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Good morning. Thank you, Derek, for that kind introduction. It's a pleasure to see so many friends, investors, and business associates at this year's conference. The tremendous growth of private equity and venture capital in Europe, the U.S., and around the world is largely the result of the hard work of the people in this room today. When I began in this business in the late 1960s, a small conference room in an office would have been more than adequate for an industry gathering.

The SuperReturn organizers asked me to speak about "value creation in the large buyout space." There have, of course, been many significant changes in the market for complex, global businesses over the years, and I thought the most efficient way to approach the topic is to focus my remarks on three areas: changes in the way KKR does business, the reasons we made them, and the impact of these changes on value creation.

KKR's transformation to the firm it is today began in the late 1990s. This was a time when my partner George Roberts and I were frankly dissatisfied with the performance of the firm. We were making too many mistakes. KKR had been a pioneer in the private equity industry, but continued industry leadership in an increasingly competitive and complex business environment, we believed, required a fundamental rethinking of our methods. Unlike the early days of management buyouts, the capital we all have had become a commodity, and anyone could run an LBO model. To deliver the returns our investors demanded, we had to bring more than cash to the table when discussing acquisition opportunities with CEOs. When we went to see a CEO and opened our briefcase and there were only dollars or Euros in it, the CEO would say, "You are no different than the last five firms with whom I have met." If we were to differentiate ourselves, we had to understand his industry and his company as well as he or she did. We had to understand the economic drivers, the metrics, the risks inherent in the business, and the opportunities to create additional value.

After serious discussion and self-assessment, we arrived at some basic conclusions about taking our business to a higher level. Perhaps the most important result of our deliberations was the realization that we needed to deepen our expertise in specific industries. The days of financial engineering were over, and we had to start thinking and acting more like "industrialists." Selecting quality opportunities and paying reasonable prices remained an important part of our work, but the focus of our firm had to move from buying a company to making an acquired company more valuable. Our job had to begin the day we bought the company. "Any fool can buy a company, just pay enough." The hard and important part of our job was what we did with the company to create shareholder value once we acquired it.

Our new emphasis on industry specialization and operational improvements in our portfolio companies went into effect in 2000 and had far-reaching implications for KKR and its investors. Among the institutional changes we made were organizing our investment professionals into industry teams and charging those professionals with becoming experts in their fields. To be credible with CEOs and other industry players, our executives had to develop a deep understanding of the various industries. Today we have nine industry groups in the US and seven industry groups in Europe, all headed by

a partner and staffed with three to five other executives from KKR.

George Roberts and I insisted that our investment professionals from each industry group spend time with purchasing managers, marketing people, sales personnel and manufacturing managers – among others – all the way up to the various CEOs. We wanted everyone at KKR to speak with customers and suppliers and to attend trade shows. I'm not talking about going to Wall Street investor conferences, but walking the floors of industry trade shows. We wanted our investment teams to learn why some company booths drew more people than others, and which new product had the potential of making an existing one obsolete and put a competitor at a complete disadvantage. In other words, we feel it is very important to focus on the detailed operations of an industry rather than merely the financial engineering.

KKR's efforts to improve operations in its portfolio companies have changed the firm's hiring practices. Many of our people – who I think are among the very best in the industry – have a broad range of strategic, consulting, operating, and finance backgrounds and come from operating corporations rather than Wall Street. Over the past five years, all of our senior hires – with one exception – have been executives with extensive industry experience. People like Michael Calbert, the former CFO of Randall's Food Markets; Ken Freeman, former CEO of Quest Diagnostics; Clive Hollick, the former CEO of United Media in the UK; Deryck Maughan, former CEO of Salomon Brothers and CEO of Citibank International; Michael Marks, the former CEO of Flextronics, a top provider of electronics manufacturing services; John Saer, the former CFO of KSL Recreation Corporation; and Reinhard Gorenflos, the former CFO of ARAL, the leading gas station operator in Central Europe. All of the people I've named work full time for KKR, and they have made a big difference in how we think about our business and businesses we acquire.

KKR's global resources also include our senior advisers, who have held top positions in major U.S. and European corporations. Our senior advisers serve on the boards of portfolio companies, sometimes acting as chairman, evaluate individual investment opportunities, and help us focus on operations once we have made the investment. They include Ed Artzt, the former chairman and CEO of Procter and Gamble; George Fisher, former chairman and CEO of Eastman Kodak and Motorola; Paul Hazen, former chairman and CEO of Wells Fargo; Joe Forehand, current chairman and former CEO of Accenture; and Roger Carr, former CEO at Williams plc in London.

Today, if you talk to a KKR professional for any length of time, you will likely hear the firm's mantra: "to be successful, the real work in a private equity transaction begins on the first day of owning a company. Buying a company is easy. Just pay enough and you will own a company." The hard part is making changes in the way a company operates so as to increase shareholder value. In the late 1990s, we made mistakes by not immediately getting the management of a newly acquired company to agree to certain first steps for change. We thought management had gone down the road and turned right, but in fact they had turned left. We had to find them and bring them back to where we thought they were going. This is time consuming and set us back by six months or more.

To make sure we corrected this mistake, we began implementing a "100-day plan" that is agreed upon by management and ourselves. This way we ring-fence the management and have an agreed upon plan to immediately improve the operations of the company. This plan is a detailed agreement on the steps necessary to achieve strategic and operational goals – for example, what are you going to do to improve margins and

productivity? How can we shorten the supply chain? It is a very detailed, line-by-line, person-by-person review and strategy. In many ways, it looks like a 100-day plan that, say, GE would implement once they buy a company. A 100-day plan assigns specific responsibilities to managers, KKR professionals, and our own in-house consultants and is an effective means of holding management accountable for results. This one improvement in the way we operate is probably the most important change we have made.

In addition to the daily or weekly KKR interaction with management, KKR actively monitors its investments at the board level, and we rigorously review the performance of companies before our portfolio committee. When necessary, we put people in the company who work with management to improve certain operations. A key KKR resource for strengthening operations is our in-house consulting business, called Capstone. We didn't have a comparable resource for most of the 1990s, and, consequently, we had been missing opportunities to improve businesses. With a team of 18 consultants based in New York, Menlo Park, and London, Capstone focuses on operational issues that have an immediate impact on the bottom line in such areas as manufacturing, product sourcing, and sales and marketing. We don't require our companies to use Capstone, but we find that most managements eagerly embrace its operational expertise and bottom-line focus. In fact, our biggest problem is getting the Capstone personnel back from the company where they are working, because managements want to keep them engaged since they are truly value added.

One of Capstone's most valuable contributions is helping our portfolio companies develop actionable metrics to monitor performance. I have been very surprised how few companies have truly good metrics in place. Financial statements, as valuable as they are, give you a rearview look at performance. Appropriate metrics in manufacturing, sales, distribution, purchasing, and other areas help you look at a business going forward. They identify opportunities to improve operations and measure progress toward goals.

Our input, including metrics, 100-day plans, and active monitoring create a productive sense of urgency in our portfolio companies from the first day of our ownership. These changes have been very instrumental in the strong improvements in our portfolio of companies.

When we looked at our business in the late 1990s, we also recognized that the world was shrinking and that we needed to have a global footprint. Many of the companies we buy are multinationals that require diligence and operational efforts across different markets. In addition to our offices in New York and Menlo Park, we have opened offices in London and Paris and we have recently established a presence in Asia, with new offices in Hong Kong and Tokyo.

Our global perspective not only helps us make better investment decisions around the world, but also strengthens our ability to improve our portfolio companies – wherever they may be. For example, we can help our U.S. and European companies globally source key parts, shorten supply chains, and enter new markets due to our Asian presence. For our European multinationals, KKR's presence in the U.S. can assist in such areas as finding management talent and addressing operating, accounting, legal, and regulatory issues.

You may have noticed that I haven't said anything this morning about financing large buyouts. Part of the reason is that, as I mentioned earlier, capital is commodity and,

unlike previous decades, leverage alone will not drive returns. Nonetheless, I believe that the right capital structure for a transaction is as important as ever. We are very careful to avoid burdening our companies with excessive levels of debt. When we set the capital structure, the right level of debt enables a company to invest for growth and to weather economic downturns. If we don't believe that we can truly improve the operations of a company after we were to purchase it, and the only way to have a reasonable IRR is to leverage it beyond what we consider prudent (because financing sources will provide the debt), we won't make the acquisition. Conversely, we have avoided over-leveraging or re-leveraging a company once we have acquired it just to pull our equity out to show a high IRR. We feel that unless there has been a major improvement in either the earnings of the company or the levels of debt, we should leave the capital structure where we originally set it. We believe in a balanced return of IRR and dollars/Euros up and dollars/Euros back. In other words, we are looking for a large multiple of cash, not just IRRs.

I'd like to devote the rest of my time this morning to discuss briefly two examples of KKR's operational approach to improving businesses and creating value. The first example is ATU, a German company that sells car parts and operates service centers. The second is Sealy, the largest U.S. bedding manufacturer. ATU and Sealy were both purchased in 2004, and both businesses are very much works in progress. Nevertheless, we think we have already made substantial headway in improving them.

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I'll start with ATU, which operates 536 stores. The automotive aftermarket in Germany, which was €27.2 billion in 2005, is an appealing industry. Auto replacement parts and maintenance items tend to be non-discretionary, and demand for them is fairly stable, regardless of the economic environment.

Based on our earlier ownership of AutoZone, a chain of auto parts stores in the United States, we felt confident about our ability to create value in a retail auto parts company in Germany. AutoZone's former chief operating officer Tim Vargo worked with us during the due diligence for ATU and after the deal closed, visiting many of the company's stores and providing expert advice in such areas as purchasing, inventory management, and marketing. Tim, by the way, is another example of the network of resources and advisers that we make available to our portfolio companies. We teamed Tim up with one of our Capstone consultants, who complemented Tim's 20-year industry expertise with Capstone's analytical tools and change management skills.

One of the ways we helped strengthen ATU was by working with the company to improve inventory management. When we purchased the company, ATU had too many suppliers – more than 800. By reducing the number of suppliers, but purchasing more units from each of them, the company was able to get volume discounts and improve margins. We improved the supply chain optimization by setting up professional category management and automated forecasts to replenish inventories.

A related inventory-management opportunity was streamlining the product portfolio of 15,000 parts available at each store and another 45,000 deliverable within 24 hours. We are helping ATU run the diagnostics to determine the Stock Keeping Units that should be part of the core product portfolio and reduce the number of unprofitable products in stores and in central warehouses. We expect to reduce inventory by 10 to 20 percent

depending on product category.

We have standardized ATU's store base to drive like-for-like sales through centralized sales space allocation and optimization. We have also begun to increase workshop utilization from 55 percent to 65 percent by improving work practices (i.e., flexible working hours to optimize peak and off-peak staffing). We introduced a dedicated workshop consultant in every branch to improve up-selling and cross-selling. ATU has also successfully built a number of peripheral businesses. These are growing rapidly. They include AEM Autoglass that sells replacement windshields, ATU's fleet business, and ATU's smart repair business. We have also driven a store roll-out program for additional sales.

As sales have grown, the EBITDA margin has grown from 11.2 percent to 13.8 percent currently, and it is expected to grow further in the next 12 to 24 months. All of this is the result of productivity improvements, better inventory mix, and cost containment.

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Now I'd like to mention some of the operational improvements we have been making at Sealy, the world's largest manufacturer of mattresses and other bedding products. Even though Sealy had been through several private equity buyouts prior to our purchase of the company, we found that we were able to work with the existing management to make major operational improvements with the help of Capstone (our in-house consulting group), all of which have led to major improvements in revenues, earnings, and margins.

One of our major operational achievements at Sealy has been helping the company develop business metrics that are consistent and actionable. For example, the absence of consistent data and standards across Sealy manufacturing plants made it difficult to distinguish between efficient and inefficient facilities. Without comparable, objective measures, every plant thought that it was the best one. The KKR and Capstone teams helped Sealy management develop manufacturing metrics that monitored costs and waste in each step of the production process and at each plant. Today Sealy's CEO posts the comparative results and productivity rankings at each facility, which has led to healthy competition among the plants.

Better manufacturing metrics identified actionable problem areas and helped drive reductions both in labor hours per bedding unit and in the amount of unused scrap material. For example, by focusing on these areas, labor hours per unit decreased 19 percent and scrap per unit fell 44 percent. At the same time, safety incidents in Sealy plants decreased 22 percent.

Our main components of value creation have come from new product development, productivity improvements, continued cost reductions and strong cash flow generation. We expect that over time, the company's top line growth will be driven evenly by growth in unit volume and average unit selling price. For example, we have pushed management to roll out new product at increased average prices.

These actions and many others have led to very strong results. Like the ATU transaction, our Sealy investment is progressing well. Over the past 20 months, Sealy's revenues have increased 21 percent, EBITDA has risen 42 percent, and margins have improved by 241 basis points. At the same time, the company has paid down substantial debt from

improved cash flow.

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I'd like to conclude my remarks with an observation about private equity that is often overlooked in discussions of our industry. KKR's approach to investing, and the various approaches of many private equity firms, leads not only to value creation but also to economic and social benefits – for example, increases in employment, innovation, and research and development in the various portfolio companies. We at KKR are very strong believers in looking out for all stakeholders, which include employees, customers, suppliers, shareholders, and the community. Along these lines, it is imperative that companies reinvest in the business for growth. Otherwise the business will eventually stagnate, and there will be value destruction rather than value creation. It takes all stakeholders to truly create a world-class company, and that is why we believe that we must pay attention to each stakeholder and invest in them accordingly. We believe in employee training to prepare each employee for better and more demanding jobs. And we strongly believe in giving back to the community to make it healthier and vibrant.

In 2005 an independent survey sponsored by the European Private Equity and Venture Capital Association found that European companies financed by buyouts created 420,000 new jobs between 2000 and 2004. Employment in both venture capital and buyout financed companies grew by an average of 5.4 percent annually during this period, which is 8x the annual growth rate of total employment in the EU. And buyout financed companies employ close to 5 million people, so the sample is quite significant.

For a longer period, 1997-2004, employment in this same category of companies grew by an average rate of 2.4 percent annually which is nearly 4x the annual growth rate of total employment in the EU 25 member states. The study, conducted by researchers at the Munich Technical University, found that two-thirds of the buyout financed companies surveyed either kept a stable headcount or increased the number of employees during the last five years.

It is true that some private equity investments require painful restructuring, particularly in industries with too much capacity, particularly in the first year after a buyout. But what critics of private equity fail to acknowledge is that without restructuring many companies would be in greater financial jeopardy, threatening even more workers' jobs. Often times it is important to build a strong foundation for future growth, which may mean some initial pruning of the workforce or relocation/consolidation of facilities. The outcry from unions in Germany, in particular, reminds me of what we faced in the US in the 1980s. At that time we commissioned a similar independent survey of our own companies and found that, in fact, we created many net new jobs, particularly in the 2nd through 5th year of our ownership. With this survey, and with our 30+ years of private equity experience owning over 130 companies, I believe that many of the concerns about employment and the stakeholders are unfounded. In fact, all of us in this room who are sponsors do create numerous jobs and much stronger companies positioned to grow. We should be very proud of this. Being an active and concerned shareholder of our companies inures to the benefit of all stakeholders in the long term.

I think all of us here today have a role to play in communicating the economic and social value of what our industry provides. Although we are private organizations, better public understanding of how we create value for all stakeholders is in our enlightened self-interest. I am confident that a deeper, more nuanced understanding of private equity investing in Europe and around the world will help lead to new opportunities for all of us,

and much stronger and vibrant companies with long-term increased employment, which will create real value for the home countries.

Thank you.