KKR & Co. L.P.
Form 10-Q
August 07, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

Form 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.

For the quarterly period ended June 30, 2014

Or

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.

For the Transition period from to .

Commission File Number 001-34820

KKR & CO. L.P.

(Exact name of Registrant as specified in its charter)

Delaware	**26-0426107**
(State or other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)

9 West 57 th Street, Suite 4200
New York, New York 10019
Telephone: (212) 750-8300
(Address, zip code, and telephone number, including
area code, of registrant s principal executive office.)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 and 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter periods that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act:

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

As of August 5, 2014, there were 415,463,584 Common Units of the registrant outstanding.

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KKR & CO. L.P.

FORM 10-Q

For the Quarter Ended June 30, 2014

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report contains forward looking statements within the meaning of Section 27A of the Securities Act of 1933, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, or the Exchange Act, which reflect our current views with respect to, among other things, our operations and financial performance. You can identify these forward looking statements by the use of words such as outlook, believe, expect, potential, continue, may, should, seek, approximately, predict, intend, will, plan, estimate, anticipate, the neg words, other comparable words or other statements that do not relate strictly to historical or factual matters. Without limiting the foregoing, statements regarding the expected synergies from the acquisition of KKR Financial Holdings LLC and Avoca Capital and their affiliates may constitute forward-looking statements that are subject to the risk that the benefits and anticipated synergies from such transactions are not realized. Forward looking statements are subject to various risks and uncertainties. Accordingly, there are or will be important factors that could cause actual outcomes or results to differ materially from those indicated in these statements. We believe these factors include those described under the section entitled Risk Factors in our Annual Report on Form 10-K for the fiscal year ended December 31, 2013, filed with the Securities and Exchange Commission on February 24, 2014 and Quarterly Report on Form 10-Q for the quarter ended March 31, 2014, filed with the Securities and Exchange Commission on May 7, 2014. These factors should be read in conjunction with the other cautionary statements that are included in this report and in our other periodic filings. We do not undertake any obligation to publicly update or review any forward looking statement, whether as a result of new information, future developments or otherwise.

In this report, the term GAAP refers to accounting principles generally accepted in the United States of America.

In this report, references to KKR, we, us, our and our partnership refer to KKR & Co. L.P. and its consolidated subsidiaries. Prior to KKR & L.P. becoming listed on the New York Stock Exchange (NYSE) on July 15, 2010, KKR Group Holdings L.P. (Group Holdings) consolidated the financial results of KKR Management Holdings L.P. and KKR Fund Holdings L.P. (together, the KKR Group Partnerships) and their consolidated subsidiaries. Each KKR Group Partnership has an identical number of partner interests and, when held together, one Class A partner interest in each of the KKR Group Partnerships together represents one KKR Group Partnership Unit.

References to our Managing Partner are to KKR Management LLC, which acts as our general partner and unless otherwise indicated, references to equity interests in KKR s business, or to percentage interests in KKR s business, reflect the aggregate equity of the KKR Group Partnerships and are net of amounts that have been allocated to our principals in respect of the carried interest from KKR s business as part of our carry pool and certain minority interests. References to principals are to our senior employees and non-employee operating consultants who hold interests in KKR s business through KKR Holdings L.P., which we refer to as KKR Holdings, and references to our senior principals are to our senior employees who hold interests in our Managing Partner entitling them to vote for the election of its directors.

References to non-employee operating consultants include employees of KKR Capstone and are not employees of KKR. KKR Capstone refers to a group of entities that are owned and controlled by their senior management. KKR Capstone is not a subsidiary or affiliate of KKR. KKR Capstone operates under several consulting agreements with KKR and uses the KKR name under license from KKR.

Prior to October 1, 2009, KKR s business was conducted through multiple entities for which there was no single holding entity, but were under common control of senior KKR principals, and in which senior principals and KKR s other principals and individuals held ownership interests (collectively, the Predecessor Owners). On October 1, 2009, we completed the acquisition of all of the assets and liabilities of KKR & Co.

(Guernsey) L.P. (f/k/a KKR Private Equity Investors, L.P. or KPE) and, in connection with such acquisition, completed a series of transactions pursuant to which the business of KKR was reorganized into a holding company structure. The reorganization involved a contribution of certain equity interests in KKR s business that were held by KKR s Predecessor Owners to the KKR Group Partnerships in exchange for equity interests in the KKR Group Partnerships held through KKR Holdings. We refer to the acquisition of the assets and liabilities of KPE and to our subsequent reorganization into a holding company structure as the KPE Transaction.

This report uses the terms total distributable earnings, net realized investment income, assets under management or AUM, fee paying assets under management or FPAUM, fee related earnings or FRE, fee and yield earnings, economic net income or ENI, committed dollars invested, gross dollars invested and syndicated capital. You should note that our calculations of these financial measures and other financial measures may differ from the calculations of other investment managers and, as a result, our financial measures may not be comparable to similar measures presented by other investment managers. These and other financial measures are defined in the section

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Management s Discussion and Analysis of Financial Condition & Results of Operations Key Financial Measures Segment Operating and Performance Measures and Liquidity Liquidity Needs Distributions.

References to our funds or our vehicles refer to investment funds, vehicles and/or accounts advised, sponsored or managed by one or more subsidiaries of KKR, unless context requires otherwise. They do not include investment funds, vehicles or accounts of any hedge fund manager in which we may acquire a stake or which we may seed, including Nephila Capital or BlackGold Capital Management.

Unless otherwise indicated, references in this report to our fully exchanged and diluted common units outstanding, or to our common units outstanding on a fully exchanged and diluted basis, reflect (i) actual common units outstanding, (ii) common units into which KKR Group Partnership Units not held by us are exchangeable pursuant to the terms of the exchange agreement described in this report, (iii) common units issuable in respect of exchangeable equity securities issued in connection with the acquisition of Avoca Capital and phantom shares held by former non-employee directors of KKR Financial Holdings LLC, and (iv) common units issuable pursuant to any equity awards actually issued under the KKR & Co. L.P. 2010 Equity Incentive Plan, which we refer to as our Equity Incentive Plan, but do not reflect common units available for issuance pursuant to our Equity Incentive Plan for which grants have not yet been made.

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KKR & CO. L.P.

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION (UNAUDITED)

(Amounts in Thousands, Except Unit Data)

	June 30, 2014	December 31, 2013
Assets		
Cash and Cash Equivalents	$ 2,504,205	$ 1,306,383
Cash and Cash Equivalents Held at Consolidated Entities	2,556,558	440,808
Restricted Cash and Cash Equivalents	91,935	57,775
Investments	57,378,768	47,383,697
Due from Affiliates	134,832	143,908
Other Assets	2,968,019	2,094,630
Total Assets	$ 65,634,317	$ 51,427,201
Liabilities and Equity		
Debt Obligations	$ 10,557,736	$ 1,908,606
Due to Affiliates	119,299	93,851
Accounts Payable, Accrued Expenses and Other Liabilities	3,192,535	2,839,926
Total Liabilities	13,869,570	4,842,383
Commitments and Contingencies		
Redeemable Noncontrolling Interests	277,084	627,807
Equity		
KKR & Co. L.P. Partners Capital (415,469,452 and 288,143,327 common units issued and outstanding as of June 30, 2014 and December 31, 2013, respectively)	5,496,720	2,727,909
Accumulated Other Comprehensive Income (Loss)	(4,843)	(5,899)
Total KKR & Co. L.P. Partners Capital	5,491,877	2,722,010
Noncontrolling Interests	45,947,973	43,235,001
Appropriated Capital	47,813	
Total Equity	51,487,663	45,957,011
Total Liabilities and Equity	$ 65,634,317	$ 51,427,201

See notes to condensed consolidated financial statements.

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KKR & CO. L.P.

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION (Continued) (UNAUDITED)

(Amounts in Thousands)

The following presents the portion of the consolidated balances presented in the condensed consolidated statements of financial condition attributable to consolidated variable interest entities (VIE) as of June 30, 2014. The assets of consolidated collateralized loan obligation (CLO) vehicles, which comprise the majority of KKR s consolidated VIEs, are held solely as collateral to satisfy the obligations of the CLO vehicles. KKR has no right to the benefits from, nor does KKR bear the risks associated with, the assets held by these CLO vehicles beyond KKR s beneficial interest therein and management fees generated from the vehicles. The assets in each CLO can be used only to settle the debt of the related CLO. The noteholders and other creditors of the CLO vehicles have no recourse to KKR s general assets. There are neither explicit arrangements nor does KKR hold implicit variable interests that would require KKR to provide any ongoing financial support to the CLO vehicles.

	June 30, 2014	
Assets		
Cash and Cash Equivalents Held at Consolidated Entities	$	1,290,426
Investments		7,787,522
Other Assets		402,139
Total Assets	**$**	**9,480,087**
Liabilities		
Debt Obligations	$	7,356,678
Accounts Payable, Accrued Expenses and Other Liabilities		465,074
Total Liabilities	**$**	**7,821,752**

See notes to condensed consolidated financial statements.

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KKR & CO. L.P.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

(Amounts in Thousands, Except Unit Data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Revenues				
Fees	$ 249,370	$ 166,376	$ 552,296	$ 317,616
Expenses				
Compensation and Benefits	358,730	200,602	689,768	531,723
Occupancy and Related Charges	16,059	13,878	31,467	28,399
General, Administrative and Other	210,536	77,542	337,261	171,230
Total Expenses	585,325	292,022	1,058,496	731,352
Investment Income (Loss)				
Net Gains (Losses) from Investment Activities	1,971,850	98,537	3,944,030	2,368,354
Dividend Income	272,902	209,486	369,606	248,955
Interest Income	215,872	128,020	377,832	237,389
Interest Expense	(65,997)	(24,614)	(100,728)	(47,637)
Total Investment Income (Loss)	2,394,627	411,429	4,590,740	2,807,061
Income (Loss) Before Taxes	2,058,672	285,783	4,084,540	2,393,325
Income Taxes	6,176	8,525	27,878	17,881
Net Income (Loss)	2,052,496	277,258	4,056,662	2,375,444
Net Income (Loss) Attributable to Redeemable Noncontrolling Interests	(6,809)	(7,800)	3,828	16,823
Net Income (Loss) Attributable to Noncontrolling Interests and Appropriated Capital	1,881,090	269,924	3,664,578	2,150,048
Net Income (Loss) Attributable to KKR & Co. L.P.	$ 178,215	$ 15,134	$ 388,256	$ 208,573
Net Income (Loss) Attributable to KKR & Co. L.P. Per Common Unit				
Basic	$ 0.47	$ 0.06	$ 1.16	$ 0.79
Diluted	$ 0.43	$ 0.05	$ 1.06	$ 0.72
Weighted Average Common Units Outstanding				
Basic	377,542,161	271,983,811	335,748,498	264,555,267
Diluted	410,179,838	298,078,764	367,877,049	290,104,942

See notes to condensed consolidated financial statements.

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KKR & CO. L.P.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (UNAUDITED)

(Amounts in Thousands)

	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Net Income (Loss)	$ 2,052,496	$ 277,258	$ 4,056,662	$ 2,375,444
Other Comprehensive Income (Loss), Net of Tax:				
Foreign Currency Translation Adjustments	(514)	(4,929)	4,829	(6,172)
Comprehensive Income (Loss)	2,051,982	272,329	4,061,491	2,369,272
Less: Comprehensive Income (Loss) Attributable to Redeemable Noncontrolling Interests	(6,809)	(7,800)	3,828	16,823
Less: Comprehensive Income (Loss) Attributable to Noncontrolling Interests and Appropriated Capital	1,880,668	266,310	3,668,428	2,145,064
Comprehensive Income (Loss) Attributable to KKR & Co. L.P.	$ 178,123	$ 13,819	$ 389,235	$ 207,385

See notes to condensed consolidated financial statements.

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KKR & CO. L.P.

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (UNAUDITED)

(Amounts in Thousands, Except Unit Data)

	KKR & Co. L.P.						
	Common Units	Partners Capital	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interests	Appropriated Capital	Total Equity	Redeemable Noncontrolling Interests
Balance at January 1, 2013	253,363,691	$ 2,008,965	$ (4,606)	$ 38,938,531	$	$ 40,942,890	$ 462,564
Net Income (Loss)		208,573		2,150,048		2,358,621	16,823
Other Comprehensive Income (Loss)- Foreign Currency Translation (Net of Tax)			(1,188)	(4,984)		(6,172)	
Exchange of KKR Holdings L.P. Units to KKR & Co. L.P. Common Units	20,592,345	244,173	(530)	(243,643)			
Tax Effects Resulting from Exchange of KKR Holdings L.P. Units and delivery of KKR & Co. L.P. Common Units		9,834	171			10,005	
Net Delivery of Common Units- Equity Incentive Plan	3,878,307	17,262				17,262	
Equity Based Compensation		53,354		108,614		161,968	
Capital Contributions				2,237,168		2,237,168	108,375
Capital Distributions		(248,619)		(5,149,385)		(5,398,004)	(6,922)
Balance at June 30, 2013	277,834,343	$ 2,293,542	$ (6,153)	$ 38,036,349	$	$ 40,323,738	$ 580,840

	KKR & Co. L.P.						
	Common Units	Partners Capital	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interests	Appropriated Capital	Total Equity	Redeemable Noncontrolling Interests
Balance at January 1, 2014	288,143,327	$ 2,727,909	$ (5,899)	$ 43,235,001	$	$ 45,957,011	$ 627,807
Net Income (Loss)		388,256		3,644,450	20,128	4,052,834	3,828
Other Comprehensive Income (Loss)- Foreign Currency Translation (Net of Tax)			979	3,841	9	4,829	
Exchange of KKR Holdings L.P. Units to KKR & Co. L.P. Common Units and Other Transfers	18,478,290	217,275	(429)	(244,522)	27,676		
Tax Effects Resulting from Exchange of KKR Holdings L.P. Units and delivery of KKR & Co. L.P. Common Units		28,974	506			29,480	
Net Delivery of Common Units- Equity Incentive Plan	4,507,807	(1,733)				(1,733)	
Equity Based Compensation		80,230		90,255		170,485	

Acquisitions	104,340,028	2,369,559		435,478		2,805,037	
Capital Contributions				7,145,096		7,145,096	87,718
Capital Distributions		(313,750)		(8,361,626)		(8,675,376)	(442,269)
Balance at June 30, 2014	415,469,452	$ 5,496,720	$ (4,843)	$ 45,947,973	$ 47,813	$ 51,487,663	$ 277,084

See notes to condensed consolidated financial statements.

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KKR & CO. L.P.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(Amounts in Thousands)

	Six Months Ended June 30, 2014	2013
Operating Activities		
Net Income (Loss)	$ 4,056,662	$ 2,375,444
Adjustments to Reconcile Net Income (Loss) to Net Cash Provided (Used) by Operating Activities:		
Equity Based Compensation	170,485	161,968
Net Realized (Gains) Losses on Investments	(3,888,183)	(1,625,493)
Change in Unrealized (Gains) Losses on Investments	(55,847)	(742,861)
Other Non-Cash Amounts	(57,251)	(35,253)
Cash Flows Due to Changes in Operating Assets and Liabilities:		
Change in Cash and Cash Equivalents Held at Consolidated Entities	(1,351,516)	122,181
Change in Due from / to Affiliates	11,997	(13,312)
Change in Other Assets	27,521	248,368
Change in Accounts Payable, Accrued Expenses and Other Liabilities	(106,289)	232,598
Investments Purchased	(20,307,521)	(13,850,467)
Proceeds from Sale of Investments and Principal Payments	23,366,999	15,465,372
Net Cash Provided (Used) by Operating Activities	1,867,057	2,338,545
Investing Activities		
Change in Restricted Cash and Cash Equivalents	878	66,112
Purchase of Furniture, Computer Hardware and Leasehold Improvements	(4,715)	(4,535)
Cash Acquired, Net of Cash Paid for Acquisitions	151,491	
Net Cash Provided (Used) by Investing Activities	147,654	61,577
Financing Activities		
Distributions to Partners	(313,750)	(248,619)
Distributions to Redeemable Noncontrolling Interests	(442,269)	(6,922)
Contributions from Redeemable Noncontrolling Interests	87,718	108,375
Distributions to Noncontrolling Interests	(8,361,626)	(5,149,385)
Contributions from Noncontrolling Interests	7,145,096	2,237,168
Net Delivery of Common Units - Equity Incentive Plan	(1,733)	17,262
Proceeds from Debt Obligations	2,006,534	814,790
Repayment of Debt Obligations	(924,947)	(230,882)
Financing Costs Paid	(11,912)	(4,960)
Net Cash Provided (Used) by Financing Activities	(816,889)	(2,463,173)
Net Increase/(Decrease) in Cash and Cash Equivalents	1,197,822	(63,051)
Cash and Cash Equivalents, Beginning of Period	1,306,383	1,230,464
Cash and Cash Equivalents, End of Period	$ 2,504,205	$ 1,167,413

See notes to condensed consolidated financial statements.

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KKR & CO. L.P.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued) (UNAUDITED)

(Amounts in Thousands)

	Six Months Ended June 30, 2014		Six Months Ended June 30, 2013	
Supplemental Disclosures of Cash Flow Information				
Payments for Interest	$	73,623	$	32,978
Payments for Income Taxes	$	15,923	$	69,448
Supplemental Disclosures of Non-Cash Investing and Financing Activities				
Non-Cash Contributions of Equity Based Compensation	$	170,485	$	161,968
Acquisitions	$	2,805,037	$	
Foreign Exchange Gains (Losses) and Translation on Debt Obligations	$	(25,360)	$	1,497
Tax Effects Resulting from Exchange of KKR Holdings L.P. Units and delivery of KKR & Co. L.P. Common Units	$	29,480	$	10,005
Net Assets Acquired				
Cash and Cash Equivalents Held at Consolidated Entities	$	765,231	$	
Restricted Cash and Cash Equivalents	$	35,038	$	
Investments	$	9,225,660	$	
Other Assets	$	885,314	$	
Debt Obligations	$	7,538,726	$	
Accounts Payable, Accrued Expenses and Other Liabilities	$	616,979	$	

See notes to condensed consolidated financial statements.

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1. ORGANIZATION

KKR & Co. L.P. (NYSE:KKR), together with its consolidated subsidiaries (KKR), is a leading global investment firm that manages investments across multiple asset classes including private equity, real assets, credit and hedge funds. KKR aims to generate attractive investment returns by following a patient and disciplined investment approach, employing world class people, and driving growth and value creation at the asset level. KKR invests its own capital alongside capital of the fund investors and brings opportunities to others through its capital markets business.

KKR & Co. L.P. was formed as a Delaware limited partnership on June 25, 2007 and its general partner is KKR Management LLC (the Managing Partner). KKR & Co. L.P. is the parent company of KKR Group Limited, which is the non-economic general partner of KKR Group Holdings L.P. (Group Holdings), and KKR & Co. L.P. is the sole limited partner of Group Holdings. Group Holdings holds a controlling economic interest in each of (i) KKR Management Holdings L.P. (Management Holdings) through KKR Management Holdings Corp., a Delaware corporation which is a domestic corporation for U.S. federal income tax purposes, and (ii) KKR Fund Holdings L.P. (Fund Holdings) and together with Management Holdings, the KKR Group Partnerships) directly and through KKR Fund Holdings GP Limited, a Cayman Island limited company which is a disregarded entity for U.S. federal income tax purposes. Group Holdings also owns certain economic interests in Management Holdings through a wholly owned Delaware corporate subsidiary of KKR Management Holdings Corp. and certain economic interests in Fund Holdings through a Delaware partnership of which Group Holdings is the general partner with a 99% economic interest and KKR Management Holdings Corp. is a limited partner with a 1% economic interest. KKR & Co. L.P., through its indirect controlling economic interests in the KKR Group Partnerships, is the holding partnership for the KKR business.

KKR & Co. L.P. both indirectly controls the KKR Group Partnerships and indirectly holds equity units in each KKR Group Partnership (collectively, KKR Group Partnership Units) representing economic interests in KKR s business. The remaining KKR Group Partnership Units are held by KKR Holdings L.P. (KKR Holdings), which is not a subsidiary of KKR. As of June 30, 2014, KKR & Co. L.P. held approximately 52% of the KKR Group Partnership Units and principals through KKR Holdings held approximately 48% of the KKR Group Partnership Units. The percentage ownership in the KKR Group Partnerships will continue to change as KKR Holdings and/or principals exchange units in the KKR Group Partnerships for KKR & Co. L.P. common units or when KKR & Co. L.P. otherwise issues new KKR & Co. L.P. common units.

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of KKR & Co. L.P. have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and the instructions to Form 10-Q. The condensed consolidated financial statements, including these notes, are unaudited and exclude some of the disclosures required in annual financial statements. Management believes it has made all necessary adjustments (consisting of only normal recurring items) such that the condensed consolidated financial statements are presented fairly and that estimates made in preparing the condensed consolidated financial statements are reasonable and prudent. The operating results presented for interim periods are not necessarily indicative of the results that may be expected for any other interim period or for the entire year. The December 31, 2013 condensed consolidated balance sheet data was derived from audited consolidated financial statements included in KKR s Annual Report on Form 10-K for the year ended December 31, 2013, which include all disclosures required by GAAP. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in KKR & Co. L.P. s Annual Report on Form 10-K filed with the Securities and Exchange Commission (SEC).

KKR & Co. L.P. consolidates the financial results of the KKR Group Partnerships and their consolidated subsidiaries, which include the accounts of KKR s management and capital markets companies, the general partners of certain unconsolidated funds and vehicles, general partners of consolidated funds and their respective consolidated funds and certain other entities including certain CLOs. References in the accompanying financial statements to principals are to KKR s senior employees and non-employee operating consultants who hold interests in KKR s business through KKR Holdings, and references to Senior Principals are to KKR s senior employees who hold interests in the Managing Partner entitling them to vote for the election of the Managing Partner s directors.

Use of Estimates

The preparation of the financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of fees, expenses and investment income (loss) during the reporting periods. Such estimates include but are not limited to the valuation of investments and financial instruments. Actual results could differ from those estimates, and such differences could be material to the financial statements.

Principles of Consolidation

The types of entities KKR assesses for consolidation include (i) subsidiaries, including management companies, broker-dealers and general partners of investment funds that KKR manages, (ii) entities that have all the attributes of an investment company, like investment funds, (iii) CLOs and (iv) other entities, including entities that employ non-employee operating consultants. Each of these entities is assessed for consolidation on a case by case basis depending on the specific facts and circumstances surrounding that entity.

Pursuant to its consolidation policy, KKR first considers whether an entity is considered a VIE and therefore whether to apply the consolidation guidance under the VIE model. Entities that do not qualify as VIEs are generally assessed for consolidation as voting interest entities (VOEs) under the voting interest model.

The consolidation rules were revised effective January 1, 2010 which had the effect of changing the criteria for determining whether a reporting entity is the primary beneficiary of a VIE. However, the adoption of these new consolidation rules was indefinitely deferred (the Deferral) for a reporting entity s interests in certain entities. In particular, entities that have all the attributes of an investment company such as investment funds generally meet the conditions necessary for the Deferral. Entities that are securitization or asset-backed financing entities such as CLOs would generally not qualify for the Deferral. Accordingly, when making the assessment of whether an entity is a VIE, KKR considers whether the entity being assessed meets the conditions for the Deferral and therefore would be subject to the rules that existed prior to January 1, 2010. Under both sets of rules, VIEs for which KKR is determined to be the primary beneficiary are consolidated and such VIEs generally include certain CLO vehicles and entities that employ non-employee operating consultants.

An entity in which KKR holds a variable interest is a VIE if any one of the following conditions exist: (a) the total equity investment at risk is not sufficient to permit the legal entity to finance its activities without additional subordinated financial support, (b) the holders of equity investment at risk (as a group) lack either the direct or indirect ability through voting rights or similar rights to make decisions about a legal entity s activities that have a significant effect on the success of the legal entity or the obligation to absorb the expected losses or right to receive the expected residual returns, or (c) the voting rights of some investors are disproportionate to their obligation to absorb the expected losses of the legal entity, their rights to receive the expected residual returns of the legal entity, or both and substantially all of the legal entity s activities either involve or are conducted on behalf of an investor with disproportionately few voting rights.

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With respect to VIEs such as KKR s investment funds that qualify for the Deferral and therefore apply the previous consolidation rules, KKR is determined to be the primary beneficiary if its involvement, through holding interests directly or indirectly in the VIE or contractually through other variable interests (e.g., carried interest), would be expected to absorb a majority of the VIE s expected losses, receive a majority of the VIE s expected residual returns, or both. In cases where two or more KKR related parties hold a variable interest in a VIE, and the aggregate variable interest held by those parties would, if held by a single party, identify that party as the primary beneficiary, then KKR is determined to be the primary beneficiary to the extent it is the party within the related party group that is most closely associated with the VIE.

Under the voting interest model, KKR consolidates those entities it controls through a majority voting interest or through other means, including those VOEs in which the general partner is presumed to have control. KKR does not consolidate those VOEs in which the presumption of control by the general partner has been overcome through either the granting of substantive rights to the unaffiliated fund investors to either dissolve the fund or remove the general partner (kick-out rights) or the granting of substantive participating rights.

The consolidation assessment, including the determination as to whether an entity qualifies as a VIE or VOE depends on the facts and circumstances surrounding each entity and therefore certain of KKR s investment funds may qualify as VIEs whereas others may qualify as VOEs.

With respect to KKR s consolidated funds that are not CLOs, KKR meets the criteria for the Deferral and therefore applies the consolidation rules that existed prior to January 1, 2010. For these funds, KKR generally has operational discretion and control, and fund investors have no substantive rights to impact ongoing governance and operating activities of the fund, including the ability to remove the general partner, also known as kick-out rights. As a result, a fund should be consolidated unless KKR has a nominal level of equity at risk. To the extent that KKR commits a nominal amount of equity to a given fund and has no obligation to fund any future losses, the equity at risk to KKR is not considered substantive and the fund is typically considered a VIE. In these cases, the fund investors are generally deemed to be the primary beneficiaries, and KKR does not consolidate the fund. In cases when KKR s equity at risk is deemed to be substantive, the fund is generally considered to be a VOE and KKR generally consolidates the fund under the VOE model.

With respect to CLOs, which are generally VIEs, the criteria for the Deferral are not met and therefore KKR applies the consolidation rules issued on January 1, 2010. In its role as collateral manager, KKR generally has the power to direct the activities of the CLO entities that most significantly impact the economic performance of the entity. In some, but not all cases, KKR, through both its residual interest in the CLO and the potential to earn an incentive fee, may have variable interests that represent an obligation to absorb losses of, or a right to receive benefits from, the CLO that could potentially be significant to the CLO. In cases where KKR has both (a) the power to direct the activities of the CLO that most significantly impact the CLOs economic performance and (b) the obligation to absorb losses of the CLO or the right to receive benefits from the CLO that could potentially be significant to the CLO, KKR consolidates the CLO.

Certain of KKR s funds and CLOs are consolidated by KKR notwithstanding the fact that KKR has only a minority economic interest in those funds and CLOs. KKR s financial statements reflect the assets, liabilities, fees, expenses, investment income (loss) and cash flows of the consolidated KKR funds and CLOs on a gross basis, and the majority of the economic interests in those funds and CLOs, which are held by fund investors or other third parties, are attributed to noncontrolling interests or appropriated capital in the accompanying financial statements. All of the management fees and certain other amounts earned by KKR from those funds and CLOs are eliminated in consolidation. However, because the eliminated amounts are earned from and funded by noncontrolling interests, KKR s attributable share of the net income (loss) from those funds and CLOs is increased by the amounts eliminated. Accordingly, the elimination in consolidation of such amounts has no effect on net income (loss) attributable to KKR or KKR partners capital.

KKR s funds are, for GAAP purposes, investment companies and therefore are not required to consolidate their investments in portfolio companies even if majority-owned and controlled. Rather, the consolidated funds and vehicles reflect their investments at fair value as described below in Fair Value Measurements .

All intercompany transactions and balances have been eliminated.

Variable Interest Entities Collateralized Loan Obligations

For the assets and liabilities of the consolidated CLO vehicles, KKR has elected the fair value option. KKR accounts for the difference between the fair value of the assets and the fair value of the liabilities of the consolidated CLOs in Net Gains (Losses) from Investment Activities in the condensed consolidated statements of operations. This amount is attributed to KKR and third party interest holders based on each beneficial holder s residual interest in the consolidated CLO vehicles. The amount attributed to third party interest holders is reflected in the condensed consolidated statements of operations in Net Income (Loss) Attributable to Noncontrolling Interests and Appropriated Capital and in the condensed consolidated statements of financial condition in Appropriated Capital within Equity. The amount is recorded as appropriated capital since the other holders of the CLOs beneficial interests, not KKR, will receive the benefits or absorb the losses associated with their proportionate share of the CLOs assets and liabilities.

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Business Combinations

Acquisitions are accounted for using the acquisition method of accounting. The purchase price of an acquisition is allocated to the assets acquired and liabilities assumed using the estimated fair values at the acquisition date. Transaction costs are expensed as incurred.

Oil and Natural Gas Properties

Primarily as a result of the KKR Financial Holdings LLC (KFN) acquisition, KKR consolidates its working and royalty interests in oil and natural gas producing properties.

Oil and natural gas producing activities are accounted for under the successful efforts method of accounting. Under this method, exploration costs, other than the costs of drilling exploratory wells, are charged to expense as incurred. Costs that are associated with the drilling of successful exploration wells are capitalized if proved reserves are found. Lease acquisition costs are capitalized when incurred. Costs associated with the drilling of exploratory wells that do not find proved reserves, geological and geophysical costs and costs of certain nonproducing leasehold costs are expensed as incurred.

Expenditures for repairs and maintenance, including workovers, are charged to expense as incurred.

The capitalized costs of producing oil and natural gas properties are depleted on a field-by-field basis using the units-of production method based on the ratio of current production to estimated total net proved oil, natural gas and natural gas liquid reserves. Proved developed reserves are used in computing depletion rates for drilling and development costs and total proved reserves are used for depletion rates of leasehold costs.

Estimated dismantlement and abandonment costs for oil and natural gas properties, net of salvage value, are capitalized at their estimated net present value and amortized on a unit-of-production basis over the remaining life of the related proved developed reserves.

Intangible Assets

Intangible assets consist primarily of contractual rights to earn future fee income, including management and incentive fees, and are recorded in Other Assets in the accompanying condensed consolidated statements of financial condition. Identifiable finite-lived intangible assets are amortized on a straight-line basis over their estimated useful lives and amortization expense is included within General, Administrative and Other in the accompanying condensed consolidated statements of operations. Intangible assets are reviewed for impairment when circumstances indicate impairment may exist. KKR does not have any indefinite-lived intangible assets.

Goodwill

Goodwill represents the excess of acquisition cost over the fair value of net tangible and intangible assets acquired in connection with an acquisition. Goodwill is assessed for impairment annually or more frequently if circumstances indicate impairment may have occurred. Goodwill is recorded in Other Assets in the accompanying condensed consolidated statements of financial condition.

Redeemable Noncontrolling Interests

Redeemable Noncontrolling Interests represent noncontrolling interests of certain investment vehicles and funds that are subject to periodic redemption by fund investors following the expiration of a specified period of time (typically between one and three years), or may be withdrawn subject to a redemption fee during the period when capital may not be otherwise withdrawn. Fund investors interests subject to redemption as described above are presented as Redeemable Noncontrolling Interests in the accompanying condensed consolidated statements of financial condition and presented as Net Income (Loss) attributable to Redeemable Noncontrolling Interests in the accompanying condensed consolidated statements of operations.

When redeemable amounts become legally payable to fund investors, they are classified as a liability and included in Accounts Payable, Accrued Expenses and Other Liabilities in the accompanying condensed consolidated statements of financial condition. For all consolidated investment vehicles and funds in which redemption rights have not been granted, noncontrolling interests are presented within Equity in the accompanying condensed consolidated statements of financial condition as Noncontrolling Interests.

Noncontrolling Interests

Noncontrolling interests represent (i) noncontrolling interests in consolidated entities and (ii) noncontrolling interests held by KKR Holdings.

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Noncontrolling Interests in Consolidated Entities

Noncontrolling interests in consolidated entities represent the non-redeemable ownership interests in KKR that are held primarily by:

(i) third party fund investors in KKR s funds;

(ii) third parties holding an aggregate of 1% of the carried interest received by the general partners of KKR s funds and 1% of KKR s other profits (losses) until a future date;

(iii) certain principals and their designees representing a portion of the carried interest received by the general partners of KKR s private equity funds that was allocated to them with respect to private equity investments made during such former principals previous tenure with KKR;

(iv) certain principals representing all of the capital invested by or on behalf of the general partners of KKR s private equity funds prior to October 1, 2009 and any returns thereon;

(v) third parties in KKR s capital markets business;

(vi) exchangeable equity securities representing ownership interests in a subsidiary of a KKR Group Partnership issued in connection with the acquisition of Avoca; and

(vii) holders of the 7.375% Series A LLC Preferred Shares of KFN whose rights are limited to the assets of KFN.

Noncontrolling Interests held by KKR Holdings

Noncontrolling interests held by KKR Holdings include economic interests held by principals in the KKR Group Partnerships. Such principals receive financial benefits from KKR s business in the form of distributions received from KKR Holdings and through their direct and indirect participation in the value of KKR Group Partnership Units held by KKR Holdings. These financial benefits are not paid by KKR and are borne by KKR Holdings.

The following table presents the calculation of noncontrolling interests held by KKR Holdings:

	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Balance at the beginning of the period	$ 5,118,491	$ 4,950,914	$ 5,116,761	$ 4,981,864
Net income (loss) attributable to noncontrolling interests held by KKR Holdings (a)	186,776	28,106	487,590	362,218
Other comprehensive income (loss), net of tax (b)	872	(3,430)	3,341	(4,750)
Impact of the exchange of KKR Holdings units to KKR & Co. L.P. common units (c)	(100,001)	(152,628)	(244,522)	(243,643)
Equity based compensation	45,161	54,382	80,312	108,614
Capital contributions	388	328	848	799
Capital distributions	(169,032)	(178,558)	(361,675)	(505,988)
Balance at the end of the period	$ 5,082,655	$ 4,699,114	$ 5,082,655	$ 4,699,114

(a) Refer to the table below for calculation of Net income (loss) attributable to noncontrolling interests held by KKR Holdings.

(b) Calculated on a pro rata basis based on the weighted average KKR Group Partnership Units held by KKR Holdings during the reporting period.

(c) Calculated based on the proportion of KKR Holdings units exchanged for KKR & Co. L.P. common units pursuant to the exchange agreement during the reporting period. The exchange agreement provides for the exchange of KKR Group Partnership Units held by KKR Holdings for KKR & Co. L.P. common units.

Net income (loss) attributable to KKR & Co. L.P. after allocation to noncontrolling interests held by KKR Holdings, with the exception of certain tax assets and liabilities that are directly allocable to KKR Management Holdings Corp., is attributed based on the percentage of the weighted average KKR Group Partnership Units held by KKR and KKR Holdings, each of which hold equity of the KKR Group Partnerships. However, primarily because of the (i) contribution of certain expenses borne entirely by KKR Holdings, (ii) the periodic exchange of KKR Holdings units for KKR & Co. L.P. common units pursuant to the exchange agreement and (iii) the contribution of certain expenses borne

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entirely by KKR associated with the KKR & Co. L.P. 2010 Equity Plan (Equity Incentive Plan), equity allocations shown in the condensed consolidated statement of changes in equity differ from their respective pro-rata ownership interests in KKR s net assets.

The following table presents net income (loss) attributable to noncontrolling interests held by KKR Holdings:

	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Net income (loss)	$ 2,052,496	$ 277,258	$ 4,056,662	$ 2,375,444
Less: Net income (loss) attributable to Redeemable Noncontrolling Interests	(6,809)	(7,800)	3,828	16,823
Less: Net income (loss) attributable to Noncontrolling Interests in consolidated entities and appropriated capital	1,694,314	241,818	3,176,988	1,787,830
Plus: Income taxes attributable to KKR Management Holdings Corp.	688	3,215	11,635	9,874
Net income (loss) attributable to KKR & Co. L.P. and KKR Holdings	$ 365,679	$ 46,455	$ 887,481	$ 580,665
Net income (loss) attributable to noncontrolling interests held by KKR Holdings	$ 186,776	$ 28,106	$ 487,590	$ 362,218

Investments

Investments consist primarily of private equity, real assets, credit, investments of consolidated CLOs, equity method and other investments. Investments are carried at their estimated fair values, with unrealized gains or losses resulting from changes in fair value reflected as a component of Net Gains (Losses) from Investment Activities in the condensed consolidated statements of operations. Investments denominated in currencies other than the U.S. dollar are valued based on the spot rate of the respective currency at the end of the reporting period with changes related to exchange rate movements reflected as a component of Net Gains (Losses) from Investment Activities in the condensed consolidated statements of operations. Security and loan transactions are recorded on a trade date basis. Further disclosure on investments is presented in Note 4, Investments.

The following describes the types of securities held within each investment class.

Private Equity Consists primarily of equity investments in operating businesses.

Real Assets Consists primarily of investments in (i) energy related assets, principally oil and natural gas producing properties, (ii) infrastructure assets, and (iii) real estate, principally residential and commercial real estate assets and businesses.

Credit   Consists primarily of investments in below investment grade corporate debt securities (primarily high yield bonds and syndicated bank loans), distressed and opportunistic debt and interests in unconsolidated CLOs.

Investments of Consolidated CLOs   Consists primarily of investments in below investment grade corporate debt securities (primarily high yield bonds and syndicated bank loans) held directly by the consolidated CLOs.

Equity Method   Consists primarily of investments in which KKR has significant influence, including investments in unconsolidated investment funds.

Other   Consists primarily of investments in common stock, preferred stock, warrants and options of companies that are not private equity, real assets, credit, investments of consolidated CLOs or equity method investments.

Equity Method

Equity method investments include (i) certain investments in private equity funds, real assets funds, funds of hedge funds, and credit funds which are not consolidated and (ii) certain investments in less than 50% owned asset management companies. Under the equity method of accounting, KKR s share of earnings (losses) from equity method investments is reflected as a component of Net Gains (Losses) from Investment Activities in the condensed consolidated statements of operations. See Note 3   Net Gains (Losses) from Investment Activities.   Because the underlying investments of unconsolidated investment funds are reported at fair value, the carrying value of these equity method investments representing KKR s interests in unconsolidated funds approximates fair value. The carrying value of equity method investments in certain less than 50% owned asset management companies is determined based on the amounts invested by KKR, adjusted for the equity in earnings or losses of the investee allocated based on KKR s respective ownership percentage, less distributions.

Fair Value Measurements

Investments and other financial instruments are measured and carried at fair value. The majority of investments and other financial instruments are held by the consolidated funds and vehicles. KKR s funds are, for GAAP purposes, investment companies and reflect their

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investments and other financial instruments at fair value. KKR has retained the specialized accounting for the consolidated funds and vehicles in consolidation. Accordingly, the unrealized gains and losses resulting from changes in fair value of the investments held by KKR s funds are reflected as a component of Net Gains (Losses) from Investment Activities in the condensed consolidated statements of operations.

For investments and other financial instruments that are not held in a consolidated fund or vehicle, KKR has elected the fair value option since these investments and other financial instruments are similar to those in the consolidated funds and vehicles. Such election is irrevocable and is applied on an investment by investment basis at initial recognition. Unrealized gains and losses resulting from changes in fair value are reflected as a component of Net Gains (Losses) from Investment Activities in the condensed consolidated statements of operations. The methodology for measuring the fair value of such investments and other financial instruments is consistent with the methodologies applied to investments and other financial instruments that are held in consolidated funds and vehicles. In addition, KKR has elected the fair value option for the investments and debt obligations of the consolidated CLO vehicles.

The carrying amounts of Other Assets, Accounts Payable, Accrued Expenses and Other Liabilities recognized on the condensed consolidated statements of financial condition (excluding Fixed Assets, Goodwill, Intangible Assets, contingent consideration and certain debt obligations) approximate fair value due to their short term maturities. Further information on KKR s debt obligations are presented in Note 9, Debt Obligations.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Where available, fair value is based on observable market prices or parameters or derived from such prices or parameters. Where observable prices or inputs are not available, valuation techniques are applied. These valuation techniques involve varying levels of management estimation and judgment, the degree of which is dependent on a variety of factors. See Note 5, Fair Value Measurements for further information on KKR s valuation techniques that involve unobservable inputs. Assets and liabilities recorded at fair value in the statements of financial condition are categorized based upon the level of judgment associated with the inputs used to measure their value. Hierarchical levels, as defined under GAAP, are directly related to the amount of subjectivity associated with the inputs to the valuation of these assets and liabilities. The hierarchical levels defined under GAAP are as follows:

Level I

Inputs are unadjusted, quoted prices in active markets for identical assets or liabilities at the measurement date. The type of investments and other financial instruments included in this category are publicly-listed equities, debt and securities sold short.

Level II

Inputs are other than quoted prices that are observable for the asset or liability, either directly or indirectly. Level II inputs include quoted prices for similar instruments in active markets, and inputs other than quoted prices that are observable for the asset or liability. The type of investments and other financial instruments included in this category are credit investments, convertible debt securities indexed to publicly-listed securities, and certain over-the-counter derivatives.

Level III

Inputs are unobservable for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability. The types of assets and liabilities generally included in this category are private portfolio companies, real assets investments and credit investments for which a sufficiently liquid trading market does not exist.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. KKR s assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and consideration of factors specific to the asset.

A significant decrease in the volume and level of activity for the asset or liability is an indication that transactions or quoted prices may not be representative of fair value because in such market conditions there may be increased instances of transactions that are not orderly. In those circumstances, further analysis of transactions or quoted prices is needed, and a significant adjustment to the transactions or quoted prices may be necessary to estimate fair value.

The availability of observable inputs can vary depending on the financial asset or liability and is affected by a wide variety of factors, including, for example, the type of instrument, whether the instrument has recently been issued, whether the instrument is traded on an active exchange or in the secondary market, and current market conditions. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. Accordingly, the degree of judgment exercised by KKR in determining fair value is greatest for instruments categorized in Level III. The variability and availability of the observable inputs affected by the factors described above may cause transfers between Levels I, II, and III, which KKR recognizes at the beginning of the reporting period.

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Investments and other financial instruments that have readily observable market prices (such as those traded on a securities exchange) are stated at the last quoted sales price as of the reporting date. KKR does not adjust the quoted price for these investments, even in situations where KKR holds a large position and a sale could reasonably affect the quoted price.

Management s determination of fair value is based upon the best information available for a given circumstance and may incorporate assumptions that are management s best estimates after consideration of a variety of internal and external factors.

Level II Valuation Methodologies

Financial assets and liabilities categorized as Level II consist primarily of securities indexed to publicly-listed securities and credit and other investments.

Credit investments and investments of consolidated CLOs generally have bid and ask prices that can be observed in the marketplace. Bid prices reflect the highest price that KKR and others are willing to pay for an asset. Ask prices represent the lowest price that KKR and others are willing to accept for an asset. For financial assets and liabilities whose inputs are based on bid-ask prices obtained from third party pricing services, fair value may not always be a predetermined point in the bid-ask range. KKR s policy is generally to allow for mid-market pricing and adjusting to the point within the bid-ask range that meets KKR s best estimate of fair value.

For securities indexed to publicly listed securities, such as convertible debt, the securities are typically valued using standard convertible security pricing models. The key inputs into these models that require some amount of judgment are the credit spreads utilized and the volatility assumed. To the extent the company being valued has other outstanding debt securities that are publicly-traded, the implied credit spread on the company s other outstanding debt securities would be utilized in the valuation. To the extent the company being valued does not have other outstanding debt securities that are publicly-traded, the credit spread will be estimated based on the implied credit spreads observed in comparable publicly-traded debt securities. In certain cases, an additional spread will be added to reflect an illiquidity discount due to the fact that the security being valued is not publicly-traded. The volatility assumption is based upon the historically observed volatility of the underlying equity security into which the convertible debt security is convertible and/or the volatility implied by the prices of options on the underlying equity security.

Level III Valuation Methodologies

Financial assets and liabilities categorized as Level III consist primarily of the following:

Private Equity Investments: KKR generally employs two valuation methodologies when determining the fair value of a private equity investment. The first methodology is typically a market comparables analysis that considers key financial inputs and recent public and private transactions and other available measures. The second methodology utilized is typically a discounted cash flow analysis, which incorporates significant assumptions and judgments. Estimates of key inputs used in this methodology include the weighted average cost of capital for the investment and assumed inputs used to calculate terminal values, such as exit EBITDA multiples. Other inputs are also used in both methodologies.

Upon completion of the valuations conducted using these methodologies, a weighting is ascribed to each method, and an illiquidity discount is typically applied where appropriate. The ultimate fair value recorded for a particular investment will generally be within a range suggested by the two methodologies.

When determining the weighting ascribed to each valuation methodology, KKR considers, among other factors, the availability of direct market comparables, the applicability of a discounted cash flow analysis and the expected hold period and manner of realization for the investment. These factors can result in different weightings among investments in the portfolio and in certain instances may result in up to a 100% weighting to a single methodology. Across the Level III private equity investment portfolio, approximately 67% of the fair value is derived from investments that are valued based exactly 50% on market comparables and 50% on a discounted cash flow analysis. Less than 5% of the fair value of the Level III private equity investment portfolio is derived from investments that are valued either based 100% on market comparables or 100% on a discounted cash flow analysis.

When an illiquidity discount is to be applied, KKR seeks to take a uniform approach across its portfolio and generally applies a minimum 5% discount to all private equity investments. KKR then evaluates such private equity investments to determine if factors exist that could make it more challenging to monetize the investment and, therefore, justify applying a higher illiquidity discount. These factors generally include (i) whether KKR is unable to sell the portfolio company or conduct an initial public offering of the portfolio company due to the consent rights of a third party or similar factors, (ii) whether the portfolio company is undergoing significant restructuring activity or similar factors and (iii) characteristics about the portfolio company regarding its size and/or whether the portfolio company is experiencing, or expected to experience, a significant decline in earnings. These factors generally make it less likely that a portfolio company would be sold or publicly offered in the near term at a price indicated by using just a market multiples and/or discounted cash flow analysis, and these factors tend to reduce the number of opportunities to sell an investment and/or increase the time horizon over which an investment may be monetized. Depending on the applicability of these factors, KKR determines the amount of any incremental illiquidity discount to be applied above the 5% minimum, and during the time KKR holds the investment, the illiquidity discount may be increased or decreased, from time to time, based on changes to these factors. The amount of illiquidity discount applied at any time requires considerable judgment about what a market participant would consider and is based on the facts and circumstances of each individual investment. Accordingly, the illiquidity discount ultimately considered by a market participant upon the realization of any investment may be higher or lower than that estimated by KKR in its valuations.

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Real Assets Investments: For energy and infrastructure investments, KKR generally utilizes a discounted cash flow analysis, which incorporates significant assumptions and judgments. Estimates of key inputs used in this methodology include the weighted average cost of capital for the investment and assumed inputs used to calculate terminal values, such as exit EBITDA multiples. For real estate investments, KKR generally utilizes a combination of direct income capitalization and discounted cash flow analysis, which incorporates significant assumptions and judgments. Estimates of key inputs used in these methodologies include an unlevered discount rate and terminal capitalization rate. The valuations of real assets investments also use other inputs. Certain investments in real estate and energy generally do not include a minimum illiquidity discount.

Credit Investments: Credit investments are valued using values obtained from dealers or market makers, and where these values are not available, credit investments are valued by KKR based on ranges of valuations determined by an independent valuation firm. Valuation models are based on discounted cash flow analyses, for which the key inputs are determined based on market comparables, which incorporate similar instruments from similar issuers.

Other Investments: KKR generally employs the same valuation methodologies as described above for private equity investments when valuing these other investments.

CLO Debt Obligations: Collateralized loan obligation senior secured and subordinated notes are initially valued at transaction price and are subsequently valued using a third party valuation service. The most significant inputs to the valuation of these instruments are default and loss expectations and discount margins.

Key unobservable inputs that have a significant impact on KKR s Level III investment valuations as described above are included in Note 5 Fair Value Measurements. KKR utilizes several unobservable pricing inputs and assumptions in determining the fair value of its Level III investments. These unobservable pricing inputs and assumptions may differ by investment and in the application of KKR s valuation methodologies. KKR s reported fair value estimates could vary materially if KKR had chosen to incorporate different unobservable pricing inputs and other assumptions or, for applicable investments, if KKR only used either the discounted cash flow methodology or the market comparables methodology instead of assigning a weighting to both methodologies.

Level III Valuation Process

The valuation process involved for Level III measurements is completed on a quarterly basis and is designed to subject the valuation of Level III investments to an appropriate level of consistency, oversight, and review. KKR has a Private Markets valuation committee for private equity and real assets investments and a valuation committee for credit (including investments held by consolidated CLOs) and other investments. The Private Markets valuation committee may be assisted by subcommittees for example in the valuation of real estate investments. Each of the Private Markets valuation committee and the credit valuation committee is assisted by a valuation team, which, except as noted below, is comprised only of employees who are not investment professionals responsible for preparing preliminary valuations or for oversight of the investments being valued. The valuation teams for energy, infrastructure and real estate investments contain investment professionals who participate in the preparation of preliminary valuations and oversight for those investments. The valuation committees and teams are responsible for coordinating and consistently implementing KKR s quarterly valuation policies, guidelines and processes. For Private Markets investments classified as Level III investment professionals prepare preliminary valuations based on their evaluation of financial and operating data, company specific developments, market valuations of comparable companies and other factors. These preliminary valuations are reviewed with the investment professionals by the applicable valuation team and are also reviewed by an independent valuation firm engaged by KKR to perform certain procedures in order to assess the reasonableness of KKR s valuations annually for all Level III investments in Private Markets and quarterly for investments other than certain investments, which fall below pre-set value thresholds and which in the aggregate comprise less than 5% of the total value of KKR s Level III Private Markets investments. For most investments classified as Level III in Public Markets, in general, an independent valuation firm is engaged by KKR to provide third party valuations, or ranges of valuations from which KKR s investment professionals select a preliminary valuation, or an independent valuation firm is engaged by KKR to perform certain procedures in order to assess the reasonableness of KKR s valuations. All preliminary valuations in Private Markets and Public Markets are then reviewed by the applicable valuation committee, and after reflecting any input by their respective valuation committees, the preliminary valuations are presented to the firm s management committee. When these valuations are approved by this committee after reflecting any input from it, the valuations of Level III investments, as well as the valuations of Level I and Level II investments, are presented to the audit committee of KKR s board of directors and are then reported on to the board of directors.

Fees

Fees consist primarily of (i) transaction fees earned in connection with successful investment transactions and from capital markets activities, (ii) management and incentive fees from providing investment management services to unconsolidated funds, CLOs and other vehicles, and separately managed accounts, (iii) monitoring fees from providing services to portfolio companies, (iv) revenue earned by oil and gas-producing entities that are consolidated and (v) consulting fees earned by entities that employ non-employee operating consultants.

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Transaction, Management, Incentive, Monitoring and Consulting Fees Recognition

Transaction, management, incentive, monitoring and consulting fees are recognized when earned based on the contractual terms of the governing agreements and coincides with the period during which the related services are performed. In the case of transaction fees, the fees are recognized upon closing of the transaction. Monitoring fees may provide for a termination payment following an initial public offering or change of control. These termination payments are recognized in the period when the related transaction closes.

Oil and Gas Revenue Recognition

Oil, natural gas and natural gas liquid revenues are recognized when production is sold to a purchaser at fixed or determinable prices, when delivery has occurred and title has transferred and collectability of the revenue is reasonably assured. The oil and gas producing entities consolidated by KKR follow the sales method of accounting for natural gas revenues. Under this method of accounting, revenues are recognized based on volumes sold, which may differ from the volume to which the entity is entitled based on KKR s working interest. An imbalance is recognized as a liability only when the estimated remaining reserves will not be sufficient to enable the under-produced owners to recoup their entitled share through future production. Under the sales method, no receivables are recorded when these entities have taken less than their share of production and no payables are recorded when it has taken more than its share of production.

For the three and six months ended June 30, 2014 and 2013, respectively, fees consisted of the following:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	**2013**	**2014**	**2013**
Transaction Fees	$ 71,822	$ 58,295	$ 226,976	$ 96,720
Management Fees	58,683	43,591	108,868	84,615
Oil and Gas Revenue	56,208		73,989	
Monitoring Fees	39,064	37,768	91,413	76,416
Consulting Fees	12,134	11,299	22,485	25,612
Incentive Fees	11,459	15,423	28,565	34,253
Total Fees	$ 249,370	$ 166,376	$ 552,296	$ 317,616

Substantially all fees presented in the table above are earned from KKR investment funds and portfolio companies. Consulting fees are earned by entities that employ non-employee operating consultants, which are consolidated by KKR but whose fees are not shared with KKR.

Recently Issued Accounting Pronouncements