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Non-U.S. Public Offerings by Private Equity Funds — A New Chapter in Fundraising

Non-U.S. Public Offerings by Private Equity Funds — A New Chapter in Fundraising

KKR Private Equity Investors' May 3 sale of $5 billion of partnership units on Euronext (Amsterdam) marks a new chapter for private equity fundraising.[1]

Although other private equity sponsors have tapped the public markets for capital (e.g., the 2005 non-U.S. public offering of a collection of Japanese and European holdings by Ripplewood Holdings and U.S. public offerings by business development companies such as American Capital Strategies and Apollo Investment Corporation), KKR is the first private equity group to establish a true "evergreen" public fund to make private equity investments and serve as a funding and liquidity source for its traditional private equity funds.

Under U.S. laws, particularly the Investment Company Act of 1940, buyout groups encounter difficulties raising capital from the U.S. public markets. KKR achieved its goal by listing outside the U.S. and limiting U.S. investor participation to qualified purchasers solicited by private placement.

By making a public offering outside the U.S., KKR avoided significant negotiated investor restrictions and investment company regulation that would constrain a U.S. public vehicle, such as a business development company or other U.S. registered investment fund.[2] As such, KKR Private Equity Investors is a hybrid fund that provides the sponsor best-in-breed/highly-favorable terms borrowed from a variety of public and private investment vehicles.

Attractive sponsor features include:

- **good sponsor economics**, such as a hedge fund-like management fee based on the fund's potentially growing net asset value and a performance or incentive fee paid on unrealized (as well as realized) portfolio appreciation for certain assets,
- **a permanent (closed-end) capital base** that can grow with reinvestment (no distribution or redemption requirements other than anticipated tax distributions) and relieve the sponsor of 3-to-5 year fundraising cycles,
- **a low cost of capital** that can be used as a powerful coinvestment tool to complement traditional private equity fund investment vehicles,
- **investor liquidity** not available in the traditional fund secondary market, and
- **flow-through tax treatment**.

The public vehicle also allows the sponsor to invest in a wide range of investments and engage in a variety of transactions with KKR affiliates, including investing up to 40% of its assets into a U.S. KKR private equity fund (or a succession of future KKR funds), co-investing along with other KKR funds in portfolio companies and purchasing secondary interests in KKR funds from existing investors in such funds.

A non-U.S. public offering is not necessarily the right path for, or available to, all private equity funds. Pursuing a public offering risks alienating traditional LPs, is not suited to ERISA investors or other tax-exempt investors who are not willing to incur UBTI (unrelated business taxable income), and requires additional internal controls to handle the complex structure. Moreover, a listed non-U.S. vehicle requires maneuvering through a maze of U.S. and non-U.S. regulatory, tax, securities, disclosure and governance issues and being subject to the constant scrutiny of the public marketplace.

Nonetheless, some sponsors may view a public offering as necessary to remain competitive on the grounds that:

- a market differentiation may develop between those funds that have a permanent public capital base (perhaps with risk-adjusted return expectations below those of traditional private equity investors) and those funds that do not,
- sponsors able to access the public markets may have a competitive advantage in transaction pricing and structure enabling them to capture market share in today's hotly contested auction environment,
- sponsors with low cost public funds may be able to support an investment platform not available to funds with a smaller capital base, rather than turning to a club deal or pursuing alternative financing outside of its control, and
- a permanent fee base and further brand recognition in the marketplace could pave the way for the sponsor itself to go public.

Who can successfully accomplish a non-U.S. public offering of a private equity focused fund? Only the market will say for sure, but it certainly helps to have a globally recognized brand name (such as KKR), a diversified portfolio and a strong and lengthy track record.

Whether the offering by KKR Private Equity Investor fund represents a permanent change in the fundraising landscape or simply signals the opening of a temporary window, like the 2004 series of U.S. business development company offerings, remains to be seen. Kirkland & Ellis LLP is currently advising a number of private equity fund sponsors considering whether a public offering might be appropriate for their firms.

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[1] As of the time of this writing, press reports indicate that Apollo Management has also placed $1.5 billion in a private placement of units in a new investment partnership which will subsequently make an application to be listed on Euronext.

[2] See *Publicly Offered Private Equity Funds — Recent BDC Offerings* Kirkland & Ellis Client Alert dated May 6, 2004 for a detailed explanation of pros and cons of the business development company option for a private equity sponsor.

Should you have any questions about the matters addressed in this Kirkland PEN, please contact the following Kirkland & Ellis authors or your regular Kirkland & Ellis contact.

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NASDAQ Update

The Nasdaq Stock Market, Inc. recently received approval from the Securities and Exchange Commission to begin operations as a national securities exchange. We expect that the transition to exchange status, as The NASDAQ Stock Market LLC, will occur June 1, 2006 for NASDAQ-listed securities. Generally, the transition to an exchange will be seamless for NASDAQ-listed issuers. However, Rule 144 sellers of NASDAQ-traded securities will need to file a copy of any required Form 144 with NASDAQ (in addition to the current requirement to file a Form 144 with the SEC).

Practising Law Institute
Tax Planning for Domestic & Foreign Partnerships, LLC, Joint Ventures & Other Strategic Alliances 2006
New York City, June 1 - 2
San Francisco, June 15 - 16

Kirkland partners Donald Rocap and Keith Villmow will present at PLI's "Tax Planning for Domestic & Foreign Partnerships, LLC, Joint Ventures & Other Strategic Alliances 2006." The program will provide updates on current developments in tax planning, discuss the impact of recent legislation, and provide insight on pending legislation and regulations.

Corporate Law for Intellectual Property Lawyers
June 2, 2006

Kirkland partner Neil S. Hirshman will present "Achieving Commercial Objectives While Protecting IP" at the "Corporate Law for Intellectual Property Lawyers" seminar hosted by Law Seminars International. This seminar provides IP practitioners with an understanding of corporate law and other factors driving business transactions.

2006 Global Asian Venture Forum: Global Perspective – Local Opportunities
June 26-28, 2006

The 5th Annual Asian Private Equity & Venture Forum entitled *China: Bridge to a New Global Private Equity and Venture Model* will cover select topics including "China Links in with Global VC Firms: Engine for a New Model" and "GPS: Raising a New China Fund" and the Keynote address "Explaining Private Equity and Venture Capital: Does China Offer a New Global Model - Hyper-Growth and Strong Cash Flow." Kirkland partner David Patrick Eich will speak on the latest opportunities and challenges in Greater China private equity.

Information Management Network
Seventh Annual U.S. Real Estate Opportunity & Private Fund Investing Forum
June 27 - 28, 2006

Kirkland partner Stephen G. Tomlinson will participate on the Hotel & Leisure Properties panel which will address the short and long-term outlook for different product types, resort properties, distressed hotels, and review how funds are taking advantage of the condo hotel boom.

Kirkland & Ellis LLP's Private Equity Practice

Kirkland & Ellis has one of the most active and highly regarded private equity practices in the world. Kirkland represents private equity clients in many different industries, including buyers and sellers of private and public companies, and is a leader in representing multiple private equity investors in "club" transactions. In 2006, *The American Lawyer's* "Corporate Scorecard" ranked Kirkland's Private Equity Buyouts practice first among law firms in handling the greatest number of Private Equity Buyouts in 2005. Kirkland was also named by *Chambers & Partners* as the "International Private Equity Law Firm of the Year" and the "USA Private Equity Law Firm of the Year." *Chambers & Partners* also ranked Kirkland first in Private Equity Fund Formation, calling the group "one of the best in the world."