulated assets.

In 2016, when Davies joined to eventually replace Olmos in Europe, as he planned his departure a few years down the line, KKR had acquired stakes in midstream assets, renewables and power projects, carkpark operator Q-Park and Calvin Capital, a firm financing the rollout of smart meters in the UK.

She came with 17 years of infrastructure experience from her time at Macquarie Group and knows the market well enough to notice how investors are changing it. "The LP market for infrastructure is a lot savvier than it was 20 years ago," Davies says. "They are discerning enough to understand fund strategies and pick where they want to play within the market."

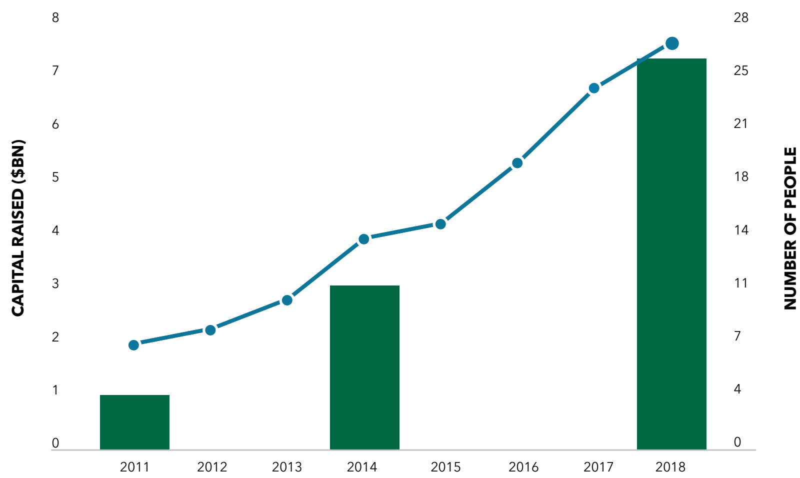
For now, the firm's strategy will stay focused on European and North American markets, where it has found success so far. But, according to Agrawal, both Asian LPs and investment opportunities are increasingly on the horizon. "If you are looking three or four decades down the road, and you want to be in the infrastructure business, you have to be in Asia," he says.

Agrawal adds that the infrastructure team saw the fastest growth and appetite for infrastructure from Asian investors while raising Fund III. And even though Fund III doesn't have a mandate to invest in that market, he says, the firm is reportedly planning to launch its first Asia-dedicated vehicle in the near future, targeting raise of up to $2 billion.

But for now, he says, "consistency is most important"; for the infrastructure team to stick to its strategy while investing Fund III. "We've talked a lot about that in Miami," Agrawal explains. "It's about not having significant mess-ups. It's about sticking to your strategy, hitting singles and doubles, not having a lot of volatility in returns. Consistency is a big part of what we're trying to do." ■

SIZING UP

Raj Agrawal, at KKR since 2006, leads the infra team, which has been historically split between North America and Europe and has grown from 7 people in 2011 to 27 today



Source: KKR June 2018 presentation to Washington State Investment Board; KKR